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MANAGEMENT LETTER

AUD-FM-18-07

To the Chief Financial Officer and Inspector General of the U.S. Department of State:

Kearney & Company, P.C. (referred to as "we" hereafter), has audited the consolidated financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2017, and has issued our report thereon dated November 15, 2017.[1] In planning and performing our audit of the Department's consolidated financial statements, we considered the Department's internal control over financial reporting and the Department's compliance with certain provisions of laws, regulations, contracts, and grant agreements. Our auditing procedures were designed for the purpose of expressing an opinion on the consolidated financial statements and not to provide assurances on internal control or compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting or on the Department's compliance with certain provisions of laws, regulations, contracts, and grant agreements.

During our audit, we noted certain matters related to internal control over financial reporting that we considered to be significant deficiencies and certain matters relating to compliance that we considered to be reportable under 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 Bulletin No. 17-03, "Audit Requirements for Federal Financial Statements." These items are not repeated in this letter, as they are explained in detail in our report on the Department's FY 2017 financial statements.

Our procedures were designed primarily to enable us to form an opinion on the Department's consolidated financial statements and therefore may not have identified all internal control weaknesses and instances of noncompliance that may exist. Although not considered to be material weaknesses, significant deficiencies, or reportable instances of noncompliance, we noted certain other matters involving internal control, operations, and noncompliance. These findings are summarized in Appendix A and are intended to assist the Department in strengthening internal controls and improving operating efficiencies.

We appreciate the courteous and professional assistance provided by Department personnel during our audit. These findings have been discussed with appropriate Department officials. Comments from Department management on this report are presented in Appendix B.

[1] OIG, *Independent Auditor's Report on the U.S. Department of State 2017 and 2016 Financial Statements* (AUD-FM-18-05, November 2017).

This letter is intended solely for the information and use of Department management, those charged with governance, and others within the Department and the Office of Inspector General and is not intended to be and should not be used by anyone other than these specified parties.

Kearney & Company

Alexandria, Virginia
February 13, 2018

MANAGEMENT LETTER COMMENTS

COMMENTS REPEATED FROM PRIOR YEAR

During the audit of the U.S. Department of State's (Department) FY 2016 financial statements, Kearney & Company, P.C. (referred to as "we" hereafter), identified matters that were reported in an internal control report[1] and a management letter.[2] The severity of one issue reported in the FY 2016 internal control report related to financial reporting has decreased and is now included in the management letter rather than the FY 2017 Report on Internal Control. Additionally, as described in Table 1, the severity of two issues included in the FY 2016 management letter has decreased, and we consider the items closed. Six issues remain open, and we have updated these issues with information obtained during the audit of the Department's FY 2017 financial statements.

Table 1: Current Status of Prior Year Management Letter Findings

FY 2016 Management Letter Findings	FY 2017 Status
Insufficient Fund Balance with Treasury Reconciliation Process	Repeat
Inaccurate Personnel Data for Foreign Service National Employees	Repeat
Inadequate Control Over Personnel Records and Actions	Repeat
Inaccurate Supporting Data for the Asbestos Remediation Estimate	Repeat
Insufficient Controls for Reporting Voluntary Contributions	Repeat
Insufficient Vendor Invoice Approvals	Repeat
Inaccurate Data Used To Estimate Grants Accrual	Closed
Security Weaknesses in the Windows Time and Attendance System	Closed

I. Financial Reporting

Material Adjustments to Budgetary Accounts For Reporting

The Statement of Budgetary Resources (SBR) is a principal financial statement providing information about how budgetary resources are made available to the Department and the status of the budgetary resources at the end of the reporting period. The SBR is the only financial statement predominantly derived 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 (Treasury) on Standard Form (SF) 133,

[1] OIG, *Independent Auditor's Report on the U.S. Department of State 2016 and 2015 Financial Statements* (AUD-FM-17-09, November 2016).

[2] OIG, *Management Letter Related to the Audit of the U.S. Department of State FY 2016 Financial Statements* (AUD-FM-17-11, February 2017).

Report on Budget Execution and Budgetary Resources, and to information reported in the Budget of the United States Government to ensure the integrity of the numbers presented.

Agencies must submit their financial information to Treasury using the Governmentwide Treasury Account Symbol Adjusted Trial Balance System (GTAS). The Department does not use its core accounting system, Global Financial Management System (GFMS), to fully compile the data used to develop the budgetary trial balance it submits to GTAS. Instead of relying on GFMS, the Department adjusts the GFMS budgetary trial balance data through two processes for reporting to GTAS. For appropriations from FY 2015 and later and for other selected appropriations, the Department creates a U.S. Standard General Ledger (USSGL) based trial balance for each appropriation, which the Department combines into a "bulk file." The Department identifies adjustments that it determines are needed and makes those adjustments directly to the bulk file. For the remaining appropriations from FY 2014 and earlier, the Department uses Excel spreadsheets, called SF 133 Workbooks, to identify and record adjustments.

We reviewed the Department's files supporting the SBR and summarized the adjustments made outside GFMS. Table 2 presents the summary of the adjustments made outside of GFMS in FY 2017 and FY 2016 for comparative purposes.

