

**INDEPENDENT AUDITOR'S REPORT**  
**AUD-FM-21-08**

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

**Report on the Financial Statements**

We have audited the accompanying financial statements of the U.S. Department of State (Department), which comprise the consolidated balance sheets as of September 30, 2020 and 2019; the related consolidated statements of net cost and changes in net position and the combined statements of budgetary resources for the years then ended; and the related notes to the financial statements.

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

Management is responsible for the preparation and fair presentation of these 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 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 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. 19-03, "Audit Requirements for Federal Financial Statements." Those standards and OMB Bulletin No. 19-03 require that we plan and perform the audit to obtain reasonable assurance about whether the 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 Financial Statements***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of September 30, 2020 and 2019, 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, Combining Statement of Budgetary Resources, Condition of Heritage Assets, and Deferred Maintenance and Repairs (hereinafter referred to as "required supplementary information") be presented to supplement the financial statements. Such information, although not a part of the 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 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 financial statements, and other knowledge we obtained during our audits of the 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 financial statements as a whole. The information in the Introduction, Message from the Secretary, Message from the Comptroller, Section III: Other Information, and Appendices 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 financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements, and accordingly, we do not express an opinion or provide any assurance on the information.

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

In accordance with *Government Auditing Standards* and OMB Bulletin No. 19-03, we have also issued reports, dated November 16, 2020, on our consideration of the Department's internal



control over financial reporting and on our tests of the Department's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements for the year ended September 30, 2020. 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 *Government Auditing Standards* and OMB Bulletin No. 19-03 and should be considered in assessing the results of our audits.

A handwritten signature in blue ink that reads "Kearney &amp; Company". The signature is written in a cursive, flowing style.

Alexandria, Virginia  
November 16, 2020

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

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

We have audited, 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. 19-03, "Audit Requirements for Federal Financial Statements," the financial statements and the related notes to the financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2020, and we have issued our report thereon dated November 16, 2020.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the 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. 19-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982,<sup>1</sup> 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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified certain deficiencies in internal control, described below, as items that we consider to be significant deficiencies.

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<sup>1</sup> Federal Managers' Financial Integrity Act of 1982, Pub. L. No. 97-255, 96 STAT 814 (September 8, 1982).

## Significant Deficiencies

### I. Property and Equipment

The Department reported more than \$26 billion in net property and equipment on its FY 2020 consolidated balance sheet. Real and leased property consisted primarily of residential and functional facilities 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 financial statements and subsequent audits. In FY 2020, 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:

- Overseas Real Property – The Department operates at more than 270 posts in more than 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. We found numerous real property acquisitions and disposals overseas that were not recorded by the Department in a timely manner. Although the Department implemented certain controls, such as a quarterly data call, to identify acquisitions and disposals related to overseas real property, the controls did not ensure that all real property transactions were recorded in the proper fiscal year. The untimely processing of property acquisitions and disposals resulted in misstatements in the Department's asset and expense balances.
- Overseas Construction Projects – During FY 2020, the Department managed over \$5 billion in overseas construction projects. All construction projects should be tracked in the construction-in-progress (CIP) account until the project reaches substantial completion. Once a construction project is substantially complete, the Department transfers the asset to the appropriate real property asset account and the asset is depreciated<sup>2</sup> over its estimated useful life. The Department notified us of construction projects that had either reached substantial completion or were terminated prior to FY 2020 but remained in the Department's CIP account. These projects were not managed in accordance with the Department's policies and controls relating to overseas construction. The projects were managed by a bureau that does not normally manage construction projects. This bureau did not provide accurate responses to data calls related to the status of the construction projects. The untimely transfer of completed and terminated construction projects resulted in misstatements in the Department's asset and expense balances.
- Domestic Construction Projects – The Department currently manages over \$400 million in domestic construction projects. Similar to overseas projects, domestic construction

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<sup>2</sup> Depreciation is the allocation of the acquisition cost of an asset, less its estimated salvage or residual value, over its estimated useful life.

projects should be tracked in the CIP account until the project reaches substantial completion. We identified domestic construction projects that were substantially complete prior to FY 2020 but that continued to be tracked in the CIP account. The Department does not have clear policies regarding the accounting treatment of domestic construction projects or processes to monitor the status of domestic construction projects. The untimely transfer of completed domestic construction projects resulted in misstatements in the Department's asset and expense balances.

