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MANAGEMENT LETTER
AUD-FM-19-16

To the Chief Financial Officer and the 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, 2018, and has issued our report thereon, dated November 15, 2018.[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. 19-01, "Audit Requirements for Federal Financial Statements." These items are not repeated in this letter because they are explained in detail in our report on the Department's FY 2018 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.

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[1] OIG, *Independent Auditor's Report on the U. S. Department of State 2018 and 2017 Financial Statements* (AUD-FM-19-03, November 2018).

KEARNEY& COMPANY

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
April 15, 2019

MANAGEMENT LETTER COMMENTS

REPEATED MANAGEMENT LETTER COMMENTS

During the audit of the U.S. Department of State's (Department) FY 2017 financial statements, Kearney & Company, P.C. (referred to as "we" hereafter), identified matters that were reported in a management letter.[1] As described in Table 1, the severity of three issues included in the FY 2017 management letter has decreased, and we consider the items closed. Seven issues remain open, and we have updated these issues with information obtained during the audit of the Department's FY 2018 financial statements.

Table 1: Current Status of Prior Year Management Letter Findings

FY 2017 Management Letter Findings	FY 2018 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 Vendor Invoice Approvals	Repeat
Accounting for Federal Advances	Repeat
Accounting for Real Property Transactions With the General Services Administration	Repeat
Insufficient Controls for Reporting Voluntary Contributions	Closed
Unrecorded Foreign Service National Bonus Liability	Closed
Material Adjustments to Budgetary Accounts for Reporting	Closed

I. 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 Department of the Treasury (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.

[1] OIG, *Management Letter Related to the Audit of the U.S. Department of State FY 2017 Financial Statements* (AUD-FM-18-07, February 2018).

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, 2018, and identified 72 variances between Treasury and Department fund balances. These variances amount to a net difference of approximately $7.2 million and an absolute difference of approximately $16.1 million.

We also found that the Department had net balances of approximately $2.7 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 2018.

Although the Department has worked to reduce the number of Treasury accounts with negative balances and eliminate some of its historical unreconciled fund balances, additional refinements to its reconciliation procedures are needed. In addition, for older variances, the Department did not have a complete history of transactions that it could compare with Treasury information because data from previous financial systems were not available to the staff performing the reconciliations.

Finally, the Department does not have effective monitoring controls in place to identify, research, and resolve suspense activity approaching or exceeding 60 days old, which also contributes to FBWT variances.

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.

II. Payroll and Related Liabilities

The Department’s workforce includes Civil Service, Foreign Service, and Foreign Service National (FSN) staff. FSN employees are generally paid in local currency, and their salaries and benefits are based on local prevailing practices, which are documented in each post’s Local Compensation Plan. FSN employees are paid using the Global Foreign Affairs Compensation System (GFACS). Civil Service and Foreign Service employees are paid according to standard Federal Government pay scales using the Consolidated American Payroll Processing System.

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 one of two Department information systems deployed at overseas posts: WebPass or the Overseas Personnel System (OPS).[2] When a personnel action is initiated for an FSN, the post enters the information into WebPass or OPS. The FSN personnel information is then submitted to a Global Financial Services Center where officials manually enter the information into GFACS.

We assessed the completeness of employee information in WebPass or OPS 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 and the names of employees in WebPass or OPS and GFACS. Table 2 shows the results of our testing for FY 2018 as well as the results of our testing from FY 2017 for comparative purposes.

Table 2: Total Number of Employees in WebPass or OPS and GFACS

Employees Reviewed	FY 2018 Employees	FY 2017 Employees
Employees in WebPass or OPS and GFACS	25,285	25,836
Employees in WebPass or OPS that were not in GFACS	784*	226
Employees in GFACS that were not in WebPass or OPS	287	188

* FSNs in Yemen comprised 566 (72 percent) of the employees in WebPass but not GFACS. During FY 2018, a reduction in force in Yemen resulted in 343 employees separated in April and 212 employees separated in July. This reduction in force accounts for most of the difference attributable to Yemen.

For the employees included in WebPass or OPS and GFACS, we performed additional testing to identify data inconsistencies related to the date of birth, service computation date, and annual salary fields. Table 3 shows the results of our testing for FY 2018 as well as the results of our testing from FY 2017 for comparative purposes.