Table 2: Absolute Value of Adjustments Recorded Outside of GFMS

Process	FY 2016 (in millions)	FY 2017 (in millions)
SF 133 Workbooks	$927	$247
Adjustments directly to GTAS bulk file	$2,747	$1,910
Total	**$3,674**	**$2,157**

To confirm the accuracy and validity of adjustments made to the budgetary accounts outside of GFMS, we tested any SF 133 Workbooks that contained adjustments over $5 million, which was only 1 of 46 workbooks. The SF 133 Workbook we tested included adjustments totaling approximately $222 million (90 percent of workbook adjustments). We also tested all budgetary adjustments over $10 million made directly to the GTAS bulk file. The resulting selection of 17 of 100 adjustments totaled approximately $1.68 billion (88 percent of GTAS bulk file adjustments). During our testing we found the following:

- One SF 133 Workbook adjustment and three GTAS adjustments were recorded because the Department identified a difference between the amount reported by Treasury for the beginning balance of the USSGL account entitled "420100 – Total Actual Resources – Collected"[3] and the amount recorded in GFMS. The Department recorded an adjustment to make the amount in the Department's GTAS bulk file equal the amount reported by Treasury. The adjustment was recorded without analyzing the event or transaction(s) that

[3] Amounts in this account are presented as unobligated balances at the beginning of the year. These amounts represent budgetary spending authority that has not yet been committed. Agencies are allowed to carry forward unobligated balances from one year to the next under certain circumstances.

caused the discrepancy. If the cause for the adjustment is not identified, the Department cannot ensure that the adjustment is supportable and correct.

- One SF 133 Workbook adjustment and one GTAS adjustment were recorded to move an abnormal balance[4] in the USSGL budgetary account entitled "490100 – Delivered Orders – Obligations, Unpaid" to the USSGL budgetary account entitled "497100 – Downward Adjustments of Prior-Year Unpaid Delivered Orders - Obligations, Recoveries." This adjustment is necessary because for certain appropriations the posting logic in GFMS has been set up to record deobligations to USSGL 490100 instead of USSGL 497100. The Department records this adjustment without validating that the abnormal balance in USSGL 490100 is due to deobligations and not for another reason. If the cause for the adjustment is not verified, the Department cannot ensure that the adjustment is supportable and correct.
- The Department recorded eight GTAS adjustments based upon comparisons to the Office of Management and Budget "Latest Approved Apportionment[5] Report."

Additionally, we noted that the Department relied on the SF 133 Workbook and GTAS bulk file processes to assign required account attributes[6] that were included in the GTAS bulk file. For example, a series of system data extracts, Excel reference and text formulas, and ad hoc updates were required to gather and report Federal and non-Federal indicators, trading partner codes, direct versus reimbursable authority, and apportionment categories.

The Department did not enable the full functionality of its accounting system to capture all budgetary accounting events and automate budgetary reporting procedures. In some cases, GFMS was not programmed to process budgetary transaction types in complete compliance with USSGL posting models. For example, GFMS did not always distinguish between direct and reimbursable activity and instead recorded most transactions as direct activity.

In addition, the Department has recorded adjustments to budgetary balances when reporting the balances to Treasury for a number of years. These adjustments were never researched and recorded into GFMS, causing continued differences between Treasury and GFMS balances the following year. The Department continues to investigate the root cause of many of the budgetary adjustments recorded within the SF 133 Workbooks and is working to better support or eliminate certain adjustments. However, other adjustments were not sufficiently investigated to identify the cause of the problem so that long-term improvements could be made. If the Department would improve the process for resolving variances, it might be able to correct issues in the financial system, thereby preventing future occurrences.

[4] For accounting purposes, line items are expected to have certain "normal" or expected types of transactions. Other types of transactions are considered "abnormal," which often indicates that the transaction was entered incorrectly.

[5] An apportionment is an Office of Management and Budget-approved plan to use budgetary resources. An apportionment typically limits the obligations an agency may incur for specified time periods, programs, activities, projects, objects, or any combination thereof. Until balances are apportioned by the Office of Management and Budget, they should be reported as unapportioned on the SBR.

[6] Account attributes report a lower level of detail than the USSGL account level. For example, Federal accounts receivable are identified separately by attributes from non-Federal accounts receivable for purposes of comparing balances between agencies.

The need to require material adjustments outside of GFMS to properly report budgetary balances to Treasury and present the balances on the SBR is high risk and resource intensive. The significant number and amount of adjustments (more than $2.1 billion in FY 2017) required to create the SBR was one condition that led to our conclusion that the Department was not in substantial compliance with the Federal Financial Management Improvement Act of 1996.

This issue was initially reported in our FY 2009 Report on Internal Control.

II. Fund Balance With Treasury

Insufficient Fund Balance With Treasury Reconciliation Process

Fund Balance with Treasury (FBWT) reflects the available funds in an agency's accounts with the Treasury for which the agency is authorized to make expenditures and pay liabilities. Each agency appropriation, receipt, or other fund account is assigned a Treasury Account Fund Symbol. Agencies must promptly reconcile their FBWT accounts on a regular and recurring basis to ensure the integrity and accuracy of their internal and Government-wide financial data.

