

MANAGEMENT LETTER
AUD-FM-16-11

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, 2015, and has issued our report thereon dated November 16, 2015.¹ 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. 15-02, “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 2015 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 and recommendations, which are summarized in Appendix A, 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 and recommendations 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 2015 and 2014 Financial Statements* (AUD-FM-16-09, Nov. 2015).

**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
February 8, 2016

MANAGEMENT LETTER COMMENTS

REPEATED FROM PRIOR YEAR

During the audit of the U.S. Department of State's (Department) FY 2014 financial statements, Kearney & Company, P.C. (referred to as "we" hereafter), identified matters that were reported in a management letter.¹ As shown in Table 1, the severity of six issues included in the FY 2014 management letter has decreased, and we consider those items closed. The severity of one issue included in the FY 2014 management letter, Inaccurate Recording of Software in Development, increased and was included in our report on the Department's FY 2015 financial statements.² Four issues remained open, and we have updated these issues with information obtained during the audit of the Department's FY 2015 financial statements.

Table 1: Current Status of Prior Year Management Letter Findings

FY 2014 Management Letter Findings	FY 2015 Status
Inaccurate Personnel Data for Foreign Service National Employees	Repeat
Insufficient Inventory of Foreign Service National After-Employment Benefits	Closed
Untimely Responses to Audit Request	Closed
Insufficient Fund Balance With Treasury Reconciliation Process	Repeat
Inadequate Control Over Personnel Records and Actions	Repeat
Inadequate Controls Over Machine Readable Visa Fee Analysis	Closed
Inaccurate Accounting for Capital Leases	Repeat
Inaccurate Recording of Software in Development	Report on Internal Control*
Inaccurate Supporting Data for the Asbestos Remediation Estimate	Closed
Incomplete Heritage Asset Disclosure	Closed
Potential Unrecorded Capital Assets	Closed

* *Independent Auditor's Report on Internal Control Over Financial Reporting*, included in OIG, *Independent Auditor's Report on the U.S. Department of State 2015 and 2014 Financial Statements* (AUD-FM-16-09, Nov. 2015).

¹ OIG, *Management Letter Related to the Audit of the U.S. Department of State FY 2014 Financial Statements* (AUD-FM-15-08, Feb. 2015).

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

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 (TAFS). Agencies must promptly reconcile their FBWT accounts on a regular and recurring basis to assure 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 (FRA) Cash Reconciliation Report. These reports document final balances for each TAFS 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 FRA Cash Reconciliation Report as of June 30, 2015, and identified 126 instances in which a variance existed between Treasury and the Department fund balances. These variances amounted to a net difference of approximately \$10.8 million. However, when the absolute value of all variances was considered, the variance totaled approximately \$155.6 million.

We also found that the Department had historical balances in several suspense accounts that had not been researched and resolved within 60 days. Specifically, we identified six suspense accounts in which the balance remained unchanged during FY 2015.

We found the Department's FBWT reconciliation procedures need to be strengthened. Specifically, the Department's ongoing process to reconcile their FBWT information with that of Treasury was not effective in investigating and resolving all variances. The Department reconciled disbursements and collections at the transaction level monthly; however, the Department did not investigate and resolve all variances. In addition, the Department does not have effective monitoring controls in place to identify, research, and resolve suspense activity approaching or exceeding 60 days old, which further contributes 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 fully reconciling the FBWT account. The Department also has not developed alternative methods to address aged reconciling items that remain unreconciled due to a lack of historical data, such as working with Treasury toward resolution.

Failure to implement timely and effective reconciliation processes could:

- 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; and
- result in erroneous financial statements.

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

Recommendation:

We recommend that the Department enhance its Fund Balance With Treasury reconciliation process. Specifically, the Department should:

- Implement procedures to ensure that reconciling items between the Department of the Treasury and the Department are reviewed and cleared in a timely manner.
- Develop alternative methods to resolve historical variances from previous financial systems.
- Design and implement a control to monitor, research, and resolve all suspense accounts transactions approaching or exceeding 60 days old. If transactions cannot be resolved within 60 days, the Department should document an explanation of the delay.