In addition to construction projects for property that the Department owns, under some circumstances the Department pays for the renovation or improvement of facilities that are occupied by the Department but that are owned or leased by the General Services Administration (GSA). The Department's policies require the capitalization of major real property renovations or leasehold improvements of \$1 million or more. We obtained a list of ongoing domestic construction projects and found that the costs for each project was being recorded as operating expenses by the Department, rather than CIP. However, we determined that several of the projects had estimated costs that met the capitalization threshold. The Department does not have a policy specific to the accounting treatment for improvements to domestic real property under occupancy agreements, such as with GSA. Without a policy, the Department may not appropriately and consistently account for domestic real property transactions, thus understating assets and overstating operating expenses in the Department's financial statements.

- Leases – The Department manages approximately 17,800 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 notes related to the financial statements. We found numerous recorded lease terms that did not agree with supporting documentation and errors in the Department's FMLP calculations. The Department's processes to record lease information and to ensure the accuracy of FMLP calculations were not always effective. The errors resulted in misstatements in the Department's notes related to the financial statements.
- Personal Property – 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 identified a significant number of personal property transactions from prior years that were not recorded in the correct fiscal year. In addition, we found that the acquisition value for numerous tested items could not be supported or was incorrect. Furthermore, we found that the gain or loss recorded for some personal property disposals was not recorded properly. The Department's internal control structure did not ensure that personal property acquisitions and disposals were recorded in a complete, timely, and accurate manner. In addition, the Department's monitoring activities were not effective to ensure proper financial reporting for personal property. The errors resulted in misstatements to the Department's 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.

- Contractor-Held Property – The Department uses contractors to provide support in overseas locations, which may include acquiring personal property on behalf of the Department. This type of property is generally referred to as contractor-held property (CHP). The Department has title to the CHP and reports all CHP with an acquisition cost over \$25,000 as an asset in its financial statements. In some cases, the property can be transferred to host-country governments for their use. Depending on the type of agreement, the Department may retain ownership of the property after it is transferred. Once an asset is provided to its intended user (e.g., a host-country government), it should be put “in service,” which means that the asset begins to depreciate over its useful life. The Department found that it had been incorrectly accounting for certain CHP. Specifically, the Department acquired assets in FY 2014 that it planned to transfer to a host-country government. That property was placed into service prior to FY 2020 but was not recorded correctly in the financial system. Although the Department implemented a quarterly CHP data call, the process did not ensure that all CHP assets were properly accounted for in the Department’s financial statements. As a result, the Department’s prior year financial statements were misstated. The Department recorded an adjustment to correct the impact on its FY 2020 financial statements.
- Software – Federal agencies use various types of software applications, called internal use software, to conduct business. Applications in the development phase are considered software in development (SID). Agencies are required to report software as property in their financial statements. We identified numerous instances in which the data recorded for SID were unsupported. We also identified some instances where completed projects were not transferred from SID to the internal use software account. 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, not all of whom understood the accounting requirements for reporting SID. Additionally, the Department did not have an effective process to confirm that information provided by project managers was complete or accurate. The errors resulted in misstatements to the Department’s financial statements. Without an effective process to obtain complete and accurate information pertaining to software applications, the Department may continue to misstate its financial statements.