The Department maintains two cash reconciliation reports: the Global Financial Services – Charleston Cash Reconciliation Report and the Financial Reporting Analysis Cash Reconciliation Report. These reports document final balances for each Treasury Account Fund Symbol for the applicable accounting period. Because of the disaggregated nature of the Department's operations, the FBWT reconciliation process involves the reconciliation of disbursements and collections processed both domestically and overseas, as well as through third parties.

The Department records unreconciled differences identified during the FBWT reconciliation process in a suspense account until the discrepancies are resolved. A suspense account is a temporary account used by agencies to record transactions with discrepancies until a determination is made on the proper disposition of the transaction. Treasury allows entities with a justifiable business need to submit a request to use suspense accounts, which are only to be used as a temporary holding place for transactions that must be cleared within 60 days.

We obtained and reviewed the Financial Reporting Analysis Cash Reconciliation Report as of June 30, 2017, and identified 73 instances in which a variance existed between Treasury and the Department fund balances. The number and absolute value of the variances were reduced from the same period in 2016. Table 3 shows the net value and absolute value of the variances identified during the FY 2017 audit and the results of our testing from FY 2016.

Table 3: Variances Between Treasury and Department Fund Balances

As of Date	Number of Instances	Net Value	Absolute Value
June 30, 2017	73	$368,590	$10,400,000
June 30, 2016	117	$25,283	$75,000,000

We also found that the Department had net balances of approximately $1 million in several suspense accounts that had not been resolved within 60 days, as required. Specifically, we identified three suspense accounts in which the balance remained unchanged during the first three quarters of FY 2017.

Although the Department reduced the absolute value of its fund balance variance with Treasury—in part due to a journal voucher accounting entry posted at the end of FY 2016 that adjusted its FBWT to match certain amounts reported by Treasury—and eliminated some of its historical negative fund balances, additional refinements to its reconciliation procedures are needed. In addition, the Department did not have effective monitoring controls in place to identify, research, and resolve suspense activity approaching or exceeding 60 days, which further contributed to FBWT variances.

For older reconciling items, the Department did not have a complete history of transactions that it could compare with Treasury information, as data from previous financial systems was not available to the staff performing the reconciliations. The absence of historical data continued to prevent the Department from researching some of the negative Treasury Account Fund Symbols.

Failure to implement timely and effective reconciliation processes could do the following:

- Increase the risk of fraud, waste, and mismanagement of funds.
- Affect the Department’s ability to effectively monitor budget execution.
- Affect the Department’s ability to accurately measure the full cost of its programs.
- Result in erroneous financial statements.

This issue was initially reported in our FY 2009 management letter.

III. Payroll and Related Liabilities

The Department’s workforce includes Civil Service, Foreign Service, and Foreign Service National (FSN) employees. Civil Service and Foreign Service employees are paid according to standard Federal Government pay scales using the Consolidated American Payroll Processing System. FSN employees are generally paid in local currency, and their salaries and benefits are based on local prevailing practice, which are documented in each post’s Local Compensation Plan. FSN employees are paid using the Global Foreign Affairs Compensation System (GFACS). Ensuring the sufficiency of controls over personnel-related activities is a key responsibility of managers.

Inaccurate Personnel Data for Foreign Service National Employees

Human resource information for FSNs, such as date hired, transfers, grade increases, and date of separation, is maintained in the Department’s WebPass application. When a personnel action is initiated for an FSN, the post enters the information into WebPass. The FSN personnel information is then submitted to a Global Financial Service Center, where officials manually enter the information into GFACS.

We assessed the completeness of employee information in WebPass and GFACS for all overseas posts that provide voluntary severance or supplemental lump sum after-employment benefits. We used automated audit techniques to compare the total number of employees with the names of individuals in WebPass and GFACS. Table 4 shows the results of our testing for FY 2017, as well as the results of our testing from FY 2016 for comparative purposes.

Table 4: Total Number of Individuals in GFACS and WebPass

Individuals Reviewed	FY 2017 Individuals	FY 2016 Individuals
Individuals in both WebPass and GFACS	25,836	25,421
Individuals in WebPass who were not in GFACS	226	299
Individuals in GFACS who were not in WebPass	188	216

For the employees included in both systems, we performed additional testing to identify data inconsistencies related to the date of birth, service computation date, and annual salary fields. Table 5 shows the results of our testing for FY 2017, as well as the results of our testing from FY 2016 for comparative purposes.

Table 5: Data Inconsistencies Between GFACS and WebPass

Inconsistency Identified	FY 2017 Discrepancies	FY 2016 Discrepancies
Employee's date of birth was not consistent	806	845
Employee's service computation date was not consistent	3,202	2,919
Employee's annual salary was not consistent	2,113	4,085
Employee's employer agency was not consistent	31	24

In both FY 2017 and FY 2016 the Department tested a judgmental sample of the discrepancies we noted and reported that WebPass contained more accurate information on each employee's date of birth and service computation date and that GFACS contained more accurate salary information. We re-performed the Department's testing and confirmed its conclusions regarding the most accurate sources of FSN employee information.