Table 3: Data Inconsistencies Between WebPass or OPS and GFACS

Exceptions Identified	FY 2018 Exceptions	FY 2017 Exceptions
Date of birth was not consistent	551	806
Service computation date was not consistent	3,087	3,202
Annual salary was not consistent	2,866	2,113
Employer agency was not consistent	65	31

In both FY 2018 and FY 2017, the Department tested a judgmental sample of the discrepancies we noted and reported that WebPass or OPS contained more accurate information on each employee's date of birth and service computation date and 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.

[2] In FY 2018, the Department began the implementation of OPS, a new human resources system that will supersede WebPass and have the capability of interfacing with GFACS. As of August 2, 2018, OPS had been implemented at 38 posts worldwide.

We found that posts were processing personnel actions inconsistently. In certain instances, posts were not notifying the responsible Global Financial Services Center in a timely manner about personnel actions that had been processed. Additionally, we noted instances where data submitted to the responsible Global Financial Services Center were not updated in GFACS to reflect changes made in WebPass or OPS. We also found instances in which approved personnel actions were not accurately entered into GFACS once the information was provided to the Global Financial Services Center because of data entry errors. The Department did not have a control in place to ensure that all post-approved personnel actions included in WebPass or OPS 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 employee 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 or OPS.

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 or OPS 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 only compensated for actual hours worked and benefits earned.

To verify the accuracy of Civil Service and Foreign Service employee salaries and benefits, we assessed the completeness of personnel records for a sample of 45 employees. Table 4 shows the discrepancies identified during our testing in FY 2018 and FY 2017 for comparative purposes.

Table 4: Discrepancies in Personnel Records

Discrepancy	FY 2018 Exceptions	FY 2017 Exceptions
Employee timesheet was not provided	2	9
Employee timesheet was not approved by a supervisor	4	0
Request for Leave or Approved Absence Form (Standard Form [SF] 71) was not provided	1	1
Annual and/or sick leave taken was not properly approved per the SF-71	0	1
Life Insurance Election Form (SF-2817) was not provided	1	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	3	2
Health Benefit Election Form (SF-2809) was not provided	1	0
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	0	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 either Charleston or Bangkok in a timely manner, or at all. Moreover, 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 (Notification of Personnel Action) or the Joint Form (JF) 62A (Personal Services Contracting Action).

We selected a sample from FY 2018 of 100 payroll disbursements, 32 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 5 and 6 show the discrepancies identified during our testing as well as the results of our testing in FY 2017 for comparative purposes.

Table 5: GFACS Testing Discrepancies

Discrepancy	FY 2018 Exceptions	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	14	1
Personnel actions in our payroll disbursement sample were not provided	7	12
Personnel actions in our separated employee sample were not approved in the pay period following the effective date on the personnel action	4	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	0	1
Personnel actions in our separated employee sample were not appropriately signed by a Certifying or Administrative Officer	2	0
Personnel actions in our new hire employee sample were not approved in the pay period following the effective date on the personnel action	1	0

Table 6: Consolidated American Payroll Processing System Testing Discrepancies

Discrepancy	FY 2018 Exceptions	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	1
Personnel actions in our separated employee sample were not approved in the pay period following the effective date on the personnel action	8	11
Personnel actions in our new hire employee sample were not approved in the pay period following the effective date on the personnel action	2	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 were 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.

III. 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 due to 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 asbestos management database, FAC Apps (previously referred to as the Facilities Environmental Tracing System). 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 FAC Apps 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 of necessary updates to a post's 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 FAC Apps. On the basis of the request, OBO may then update the post's data or perform independent ACBM inspections to confirm the requested changes.

We reviewed the data in FAC Apps as of October 1, 2017, by selecting a risk-based sample of 50 specific ACBMs that existed at 6 posts for physical confirmation. We noted discrepancies related to FAC Apps data at four posts. At those 4 posts, there were 39 ACBMs tested and we noted exceptions for 12 of the reported ACBMs. Table 7 provides information on the exceptions identified during site visits.

Table 7. Post Asbestos Existence Testing Exceptions

Post	Number of ACBMs Tested	Number of ACBMs Inaccurately Reported	Details of Exceptions
Pretoria, South Africa	18	3	- 2 ACBMs remediated - 1 inaccurate ACBM quantity
Cape Town, South Africa	2	1	- 1 ACBM remediated
Johannesburg, South Africa	4	3	- 3 ACBMs never existed
Jakarta, Indonesia	15	5	- 4 ACBMs remediated - 1 inaccurate ACBM quantity
Total	**39**	**12**	

After noting these exceptions, we reviewed a listing of ACBM change requests submitted to OBO by overseas posts from October 2, 2017, through June 30, 2018. We found that 10 of the 12 exceptions had not been communicated to OBO through change requests prior to our facility tours.