## **II. 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 financial statements, we identified budgetary accounting as a significant deficiency. During FY 2020, 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 include a reasonable estimate of potential future outlays. We identified



several low-value obligations (i.e., obligations that are \$5 or less) 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. Although Department officials indicated that improvements were made in the oversight of low-value obligations, these efforts were not fully effective during FY 2020. As in past years, we found that allotment holders did not always record valid and accurate obligations prior to the receipt of goods and services; therefore, the Department established low-value obligations that allowed invoices to be paid in compliance with the Prompt Payment Act.<sup>3</sup> This process effectively bypassed system controls. The continued use of this practice could lead to a violation of the Antideficiency Act<sup>4</sup> 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 the audit, we identified numerous obligations that were not recorded within the requisite 15 days of execution of the obligating document and that were recorded in the financial management system prior to the execution of the obligating document. We also noted instances where goods and services were received, or periods of performance began, prior to the execution of a proper obligating document. The Department did not have processes to ensure the 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<sup>5</sup> and the Prompt Payment Act.<sup>6</sup>
- 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 obligates leases on an annual basis rather than for 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 financial statements were misstated.
- 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 overrides that allowed officials to exceed allotments. The Department did not have an automated control to prevent users from recording obligations that exceeded allotment amounts. Department management stated that such an automated control is not reasonable because of instances in which an allotment may need to be exceeded; however, the Department has not formally identified and documented the circumstances under which an allotment override

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<sup>3</sup> 31 U.S.C. § 39, "Prompt Payment."

<sup>4</sup> Antideficiency Act, Pub. L. No. 97-258, 96 STAT. 923 (September 13, 1982).

<sup>5</sup> Ibid.

<sup>6</sup> 31 U.S.C. § 39.



is acceptable. Overriding allotment controls could lead to a violation of the Antideficiency Act<sup>7</sup> and increases the risk of fraud, misuse, and waste.

### **III. 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 that requires allotment holders to perform at least monthly reviews of ULOs. Weaknesses in controls over ULOs were initially reported in the audit of the Department's FY 1997 financial statements. We continued to identify a significant number and amount of invalid ULOs based on expired periods of performance, inactivity, lack of supporting documentation, or inability to support bona fide need.

Although the Department continues to take steps to remediate long-standing ULO validity issues through its annual ULO review, the scope of the review does not include all ULOs. Overseas ULOs and domestic ULOs that do not meet the annual domestic review categories established by the Department continue to be a risk for invalidity. Furthermore, not all allotment holders were performing periodic reviews of ULO balances as required. As a result of invalid ULOs that were identified by our audit, the Department adjusted its FY 2020 financial statements. In addition, funds that could have been used for other purposes may have remained open as invalid ULOs, and the risk of duplicate or fraudulent payments because of the large number of invalid ULOs is increased.

### **IV. Financial Reporting**

In FY 2019, the Department's internal control structure was not sufficient to ensure that financial statement balances were consolidated and classified accurately. We concluded that the combination of financial reporting-related control deficiencies was a significant deficiency. In FY 2020, the Department addressed a control deficiency related to the classification of Funds from Dedicated Collections. However, we continued to identify a control deficiency related to the monitoring of allocation transfers that we concluded was a significant deficiency.

In some cases, appropriated funds are required to be transferred to another agency for programmatic execution (referred to as "child funds"). Despite transferring these funds to another agency, the Department is required to report on the use and status of child funds in its financial statements. During FY 2020, the Department made significant child fund transfers to three agencies. To obtain audit coverage of the Department's most significant child funds, we requested that the financial statements auditors of two of the three agencies perform certain audit steps. Those other auditors identified numerous invalid ULOs. We also requested detailed financial information from the third agency, which received a less significant amount of child funds from the Department. However, the data provided by the third agency did not reconcile to trial balance data. Therefore, we were unable to validate the information provided. The Department did not have an effective, routine process to ensure that amounts reported by agencies receiving child

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<sup>7</sup> Pub. L. No. 97-258, 96 STAT. 923.

funds were accurate. For example, the Department did not communicate effectively with child fund agencies to ensure that the validity of ULOs was reviewed periodically. In addition, the Department did not have a routine process to ensure that transaction-level details were readily available from the other agencies and were auditable. The Department adjusted its financial statements to correct the errors identified with the ULOs. However, without an effective process to accurately monitor child funds, a risk of errors remains in the Department's future financial statements.