We found that posts were processing personnel actions inconsistently. In certain instances, posts were not notifying the responsible Global Financial Service Center in a timely manner about personnel actions that had been processed. Additionally, we noted instances in which data submitted to the responsible Global Financial Service Center was not updated in GFACS to reflect changes made in WebPass. We also found instances in which approved personnel actions were not accurately entered into GFACS once the information was provided to the Global Financial Service Center due to data entry error. The Department did not have a control in place to ensure that all post-approved personnel actions included in WebPass were also entered into GFACS, such as a process to regularly reconcile the data between the applications.

The Department estimates a liability to include in its annual financial statements for after-employment benefits offered to some FSNs. The reasonableness of the liability estimate related to after-employment benefits relies on accurate underlying employee demographic data. Without accurate and complete FSN personnel data, the Department may not be able to efficiently or accurately calculate its annual liability for after-employment benefits. The Department was able to adjust its liability estimation methodology to address the discrepancies identified during our testing through manual manipulation of data in GFACS and WebPass.

In addition, the risk of improper payments exists if payroll and benefit payments are calculated on the basis of inaccurate data. The lack of reconciliation between GFACS and WebPass may result in errors and inconsistencies remaining undetected and uncorrected for long periods of time.

The issue was initially reported in our FY 2012 Report on Internal Control.

Inadequate Control Over Personnel Records and Actions

<u>Insufficient, Inconsistent, or Incorrect Personnel Record Documentation</u>

The Office of Personnel Management requires agencies, including the Department, to maintain up-to-date, complete, and correct personnel records for each employee. These personnel folders should include all benefit election forms, as well as any elections resulting in deductions to an employee's pay. In addition, the Department is required to review time and attendance submissions for accuracy. Maintaining up-to-date personnel folders and reviewing time and attendance submissions for accuracy help ensure that employees are compensated only for actual hours worked and benefits earned.

To verify the accuracy of Civil Service and FSN employee salaries and benefits, we assessed the completeness of personnel records for a sample of 45 employees. Table 6 shows the discrepancies identified during our testing.

Table 6: Discrepancies in Personnel Records

Discrepancy	FY 2017 Exceptions
Employee timesheet was not provided	9
Request for Leave or Approved Absence Forms (SF-71) were not provided	1
Annual and/or sick leave taken was not properly approved per the SF-71	1
Life Insurance Election Form (SF-2817) was not provided	3
Federal Employees' Group Life Insurance election selected on the SF-2817 was not the same as the election on the employee's Notification of Personnel Action	2
Thrift Savings Plan withholding amount on the employee's Earnings and Leave Statement did not recalculate on the basis of the employee's Thrift Savings Plan election percentage selected on the Thrift Savings Plan election form and documented on the Earnings and Leave Statement.	2

Each bureau and post has been delegated the authority to approve personnel actions and time and attendance data, enter information into the personnel system, and submit information to payroll service centers in either Charleston, SC, or Bangkok, Thailand. We found that bureaus and posts were processing personnel actions and time and attendance data inconsistently. Additionally, bureaus and posts did not always submit information to the payroll service centers in a timely manner or at all. Additionally, the Department did not sufficiently oversee and review the documentation maintained in personnel files and time and attendance reports.

Poor administrative control over the payroll cycle and lack of sufficient and updated supporting documentation in the Official Personnel File may lead to errors in employee pay, improper benefit elections, or increased benefit costs. Incomplete personnel records prevent the timely receipt of sufficient and accurate documentation when requested and hinder the prompt identification and remediation of errors.

This issue was initially reported in our FY 2009 management letter.

Improper and Untimely Processing of Personnel Actions

The Department processes personnel actions when an employee is hired or an existing employee has a change in personnel status, such as resignation, retirement, or promotion. These personnel actions are documented either on the SF-50 or the Joint Form (JF) 62A (Personal Services Contracting Action).

We selected a sample from FY 2017 of 100 payroll disbursements, 48 separated employee personnel actions, and 50 new hire personnel actions from GFACS and 45 payroll disbursements, 45 separated employee personnel actions, and 45 new hire employee personnel actions from the Consolidated American Payroll Processing System. For each of the sample items selected, we reviewed the SF-50 or JF-62A for proper and timely approvals. Tables 7 and 8 show the discrepancies identified during our testing.

Table 7: GFACS Testing Discrepancies

Discrepancy	FY 2017 Exceptions
Personnel actions in our payroll disbursement sample were not approved in the pay period following the effective date on the personnel action	1
Personnel actions in our disbursement sample were not provided	12
Personnel actions in our separated employee sample were not approved in the pay period following the effective date on the personnel action	1
Employees in our separated employee sample were not deactivated in the personnel system in the pay period following the SF-50 separation effective date	1

Table 8: Consolidated American Payroll Processing System Testing Discrepancies

Discrepancy	FY 2017 Exceptions
Personnel actions in our payroll disbursement sample were not approved in the pay period following the effective date on the personnel action	1
Personnel actions in our separated employees sample were not approved in the pay period following the effective date on the personnel action	11
Personnel actions in our new hire employees sample were not approved in the pay period following the effective date on the personnel action	2

Each bureau and post had been delegated the authority to approve personnel actions and enter the information into the personnel systems. We found that bureaus and posts were processing personnel actions inconsistently. The Department did not have a centralized process to ensure that bureaus and posts were approving employee actions and entering the information into the personnel system in a timely manner.