During our testing at posts, we also identified one facility in Jakarta, Indonesia, that contained ACBMs that were not included in FAC Apps.

In addition to our testing at overseas posts, we performed steps to determine whether the Department had corrected, in FAC Apps, exceptions identified during prior year post visits (FY 2016 and FY 2017), as appropriate. As shown in Table 8, we found that 13 of 20 exceptions identified (that is, ACBMs identified as remediated but not reflected in FAC Apps at the time of our FY 2016 or FY 2017 post visits) had not been corrected in FAC Apps as of June 30, 2018.

Table 8. Follow-up Testing of FY 2016 and FY 2017 Existence Exceptions

Fiscal Year of Post Visit	Post	Number of Exceptions	Number of Exceptions Remaining as of June 30, 2018
2016	Budapest, Hungary	2	1
2016	Manila, the Philippines	6	5
2016	Rome, Italy	4	4
2017	Brasilia, Brazil	3	2
2017	Brussels, Belgium	5	1
Total		**20**	**13**

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 the majority of overseas posts where we have historically identified exceptions, 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 FAC Apps data, we found that posts did not always use this process. In addition, the Department did not consider the results of prior audits to identify items that required updates.

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 reported in our FY 2013 management letter.

IV. 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 the Contracting Officer's Representative (COR) or the designated billing official (DBO). 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 DBO/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 are designated by the Contracting Officer to assist the CORs. Accordingly, these individuals are responsible for overseeing contracts and have detailed knowledge of the work being performed. Additionally, CORs and Government Technical Monitors 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 selected a sample of 105 domestic vendor payments that were processed between October 1, 2017, and June 30, 2018, 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 individual had an active certification in the FAC-COR database. We identified issues with 11 (10.5 percent) of the 105 sampled transactions. Specifically, seven invoices were approved by individuals other than the contract's designated COR, all of whom also did not have an active FAC-COR certification in the database. In addition, four invoices were approved by the COR, but the COR did not have an active FAC-COR certification in the database. Table 9 shows the results of and additional details on the invoice testing exceptions.

Table 9: 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
SAQMMA14F3634	INV-00323	$1,557,644	Professional services	No	No
SAQMMA15L0479	AFS00641171	$305,591	IT services	No	No
SAQMMA15F2987	17682R	$275,071	IT services	No	No
SAQMMA17F2837	BLK-00136	$180,827	IT services	No	No
SAQMMA17F2982	DOS0140030 13-001	$150,423	IT services	No	No
SAQMMA14F3634	INV-00210	$116,518	Supplies	No	No
SAQMMA13F2905	14020	$49,495	Other Contract Personnel	No	No
107418I0005	NYPD UNGA 64, UNGa64-FY09-NYPD	$21,439,343	Professional services	Yes	No
SAQMMA16F1420	TO10-23OY2	$6,965,395	Professional services	Yes	No
SAQMMA16F1420	TO10OY2-20	$6,308,529	Professional services	Yes	No
SAQMMA17M2032	0000018485	$419,930	IT supplies	Yes	No
Total		**$37,768,766**			

We found that the Department lacked oversight procedures to ensure that appropriate approvals were obtained prior to the processing of vendor payments. For example, the Department did not have procedures to ensure that the individual approving vendor invoices was the designated COR. In addition, the Department did not have procedures to ensure that all active CORs had required certifications.

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 the Department pays for goods or services that were not received.

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

V. Other Assets

Accounting for Federal Advances

At times, Federal agencies request other agencies to provide some type of service. A reimbursable or interagency 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 (or advance payment) 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. Federal accounting standards require agencies to record advance payments as an asset. 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 the Bureau of the Comptroller and Global Financial Services (CGFS) are assigned the 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 rather than an asset. The CGFS accountant uses this information to create monthly journal vouchers to recognize a new advance balance or to adjust an existing one.

For intragovernmental obligations that had more than $10 million in payments during the second and third quarters of FY 2018, we determined whether advance payments were correctly identified and recorded. Specifically, we tested 15 obligations that had approximately $1.2 billion in related payments. On the basis of our testing, we identified one obligation with the Department of Energy that had two unrecorded prepayments, totaling $12.5 million.

Although CGFS has a process to manually record Federal advances as assets, it did not identify the two exceptions identified. According to CGFS officials, this occurred because CGFS requested information from the Department of Energy regarding the status of the reimbursable agreement; however, the Department of Energy point of contact did not have information regarding that agreement. The CGFS accountant did not attempt to obtain more information.