II. Payroll and Related Liabilities

Inadequate Control Over Personnel Records and Actions

The Department's workforce includes Civil Service, Foreign Service, and Foreign Service National (FSN) staff. Civil Service and Foreign Service employees are paid according to standard Federal Government pay scales using the Consolidated American Payroll Processing System (CAPPS). FSN employees are generally paid in local currency and their salary and benefits are based on local prevailing practice, which is documented in each post's Local Compensation Plan. FSN employees are paid using the FSN Payroll (FSNPay) application and the Global Foreign Affairs Compensation System (GFACS). Ensuring the sufficiency of controls over personnel-related activities is a key responsibility of managers. We identified control deficiencies related to maintaining personnel data, processing personnel actions and calculating benefits, and processing employee separations.

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 (GFSC), where officials manually enter the information into the FSNPay or GFACS.³

We assessed the completeness of employee information in WebPass, FSNPay, 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 individuals in WebPass, FSNPay, and GFACS. Table 2 shows the results of our testing for FY 2015, as well as the results of our testing from FY 2014 for comparative purposes.

Table 2: Total Number of Individuals in WebPass and the Payroll Applications

Individuals Reviewed	FY 2015 Individuals	FY 2014 Individuals
Individuals in both WebPass and the applicable payroll application	24,204	23,161
Individuals in WebPass that were not in the applicable payroll application	427	347
Individuals in a payroll application that were not in WebPass	385	258

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 3 shows the results of our testing for FY 2015, as well as the results of our testing from FY 2014 for comparative purposes.

Table 3: Data Inconsistencies Between WebPass and the Payroll Applications

Inconsistency Identified	FY 2015 Discrepancies	FY 2014 Discrepancies
Employee's date of birth was not consistent	849	736
Employee's service computation date was not consistent	2,787	2,751
Employee's annual salary was not consistent	3,579	2,447

The Department tested a judgmental sample of the discrepancies we noted and reported that WebPass contained more accurate information on employee's date of birth and service computation date, and FSNPay or 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 GFSC in a timely manner about personnel actions that had

³ The Department began implementing GFACS on a post-by-post basis in FY 2013. As of October 2015, the Department is processing payroll from both payroll applications; however, FSNPay is scheduled for retirement in FY 2016.

been processed. Additionally, we noted instances where data submitted to the responsible GFSC was not updated in the applicable payroll application to reflect changes made in WebPass. We also found instances where approved personnel actions were not accurately entered into the applicable payroll application once the information was provided to the GFSC 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 either FSNPay or 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, such as date of birth and service computation date. 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 either FSNPay or GFACS and WebPass. These manual calculations required additional time and effort and were more prone to inaccuracies.

In addition, the risk of improper payments exists if personnel actions are not processed properly or timely or when payroll and benefit payments are calculated based on inaccurate data. The lack of reconciliation between the payroll applications 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.

Recommendation:

We recommend that the Department:

- Standardize requirements for processing personnel actions at the posts to include deadlines for submitting information to the responsible Global Financial Service Center.
- Develop and implement centralized monitoring procedures, including periodic reviews of documentation, to ensure that posts comply with policies for timely processing of personnel actions for Foreign Service National employees.
- Periodically perform reconciliations between WebPass and the payroll applications to identify data discrepancies.
- Refine the existing process used to calculate the Foreign Service National after-employment liability estimate based on the results of any data remediation or validation efforts.

Insufficient, Inconsistent, or Incorrect Personnel Record Documentation

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 Foreign Service employee salaries and benefits, we assessed the completeness of personnel records for a sample of 78 employees. Table 4 shows the results of our testing for FY 2015, as well as the results of our testing from FY 2014 and FY 2013 for comparative purposes.

Table 4: Discrepancies in Personnel Records

Discrepancy	FY 2015 Exceptions	FY 2014 Exceptions	FY 2013 Exceptions
Employee timesheets were not provided	31	16	22
Employee timesheet provided was not properly approved	6	8	1
Request for Leave or Approved Absence Forms (Standard Form [SF]-71) were not provided	13	12	9
Annual leave hours reported on the SF-71 were not the same as the employee's annual leave hours on their Earning and Leave Statement (ELS)	0	1	0
Sick leave hours reported on the SF-71 were not the same as the employee's sick leave hours on their ELS	0	2	1
Overtime and other premium pay hours were not compensated at the appropriate rates	0	5	0
Life Insurance Election Form (SF-2817) was not provided.	0	8	12
Federal Employees' Group Life Insurance (FEGLI) election selected on the SF-2817 was not the same as the election on the employee's Notification of Personnel Action (SF-50)	3	10	2
Health Benefit Election Form (SF-2809) was not provided	2	3	0
Health benefits election selected on the SF-2809 did not match the election on the employee's ELS	0	9	4