The potential for improper payment exists if personnel actions are not processed properly or timely. In addition, the lack of proper oversight of personnel actions may result in errors remaining undetected and uncorrected for long periods of time. Untimely personnel actions are often processed retroactively, leading to supplemental payments being processed manually and increasing the risk of human error and decreasing efficiency.

This issue was initially reporting in our FY 2009 management letter.

IV. Environmental Liability Associated With Asbestos Cleanup

Inaccurate Supporting Data for the Asbestos Remediation Estimate

Asbestos is a mineral-based material that was widely used worldwide in construction during the 19th and early 20th centuries because of its affordability and resistance to fire, heat, and electrical damage. The Department owns buildings constructed when the use of asbestos in various building materials was common. Because of health concerns, many countries prohibited the use of asbestos in building materials in the 1980s and 1990s. The Department’s Bureau of Overseas

Buildings Operations (OBO) periodically assesses posts to identify buildings that have asbestos-containing building materials (ACBM). Upon completion of this analysis, the results for each post are recorded in OBO's Facilities Environmental Tracing System (FACETS). Because of the significance of its property inventory and the lack of property-specific estimates, the Department uses a cost-modeling technique to estimate asbestos-abatement costs. The data in FACETS is used as the starting point for the Department's asbestos remediation cost model.

In FY 2015, the Department implemented a new process for overseas post officials to alert OBO to necessary updates to the posts' asbestos data. For example, overseas posts can notify OBO that ACBMs have been remediated during facility renovations. The notifications are executed by submitting an ACBM change request in FACETS. On the basis of the request, OBO may then update the posts' data or perform independent ACBM inspections to confirm the requested changes.

We reviewed the data in FACETS as of October 1, 2016, by selecting a sample of 15 overseas buildings for physical confirmation. FACETS listed 27 specific ACBMs that existed across the 15 sampled facilities. We toured each selected facility from May to June 2017 to corroborate the FACETS data. We were unable to confirm the physical existence of 15 ACBMs at several of the facilities. Table 9 provides information on the exceptions identified during site visits.

Table 9: Post Asbestos Existence Testing Exceptions

Post	Number of ABCMs Reported in FACETS	Number of ABCMs Remediated or Removed
Brussels, Belgium	16	5
Panama City, Panama	3	3
Brasilia, Brazil	3	3
Sao Paulo, Brazil	5	4
Total	**27**	**15**

After noting these exceptions, we reviewed a listing of ACBM change requests submitted to OBO by overseas posts from October 2, 2016, through June 30, 2017. We confirmed that none of the identified remediated ACBMs were communicated through change requests prior to our facility tours.

The Department does not have an effective process to ensure that its asbestos remediation liability estimate is based on the most current conditions at overseas posts. At each overseas post that had exceptions noted, facility surveys were performed several years prior to our testing. Although the Department developed a process for posts to notify OBO of necessary updates of FACETS data, we found that four of the seven posts visited during our audit did not use this process to communicate the remediated ACBMs to OBO. Additionally, one exception related to a building formerly containing ACBMs that had been sold, but the building was still listed in FACETS.

Inaccurate or outdated underlying data regarding the presence of asbestos in its facilities may limit the Department's ability to produce a reasonable asbestos remediation estimate. Specifically, when facility records do not accurately reflect the removal of ACBMs, estimated asbestos remediation liability estimates will be overstated.

This issue was initially reporting in our FY 2013 management letter.

V. Voluntary Contribution Accrual Estimates

Insufficient Controls for Reporting Voluntary Contributions

The Department provides discretionary financial assistance to foreign countries, public international organizations, international societies, commissions, and other international organizations (IO). This financial assistance is called voluntary contributions. The Bureau of Population, Refugees, and Migration (PRM) is responsible for the majority of voluntary contributions within the Department. Specifically, of the approximately $3.6 billion in voluntary contributions paid in FY 2016, PRM was responsible for approximately $2.9 billion (81 percent). PRM makes voluntary contributions to approximately 10 organizations, including the International Organization for Migration. These contributions were made in accordance with Federal assistance award agreements that PRM established with the recipient organizations. The Department uses the Department of Health and Human Services Payment Management System (PMS) to process disbursements to contribution recipients.

Federal agencies should record a liability for all amounts owed as of the financial statement date, including amounts related to voluntary contributions. In addition, Federal agencies should record an asset, specifically an advance, for all funds provided for voluntary contributions that have not been expended by the recipient. To identify and record liabilities and advances related to PRM's voluntary contributions, PRM contacts each organization that has an established Federal assistance award agreement. PRM provides each organization with a spreadsheet, the "IO Confirmation Spreadsheet," listing the amounts pledged in the Federal assistance award agreement and the amounts paid as of September 30 each year. PRM provides the organizations with an estimate of the amounts that should be considered a liability or an advance at year end on the basis of PRM's understanding of the organization and its agreement. PRM requests that the organization assess the accuracy of PRM's estimates and make any necessary adjustments. The Bureau of the Comptroller and Global Financial Services (CGFS) uses these responses to prepare the voluntary contributions advance and liability accrual. As of September 30, 2016, the Department recorded a voluntary contributions liability of $41 million and an advance of $73 million.