## **V. Information Technology**

The Department's information systems and electronic data depend on the confidentiality, integrity, and availability of the Department's comprehensive and interconnected IT infrastructure using various technologies around the globe. Therefore, it is critical that the Department manage information security risks 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 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),<sup>8</sup> the Office of Inspector General (OIG) is responsible for annually auditing the Department's information security program. In the FY 2019 FISMA report,<sup>9</sup> OIG reported security deficiencies that significantly impacted the Department's information security program and were considered a significant deficiency within the scope of the FY 2019 financial statements audit.<sup>10</sup> Due to the COVID-19 pandemic, OMB granted OIG an extension, from October 2020 to December 2020, for reporting the results of the FY 2020 FISMA audit. As a result, the FY 2020 FISMA audit report was not available before the deadline for reporting the results of the annual financial statements audit. Therefore, we performed procedures to assess the Department's corrective actions to remediate deficiencies in the FY 2019 FISMA audit report that we considered to be the most significant to the FY 2020 financial statements. We found that the Department did not sufficiently develop, prioritize, and monitor corrective actions to remediate known security weaknesses and deficiencies, including those identified and reported to the Department by OIG.

Without an effective information security program, the Department remains vulnerable to IT-centered attacks and threats to its critical mission-related functions. Information security program weaknesses can affect the integrity of financial applications, which increases the risk that sensitive financial information could be accessed by unauthorized individuals or that financial transactions could be altered, either accidentally or intentionally. Information security program weaknesses and deficiencies increase the risk that the Department will be unable to report financial data accurately.

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<sup>8</sup> Pub. L. No. 113-283, 128 STAT. 3079-3080 (December 18, 2014).

<sup>9</sup> OIG, *Audit of the Department of State Information Security Program* (AUD-IT-20-04, October 2019).

<sup>10</sup> OIG, *Independent Auditor's Report on the U.S. Department of State FY 2019 and FY 2018 Consolidated Financial Statements* (AUD-FM-20-18, January 2020).

We considered the unremediated issues to be a significant deficiency within the scope of the FY 2020 financial statements audit. We have reported deficiencies in IT security controls as a significant deficiency in each audit 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 that was included in the audit report on the Department's FY 2019 financial statements,<sup>11</sup> we noted several issues that were related to internal control over financial reporting. The status of the FY 2019 internal control findings is summarized in Table 1.

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

<b>Control Deficiency</b>	<b>FY 2020 Status</b>	<b>FY 2019 Status</b>
<b>Property and Equipment</b>	Significant Deficiency	Significant Deficiency
<b>Budgetary Accounting</b>	Significant Deficiency	Significant Deficiency
<b>Validity and Accuracy of Unliquidated Obligations</b>	Significant Deficiency	Significant Deficiency
<b>Intragovernmental Revenue</b>	Not Reported	Significant Deficiency
<b>Financial Reporting</b>	Significant Deficiency	Significant Deficiency
<b>Information Technology</b>	Significant Deficiency	Significant Deficiency

### **Department's Response to Findings**

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

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<sup>11</sup> Ibid.

**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 *Government Auditing Standards* and OMB Bulletin No. 19-03 in considering the entity's internal control over financial reporting. Accordingly, this report is not suitable for any other purpose.



Alexandria, Virginia  
November 16, 2020

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

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

We have audited, 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. 19-03, "Audit Requirements for Federal Financial Statements," the financial statements, and the related notes to the financial statements, of the U.S. Department of State (Department) as of and for the year ended September 30, 2020, and we have issued our report thereon dated November 16, 2020.

### **Compliance**

As part of obtaining reasonable assurance about whether the Department's financial statements are free from material misstatement, we performed tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, including the provisions referred to in Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA),<sup>1</sup> 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 or potential noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 19-03 and which are summarized as follows:

- *Antideficiency Act.*<sup>2</sup> 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; or (3) making obligations or expenditures in excess of an apportionment or reappropriation, 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

<sup>1</sup> Federal Financial Management Improvement Act of 1996, Pub. L. No. 104-208, 110 STAT. 3009 (September 30, 1996).

<sup>2</sup> Antideficiency Act, Pub. L. No. 97-258, 96 STAT. 923 (September 13, 1982).