Discrepancy	FY 2015 Exceptions	FY 2014 Exceptions	FY 2013 Exceptions
Thrift Savings Plan (TSP) election form was not provided	0	6	0
TSP election selected on the TSP election form did not match the election on the employee's ELS	0	33	5
TSP withholding amount on the employee's ELS did not recalculate based on the employee's TSP election percentage selected on the TSP election form and documented on the ELS	0	7	0

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 or Bangkok. 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 fashion 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.

Recommendation:

We recommend that the Department strengthen controls over personnel records by:

- Conducting periodic reviews of personnel records.
- Instituting mandatory training sessions.
- Increasing accountability for employees processing personnel actions at the bureaus and posts.

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 2015, of 100 payroll disbursements, 35 separated employee personnel actions, and 50 new hire personnel actions from FSNPay and GFACS; and 78 payroll disbursements, 45 separated personnel actions, and 45 new hire employee personnel actions from CAPPS. 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 results of our testing for FY 2015, as well as the results of our testing from FY 2013 and FY 2014 for comparative purposes.

Table 5: Exceptions Noted in GFACS and FSNPay Testing

CAPPS Testing Results	FY 2015 Exceptions	FY 2014 Exceptions	FY 2013 Exceptions
Personnel actions in our payroll disbursement sample were not approved in the pay period following the effective date on the personnel action	26	15	16
Employees in our separated employee sample were paid incorrectly following the SF-50 separation effective date	0	2	0

Table 6: Exceptions Noted in CAPPS Payroll Testing

Testing Results	FY 2015 Exceptions	FY 2014 Exceptions	FY 2013 Exceptions
Personnel actions in our payroll disbursement sample were not approved in the pay period following the effective date on the personnel action	5	9	4
Personnel actions in our separated employee sample were not approved in the pay period following the effective date on the personnel action	9	10	5
Personnel actions in our separated employees sample were not provided	0	1	0
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	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	5	0
Personnel actions in our new hire employee sample were not provided	0	1	0

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 reported in our FY 2009 management letter.

Recommendation:

We recommend that the Department develop a centralized and standardized process that will ensure bureaus and posts are complying with policies for timely and appropriately approving personnel actions, including periodic reviews of documentation.

III. Property, Plant, and Equipment

Inaccurate Accounting for Capital Leases

Capital leases are leases that transfer substantially all of the benefits and risks of ownership to the lessee. Of the 10,400 real property leases used by the Department overseas, only 33 leases were capitalized in the Department's FY 2015 financial statements. During the audit, we tested all 33 reported capital leases to determine whether the Department correctly accounted for these leases. We identified nine specific exceptions with the valuation of seven assets recorded as capital leases. For example, we found that:

- The acquisition cost of five leases was not recorded correctly.
- The lease liability reported for two leases was not correct.
- The depreciation expense and accumulated depreciation for two leases were incorrect.

The Bureau of the Comptroller and Global Financial Services, which calculates the accounting information that will be reported in the financial statements for capital leases, did not receive copies of all lease agreements, amendments, and renewals timely, and was therefore unable to ensure the accuracy of the recorded lease amounts. As a result, the Department may misstate future minimum lease payments and expenses.

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

Recommendation:

We recommend that the Department refine the process for accounting for capital leases. Specifically, the Bureau of the Comptroller and Global Financial Services should implement a process to obtain the documentation needed to accurately account for capital leases.

Department of State Response



United States Department of State
Comptroller
Washington, DC 20520

February 6, 2016

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MEMORANDUM

TO: OIG – Steve A. Linick
Christina H. Flagg
FROM: CGFS – 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 2015 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 6 of the 11 FY 2014 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 – U/S Patrick F. Kennedy
OIG/AUD –Norman P. Brown
Kearney & Company, P.C. –Kelly E. Gorrell
CGFS/EX – Joseph A. Kenney

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