Annually, CGFS performs a validation of its accrual estimate during the following fiscal year. Specifically, CGFS reviews supporting documentation for payments processed during the first and second quarters of the following fiscal year and compares information in the documentation with the prior year accrual amounts for reasonableness.

During its validation procedure, CGFS identified payments totaling $31 million to the International Organization for Migration that were recorded as an advance as of September 30, 2016, but the payments were not disbursed until October 12, 2016 (that is, in FY 2017).

Although CGFS has a process in place to estimate and record liabilities and advances related to voluntary contributions, the process is manual in nature. Specifically, PRM's process to prepare the "IO Confirmation Spreadsheet" lacks steps to identify payments that are approved in PMS but are not disbursed as of the end of the fiscal year. In addition, when reviewing the response provided by the International Organization for Migration in the "IO Confirmation Spreadsheet" and calculating the accrual estimate, we found that CGFS did not properly determine that unpaid amounts were included in the total amount paid. Specifically, even though the $31 million had not been disbursed by PMS, the International Organization for Migration indicated in its response on the "IO Confirmation Spreadsheet" that the amount was an advance. Additional procedures are needed to identify when payments have been approved but are not yet disbursed by PMS.

Insufficient control procedures may limit the Department's ability to identify timing differences and produce an accurate voluntary contributions accrual estimate. Specifically, the erroneous accrual resulted in the Department's 2016 advance account being overstated by $31 million.

This issue was initially reporting in our FY 2016 management letter.

VI. Expenses

Insufficient Vendor Invoice Approvals

Agencies, including the Department, obtain goods and services from vendors and other Federal agencies as part of normal business operations. The approval of invoices for goods or services from vendors is a critical point in the acquisition and payment cycle. An agency should identify employees who are authorized to accept the receipt of goods or services or administratively approve invoices for which the receipt of goods and services does not apply (for example, utility bills). Within the Department, the individual approving an invoice is referred to as the "certifying officer" or the "designated billing official." The Department maintains an Invoice Approval Form to facilitate and document the acceptance of goods and services or administrative approval of invoices.

The instructions for completing the Invoice Approval Form state, "Enter the name of the [designated billing official] DBO/[Contracting Officer's Representative] (COR) or the designated representative to approve this invoice." CORs are individuals who are responsible for technical monitoring and evaluation of the contractor's performance and who have been officially appointed by the contracting officer in writing. Government Technical Monitors (GTM) are designated by the contracting officer to assist the CORs. Accordingly, GTMs are responsible for overseeing contracts and have detailed knowledge of the work being performed. Additionally, CORs and GTMs are required to attend contract oversight training and obtain the Office of Management and Budget, Office of Federal Procurement Policy Federal Acquisition Certification for Contracting Officer's Representatives (FAC-COR), which is issued by the Department's Bureau of Administration, Office of the Procurement Executive. The Department maintains a database of all personnel who hold an active FAC-COR certification.

We tested a sample of 78 domestic vendor payments that were processed between October 1, 2016, and June 30, 2017, to test internal controls for invoice approval. For each sampled transaction, we tested to determine whether the individual approving the invoice was the COR and whether the COR had an active FAC-COR certification in the FAC-COR database. We identified issues with 13 (16.7 percent) of 78 sampled transactions. Specifically, 10 invoices were approved by individuals other than the contracts' designated COR, of which 8 individuals also did not have an active FAC-COR certification in the database. In addition, three invoices were approved by the COR, but the COR did not have an active FAC-COR certification in the database. Table 10 shows the results of and additional details on the invoice testing exceptions.

Table 10: FAC-COR Invoice Approval Internal Control Exceptions

Contract/Obligation Number	Vendor Invoice Number	Total Invoice Amount	Description	Invoice Approver Is COR	Invoice Approver With Active FAC-COR Certification
SAQMMA13C0044	BI2016-001758	$1,610,498	Administrative support services	Yes	No
SINLEC15L0153	111-2296	$14,759	Professional services	Yes	No
SAQMMA16C0003	FSI0014	$877,888	FSI* space expansion	Yes	No
SAQMMA16L1314	AFS00579033	$374,052	Security services	No	No
SAQMMA15L2220	AFS00604473	$2,035,929	Security services	No	No
SAQMMA15L2255	AFS00542817	$929,191	Security services	No	No
SAQMMA16F1152	SI014348	$1,728,180	Equipment	No	No
SAQMMA13F2905	114085	$1,112,427	IT services	No	No
SAQMMA16F4919	IN407542R3	$3,721,271	Equipment	No	No
SAQMMA16L1015	25009	$1,727,184	IT services	No	No
SAQMMA16L0167	GQG7059	$36,307,689	Software	No	No
SAQMMA16F4855	2956-03CV	$869,395	Equipment	No	Yes
SAQMMA15F2545	INL-E3-IRAQ-23B	$2,391,184	Aviation support services	No	Yes
Total		**$53,699,647**			

*FSI is the Foreign Service Institute.