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.*<sup>3</sup> 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 consistently calculate or pay interest penalties for overdue payments to overseas vendors or international organizations. The Department was unable to provide legal justification exempting the Department from paying interest penalties for payments to these types of entities. Conditions impacting the Department's compliance with the Prompt Payment Act have been reported annually since our FY 2009 audit.

Under FFMIA,<sup>4</sup> 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 or with the application of the USSGL at the transaction level, we identified 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.

#### Federal Financial Management Systems Requirements

- The Department has long-standing 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 property and equipment, budgetary accounting, unliquidated obligations, and financial reporting.
- During its FY 2019 evaluation of the Department's information security program, as required by the Federal Information Security Modernization Act (FISMA), the Office of Inspector General (OIG) reported control weaknesses and deficiencies in all eight FY 2019 Inspector General FISMA metric domains.<sup>5</sup> During FY 2020, we assessed the Department's actions to address deficiencies reported in the FY 2019 FISMA audit report that we considered to be significant to the FY 2020 financial statements. We found that the Department did not remediate known FISMA deficiencies. We considered the unremediated issues to be a significant deficiency within the scope of the FY 2020 financial statements audit.
- 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

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<sup>3</sup> 31 U.S.C. § 39, "Prompt Payment."

<sup>4</sup> Pub. L. No. 104-208, 110 STAT. 3009.

<sup>5</sup> OIG, *Audit of the Department of State Information Security Program* (AUD-IT-20-04, October 2019).

identified in the Department's use of allotment overrides that allowed officials to exceed allotments.

- The Department did not always minimize waste, loss, unauthorized use, or misappropriation of Federal funds. For example, OIG reported a significant amount of questioned costs and funds put to better use during FY 2020.
- In addition, the previously reported matters related to the Antideficiency Act and the Prompt Payment Act impact the Department's compliance with FFMIA.

The Department had not implemented and enforced systematic financial management controls to ensure substantial compliance with FFMIA. Although the Bureau of the Comptroller and Global Financial Services (CGFS) performed an analysis to assess the Department's compliance with FFMIA, CGFS has not developed remediation plans to address instances of noncompliance. The Department's ability to meet Federal financial management systems requirements was hindered by limitations in systems and processes. Since our FY 2009 audit, we have reported annually that the Department did not substantially comply with all requirements of FFMIA.

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 has provided its response to our findings in a separate letter 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 *Government Auditing Standards* and OMB Bulletin No. 19-03 in considering the entity's compliance. Accordingly, this report is not suitable for any other purpose.



Alexandria, Virginia  
November 16, 2020





**United States Department of State**

*Comptroller*

Washington D.C. 20520

November 15, 2020

**UNCLASSIFIED**  
**MEMORANDUM**

TO:           OIG – Diana Shaw, Deputy Inspector General

FROM:       CGFS – Jeffrey C. Mounts, Comptroller *Jeffrey C. Mounts*

SUBJECT:   Draft Report on the Department of State's Fiscal Year 2020 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 in over 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 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 (AFR), as we all work to demonstrate our commitment to strong financial management and to producing meaningful financial statements. It is a rigorous process and has been a concerted and dedicated effort this year by all stakeholders involved.

While we may not agree on every aspect of the process and findings, we appreciate and extend our sincere thanks for the professionalism and commitment by all parties, including the OIG and Kearney & Company, to work together in a constructive manner, in a concentrated timeframe, to complete the comprehensive audit process. We know there will always be new challenges and concerns given our global operating environment and scope of compliance requirements. Efforts to meet the process requirements and cadence of the audit this year reflect remarkable resilience and flexibility by all parties. The overall results of the audit reflect the continuous improvement and strong performance 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 the Department has received an unmodified ("clean") audit opinion on its FY 2019 and FY 2020 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 Senior Assessment Team (SAT), Management Control Steering Committee (MCSC), and validated by senior leadership. We

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appreciate the OIG's participation in both the SAT and MCSC forums. For FY 2020, 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 recognize there is more to be done and the items identified in the Draft Report will require our continued attention, additional action, and improvement. We look forward to working with you, Kearney & Company, and other stakeholders addressing these issues in the coming year.

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