Insufficient processes limit the Department's ability to accurately report Other Assets and expenses in its financial statements. Specifically, Other Assets were understated and expenses were overstated by $12.5 million in FY 2018. Although the Department corrected these amounts on the basis of the results of our audit, unidentified advances may continue to exist unless the Department improves the process.

This issue was initially reported in our FY 2017 management letter.

VI. Real Property

Accounting for Real Property Transactions With the General Services Administration

The General Services Administration (GSA) may acquire, renovate, or construct 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 usually the custodian of the property it acquires on behalf of other Federal agencies and, when that is the case, the property is included in GSA's real property inventory. However, in some cases, when a Federal agency provides funding for the acquisition, renovation, or construction of property, GSA may include a rent consideration in the "Occupancy Agreement"[3] 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. In other cases, GSA may transfer ownership of the property to the funding agency upon completion of acquisition, renovation, or construction.

The Department has several active RWAs with GSA relating to domestic facilities. Each RWA involves unique terms and conditions. For example, the Department entered into two separate RWAs with GSA, with a combined total of approximately $111 million, to acquire and renovate units in a domestic office space known as the American Red Cross building. This office space would be used by the Department under an Occupancy Agreement. The first RWA, for $87 million, which was paid by the Department during FY 2017, was to acquire the office space. In FY 2017, the Department determined that it would account for the office space as a capital lease upon completion of the acquisition and renovation. Therefore, the Department properly accounted for the $87 million payment as a prepaid asset in FY 2017. The second RWA, for $24 million, was to renovate the office space. Of the $24 million, the Department paid GSA $3 million in FY 2017 and $18 million in FY 2018 (the Department had $3 million available as of the end of FY 2018). Initially, the Department recorded these transactions as operating expenses rather than prepaid assets.

The Department also entered into a series of RWAs with GSA for the design and construction of the Foreign Affairs Security Training Center (FASTC). The funding for the FASTC project totaled approximately $413 million. During FY 2010 through FY 2018, the Department paid GSA a total of $248 million for FASTC RWAs. The Department's agreement with GSA states that ownership of FASTC will transfer to the Department upon the completion of construction. Initially, the Department also recorded these transactions as operating expenses rather than prepaid assets.

When the Department makes any sort of payment, the accounting transaction is, by default, recognized as an operating expense in the Department's financial system. To account for payments made related to assets, the Department has to manually reverse those operating expenses and record the transaction as an asset.

On the basis of our review, we opined to the Department that asset recognition was the most appropriate accounting treatment for the expenditures related to renovating the American Red Cross office space and the FASTC construction. As a result, the Department adjusted these accounting transactions.

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

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

acquire domestic buildings and office spaces. In July 2018, in an effort to determine the correct accounting treatment of the RWAs, the Department, Treasury, and GSA jointly submitted a technical inquiry to the Federal Accounting Standards Advisory Board for guidance. However, the Federal Accounting Standards Advisory Board had not responded to the inquiry as of November 15, 2018 (the end of fieldwork for the financial statement audit). Therefore, Department officials stated that they would postpone final policy decisions regarding domestic real property transactions with GSA.

The Department adjusted its financial statements to properly account for the RWA transactions. However, without a formal process to determine the proper accounting treatment for RWAs with GSA, the Department may not appropriately and consistently account for future domestic real property acquisitions, therefore understating assets and overstating operating expenses in the Department's financial statements.

This issue was initially reported in our FY 2017 management letter.

NEW MANAGEMENT LETTER COMMENTS

During the audit of the Department's FY 2018 financial statements, additional matters came to our attention that were not previously reported in the FY 2017 management letter.

VII. Other Assets

Accounting for Prepaid Education Expenses

Federal law authorizes Federal employees to receive cost-of-living allowances to cover certain costs incurred when stationed in foreign areas. This includes an education allowance to assist employees in meeting the extraordinary and necessary expenses incurred in providing adequate elementary and secondary education for dependent children at assigned overseas posts. In FY 2018, the Department spent over $183 million on the education allowance.

When payments are made to cover certain periodic expenses before those expenses are incurred (that is, an advance payment or a prepayment), Federal accounting standards require agencies to record the transaction as an asset. The Department reports certain prepaid expenses in the "Other Assets" line item on its annual financial statements.