We found that the Department's guidance and its Invoice Approval Form were not always consistent and that Department officials had varying interpretations of the Department's policies pertaining to requirements for invoice approval. Specifically, policies in the Foreign Affairs Manual[7] (FAM) and the Foreign Affairs Handbook[8] (FAH) explain that it is the responsibility of the certifying officer to review and approve invoices, but Section 3 of the Invoice Approval Form is titled "DBO/COR," and the instructions for completing the Invoice Approval Form state, "Enter the name of the DBO/COR." The instructions on the Invoice Approval Form also

[7] 4 FAM 414, "Definitions."
[8] 4 FAH-3 H-065.1, "Policy."

state, “or the designated representative authorized to approve this invoice,” but the form does not use the term “certifying officer,” which is defined in the FAM and the FAH.

Further, the roles and responsibilities of the certifying officer, designated billing official, COR, and GTM are not clear in the Department’s guidance. For example, the only reference to a “DBO” in the FAM and the FAH is in reference specifically to vouchering requirements for petty cash expenditures and usage and oversight of U.S. Government purchase cards. Moreover, the FAH stresses the significance of the COR and the GTM in the invoice review process, but it does not place into context the relationship to a certifying officer.[9] Finally, the Department lacked oversight procedures to ensure that appropriate approvals, including officials with required active FAC-COR certifications, were obtained prior to the processing of vendor payments.

Invoice approvals by untrained and uncertified officials increase the likelihood that improper payments could be made or that waste, fraud, and abuse could occur and go undetected. Ineffective vendor oversight practices could create circumstances in which payment is made for goods or services that were not received.

This issue was initially reported in our FY 2016 management letter.

NEW MANAGEMENT LETTER COMMENTS

During the audit of the Department’s FY 2017 financial statements, additional matters came to our attention that were not previously reported in the FY 2016 Report on Internal Control or the management letter.

VII. Payroll and Related Liabilities

Unrecorded Foreign Service National Bonus Liability

On the basis of prevailing wage practices, the Department provides some FSN employees with bonuses through a variety of arrangements. The specific calculations for these bonuses vary, but the bonuses are determined primarily based upon a percentage of the employee’s annual basic salary and the employee’s employment status throughout the year. One of the more common bonuses is a payment of 1 month’s salary in December. The Department documents the compensation and benefit arrangements in place for FSNs in each country’s Local Compensation Plan.

We reviewed the Local Compensation Plan for each country and found that FSNs are eligible for bonuses in 134 of 182 countries. The Department had not calculated or reported an estimated liability for FSN bonuses in its annual financial statements.

We found that the Department did not have a process to quantify and report FSN bonus liabilities in its financial statements. Historically, the Department had fully expensed all FSN bonus

[9] 14 FAH-2 H-114, “COR Work Commitments.”

payments when the bonus was processed. Although Department officials were generally aware of the accounting requirements relating to liabilities, the Department had not considered applying the criteria to FSN bonuses.

On the basis of the results of our audit, the Department adjusted its financial statements to properly account for the FSN bonus liability by recording a $44 million liability. However, by not having an annual process to estimate FSN bonus liabilities, the Department increases the likelihood that it will understate liabilities in future annual financial statements.

VIII. Other Assets

Accounting for Federal Advances

When payments are made for services before those services are provided (that is, an advance payment or a prepayment), Federal accounting standards require agencies to record the transaction as an asset. The Department sometimes makes prepayments to other Federal agencies when it enters into a reimbursable or interagency agreement (hereafter referred to as "reimbursable agreement"). The reimbursable agreement documents the specific services that the servicing agency will perform and the amount that the purchasing agency will pay for these services. A prepayment associated with these reimbursable agreements is often necessary so that the servicing agency has the funds necessary to perform the work to provide the services to the purchasing agency. The Department reports prepaid expenses arising from reimbursable agreements with other Federal agencies in the "Other Assets" line item on its annual financial statements.

The Department has a process to identify transactions that should be recorded as prepayments for reimbursable agreements. When payments for reimbursable agreements are initially made, the entire payment amount is recognized as an expense in the Department's accounting system. Therefore, the Department must manually identify any amounts that are prepaid and reclassify them as an Other Asset. Accountants in CGFS are assigned responsibility for certain Federal agencies with which the Department has reimbursable agreements. Each month, the CGFS accountants communicate with their assigned Federal agencies to determine the status of reimbursable agreements. The Federal agencies provide the Department with information such as the status of services provided, costs incurred, percentage of completion, or other relevant information that would indicate how much of the payment should be classified as an expense versus Other Assets. The CGFS accountant uses this information to create monthly journal vouchers to recognize a new advance balance or to adjust an existing one.

We tested 41 payments made by the Department in the first three quarters of FY 2017 to other Federal agencies to determine whether the transactions were correctly recorded. During this testing, we identified two advances, totaling $88.8 million, made for two reimbursable agreements with the Defense Finance and Accounting Service (DFAS) that were not correctly reclassified from expenses to Other Assets.

Although CGFS has a process to manually report Federal advances, it did not identify the two errors identified during the audit. CGFS did not request information from DFAS regarding the status of the two reimbursable agreements, which may have indicated that advance payments should have been reported. The CGFS accountant responsible for the DFAS agreements stated that the two expenditures, individually, were not significant enough to request information regarding the status of the reimbursable agreement from DFAS.

Insufficient processes limit the Department's ability to accurately report Other Assets and expenses in its financial statements. Specifically, Other Assets were initially understated by $88.8 million, and expenses were initially overstated by $88.8 million in FY 2017. Although the Department corrected these amounts on the basis of the results of our audit, unidentified advances may continue to exist unless improvements in the process to identify advances are made.

IX. Real Property

Accounting for Real Property Transactions With the General Services Administration

The General Services Administration (GSA) may acquire, construct, or alter facilities on behalf of other Federal agencies through a reimbursable work authorization (RWA), which provides GSA funding to cover all or a portion of the costs. GSA is the custodian of the property it acquires on behalf of other Federal agencies, and the property is included in GSA's real property inventory. However, when a Federal agency provides funding for the acquisition or alteration of property, GSA may include a rent consideration in the "Occupancy Agreement"[10] with the agency. For example, rent may be reduced or eliminated for a certain time period in recognition of the funds provided by the agency.

Between FY 2013 and FY 2016, the Department entered into two RWAs with GSA to purchase a domestic real property known as State Annex 20 (SA-20). The funding for the purchase totaled approximately $240 million. The Department signed a 20-year, non-cancelable Occupancy Agreement with GSA on April 10, 2017, which included a description of how the funding that the Department provided would be applied to its rent obligation. Specifically, the Agreement states that the Department will not be charged rent for its occupancy for the first 5 years of the lease, which will be approximately $88.8 million. The Agreement further states that for the remaining 15 years of the lease, the Department will be charged a reduced rent that will cover the remaining $151.2 million that the Department contributed to the purchase.

In FY 2016, the Department entered into a separate RWA with GSA totaling approximately $86.8 million to purchase units in a domestic real property known as the American Red Cross building. The Department signed a 20-year, non-cancelable Occupancy Agreement with GSA on April 10, 2017, which included a description of how the funding that the Department provided would be applied to its rent obligation. Specifically, the Agreement states that the Department will not be charged rent for its occupancy for the first 5 years, which will be approximately $35.9 million. The Agreement provides two options for rent for the remaining 15 years of the

[10] The Occupancy Agreement outlines the terms and conditions of the Federal agency's use of the property and is similar to a lease agreement.

lease; in both options, the Department recovers the remaining $50.9 million contributed to the purchase.

The Department paid GSA a total of approximately $326.8 million for SA-20 and units in the American Red Cross building in the first two quarters of FY 2017. The Department recorded the transactions associated with the purchases as operating expenses in the Department's accounting system. In the third quarter of FY 2017, Department officials informed us of the acquisitions and stated that there was a difference in the accounting treatment that they had applied and that GSA had applied. The officials further stated that they were communicating with GSA and Treasury to determine the proper accounting treatments for the acquisitions. However, as of October 31, 2017, the Department had not decided on the proper accounting treatment or posted adjusting entries in the accounting system to recognize the acquisitions as assets.

The Department did not have policies or procedures relating to accounting for significant domestic real property transactions handled by GSA. According to Department officials, unlike the purchase of overseas properties for diplomatic missions, the Department does not frequently acquire domestic buildings and office spaces through GSA.

The Department adjusted its financial statements to properly account for the transactions with GSA. However, without a process to appropriately record transactions associated with the purchase of a building or other facility through GSA, assets may be understated and operating expenses may be overstated on the Department's financial statements.

United States Department of State
Comptroller
Washington, DC 20520

February 9, 2018

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MEMORANDUM

TO: OIG – Steve A. Linick

FROM: CGFS – Christopher H. Flaggs

Christopher H Flaggs

Thank you for the opportunity to review and comment on the Draft Report - Management Letter Related to the Audit of the U.S. Department of State FY 2017 Financial Statements.

The Bureau of the Comptroller and Global Financial Services (CGFS) does not have any substantive comments on the Draft Report and associated recommendations. We appreciate the efforts of the Office of Inspector General Audit Division (OIG/AUD) and the independent auditor Kearney & Company (Kearney) throughout the financial audit process. We are pleased that working collaboratively with your office and Kearney that we were able to close 2 of the 8 FY 2016 Management Letter Findings. We will continue to strive for improvements in the areas noted in the Draft Report and look forward to working collaboratively and constructively with your office and Kearney to build on the progress made over the last year.

cc: M – Mr. Greg Stanford
M – Ms. Deborah Winters
OIG/AUD – Mr. Norman P. Brown
Kearney & Company, P.C. – Mr. Kelly E. Gorrell
CGFS – Mr. Alan Evans
CGFS – Mr. William Davisson
CGFS/EX – Mr. Joseph A. Kenney

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