We found that of the $183 million in total educational allowance payments during FY 2018, $121 million (66 percent) in allowance payments were made during the fourth quarter. We considered these fourth quarter payments to be at a higher risk for being a prepayment rather than an expense because of the proximity to the end of the fiscal year. In addition, the school year at most locations will generally begin in August or September, which is near the end of the fiscal year.

To determine whether the Department's Other Assets balance was complete, we selected a statistical sample of 34 payments, totaling $5.2 million, from the fourth quarter population. We found that 31 payments included costs for the full school year. However, the costs associated with

FY 2019 (that is, a prepayment in FY 2018), which totaled $4 million, were not correctly recorded as an asset; instead these costs were recorded as an FY 2018 expense.

We found that the Department does not have a process to quantify and report prepaid education expenses as Other Assets in its financial statements. The Department has historically fully expensed all payments related to education when the payment was processed. Although Department officials were generally aware of the accounting requirements relating to prepayments, the Department had not considered applying these criteria to education expenses.

Without a process to identify advance payments, the Department is understating assets in its annual financial statements. Specifically, according to the results of our test work and additional analysis, assets were understated by an estimated $89 million for FY 2018 and $84 million for FY 2017.

VIII. Information Technology

Unidentified GEMS Segregation of Duties Weaknesses

The Global Employment Management System (GEMS) is the Department's human resources management information system for Civil and Foreign Service employees. GEMS provides comprehensive employment data, both personal and job-related, for all direct-hire Department employees. Personnel actions are executed completely in GEMS, using the SF-52 (Request for Personnel Action) and SF-50 (Notification of Personnel Action) when an employee is hired or an existing employee has a change of status, such as resignation, retirement, or promotion. The SF-52 is used to initiate the personnel action and the SF-50 is used to finalize the personnel action.

Internal controls are important for personnel systems, which maintain a significant amount of personally identifiable information and are susceptible to fraud. One key component of internal control is segregation of duties (SoD), which ensures responsibilities, such as authorizing, processing, recording, and reviewing transactions; systems configuration; and security administration are assigned to different individuals to separate incompatible functions. A user's access to an information system should allow for functional capabilities that are consistent with the employee's position and responsibilities.

We selected a random sample of 51 new hire Civil and Foreign Service employees as of March 31, 2018. Kearney reviewed the most recent personnel actions for each employee selected to determine whether segregation of duties was appropriate during execution. Kearney found that 43 of 51 (84 percent) personnel actions tested were executed entirely by the same person.

Although the Department developed a GEMS SoD matrix, Kearney found that the matrix was not sufficient. Specifically, the matrix did not identify three of the main user roles as conflicting, even though the roles had functions that should not be performed by the same person. Unless the user roles are clearly identified as conflicting, the roles can be assigned to the same person. Kearney found that of the 737 GEMS users, 19 (3 percent) had been assigned 2 or more conflicting roles.

An even more significant issue is that employees assigned one of the user roles in GEMS can perform the actions provided in all three main roles; that is, the role is not limited to one type of activity, as would be appropriate. As of May 18, 2018, 252 (34 percent) of 737 GEMS users were assigned this user role.

Improper SoD controls surrounding the user roles may lead to fraud or unauthorized transactions to financial and personnel records. Within personnel systems, inadequate SoD increases the risk that inappropriate personnel actions are approved without being identified. For example, employees with a certain GEMS user role could fully execute a personnel action for themselves, such as a promotion.

United States Department of State
Comptroller
Washington, DC 20520

April 9, 2019

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MEMORANDUM

TO: OIG – Steve A. Linick

FROM: CGFS – Jeffrey C. Mounts, Acting Jeffrey C. Mounts

SUBJECT: Draft Report - Management Letter Related to the Audit of the U.S. Department of State FY 2018 Financial Statements

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 2018 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 three of the prior year Management Letter findings. We will continue to strive for improvements in the areas noted in the Draft Report and appreciate your valuable input. The Department has benefitted significantly from the past ten years of Kearney's knowledge sharing and professionalism, and the excellent working relationships that you and Kearney maintained throughout the past annual audits of the financial statements.

cc: OIG/AUD – Norman P. Brown
Kearney & Company, P.C. – Mr. Kelly E. Gorrell
CGFS – Mr. William Davisson
CGFS – Mr. Joseph Kenny

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Approved: Jeff Mounts (JCM)

Drafter: CGFS/MC: Carole Clay, 202-663-2084, 1/24/19

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Clearance: CGFS/OMA: BDavisson (ok 4/9/19)