



OIG

Office of Inspector General

U.S. Department of State • Broadcasting Board of Governors

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AUD-SI-16-49

Office of Audits

September 2016

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# Audit of the Bureau of Political-Military Affairs Federal Assistance Awards

## SECURITY AND INTELLIGENCE DIVISION

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# OIG HIGHLIGHTS

AUD-SI-16-49

## What Was Audited

The Bureau of Political-Military Affairs (PM) provides policy direction in the areas of international security, security assistance, military operations, defense strategy and plans, and defense trade. PM awards grants and cooperative agreements to facilitate its mission. The majority of PM's awards relate to humanitarian demining programs, which involve the removal of land mines and other remnants of war.

Acting on the Office of Inspector General's (OIG) behalf, Kearney & Company, P.C. (Kearney), an independent public accounting firm, conducted this audit to determine the extent to which (1) PM's grantees claimed expenses that were allowable, allocable, reasonable, supported, and made in accordance with Federal requirements; and (2) the unliquidated obligations (ULO) associated with PM's grants and cooperative agreements remain valid.

## What OIG Recommends

OIG made three recommendations to address the deficiencies noted in this report relating to PM's grant monitoring process, as well as \$2.8 million in identified questioned expenditures that were either unsupported or unallowable costs, and \$2.6 million in statistically projected questioned costs. Based on the response from PM, OIG considers two recommendations unresolved and one recommendation closed.

PM's comments are included in this report in their entirety as Appendix B.

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Security and Intelligence Division

## Audit of the Bureau of Political-Military Affairs Federal Assistance Awards

### What Was Found

Kearney found that \$2.8 million (18 percent) of \$15.8 million in grant expenditures tested for this audit were unsupported or unallowable, as defined by Federal policies. These questioned costs occurred, in part, because PM's grants monitoring process was not sufficiently designed to prevent or detect unallowable and unsupported costs. PM did not independently verify that all award recipients have sufficient financial management controls in place to prevent unsupported and unallowable costs. Further, during site visits, PM did not review recipient expenditures as recommended by Department guidance. Without reviews of recipient expenditures, it is difficult for PM to ensure grantees are performing the activities that are being funded. Further, the funds expended on questioned costs may have been put to better use.

In addition, because of PM's lack of oversight of grantees, it is difficult for PM to ensure that award recipients are using funds to support PM's overall mission and programs. Moreover, when the questioned costs identified are extrapolated over the 18 sampled grants and cooperative agreements, Kearney estimates a total of \$4.6 million may be unallowable and unsupported. Further, Kearney believes that there is a likelihood that unallowable and unsupported costs exist in some other PM grants outside the scope of this audit.

ULOs represent the cumulative amount of orders, contracts, and other binding agreements for which the goods and services ordered have not been received, or the goods and services have been received but payment has not yet been made. With respect to ULOs associated with PM's grants, Kearney selected a sample of 49 ULOs to review from a population of 181 ULOs as of October 31, 2015. Kearney did not identify any invalid ULOs as a result of its test work. According to PM officials, PM had no invalid ULOs because Program Managers, who have direct knowledge of award status, review ULOs monthly. In addition, the Grants Officer verifies the status of all ULOs. In cases where a grant's period of performance has ended, PM will promptly adjust the obligation. PM self-identified 17 ULOs that needed adjustment because the period of performance had ended. Therefore, Kearney concludes that PM is in compliance with Department policy regarding obligation management.

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1701 Duke Street, Suite 500, Alexandria, VA 22314  
PH: 703.931.5600, FX: 703.931.3655, www.kearneyco.com

Audit of Department of State  
Bureau of Political-Military Affairs Federal Assistance Awards

Office of Inspector General  
U.S. Department of State  
Washington, D.C.

Kearney & Company, P.C. (Kearney), has performed an audit of the Department of State Bureau of Political-Military Affairs Federal Assistance Awards. This performance audit, performed under Contract No. SAQMMA14A0050, was designed to meet the objective identified in the report section titled "Objective" and further defined in Appendix A, "Purpose, Scope, and Methodology," of the report.

Kearney conducted this performance audit from August 2015 through May 2016 in accordance with *Government Auditing Standards*, 2011 Revision, issued by the Comptroller General of the United States. The purpose of this report is to communicate the results of Kearney's performance audit.

Kearney appreciates the cooperation provided by personnel in Department offices during the audit.

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

Kearney & Company, P.C.  
Alexandria, Virginia  
September 7, 2016

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## OBJECTIVE

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The objectives of this audit were to determine the extent to which (1) the Bureau of Political-Military Affairs (PM) grantees claimed expenses that were allowable, allocable, reasonable, supported, and made in accordance with Federal requirements; and (2) the unliquidated obligations (ULOs) associated with PM's grants and cooperative agreements remain valid.

## BACKGROUND

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PM provides policy direction in the areas of international security, security assistance, military operations, defense strategy and plans, and defense trade. PM promotes regional stability by facilitating the education and training of international peacekeepers and other foreign military personnel, as well as by combating the unlawful trafficking in small arms and light weapons. PM also partners with the Department of Defense on policy issues, including foreign assistance and military-related activities with foreign policy implications. Among these matters are military deployment and operations orders for U.S. and allied forces, maritime interception operations, freedom of navigation exercises, certain humanitarian operations, certain training and exercise programs with foreign forces, noncombatant evacuation operations, and sensitive reconnaissance operations.

PM awards grants and cooperative agreements<sup>1</sup> to non-governmental organizations, international organizations, the private sector, and government institutions, both in the United States and abroad. The majority of PM's grant-making activity relates to humanitarian demining programs—removal of land mines and other remnants of war—sponsored by PM's Office of Weapons Removal and Abatement. The sponsored activities under the Office of Weapons Removal and Abatement's demining grants take place in countries around the world, generally in areas that have experienced wars and other conflicts in the recent past.<sup>2</sup> Table 1 shows the annual awards for PM for FY 2012 – FY 2014.

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<sup>1</sup> Grants and cooperative agreements—collectively referred to as Federal awards, Federal financial assistance, or Federal assistance awards—are similar instruments that Federal agencies use to provide a thing of value to non-Federal entities to carry out a public purpose. As noted in title 31, United States Code (U.S.C.) § 6304, a grant agreement shall be used when substantial involvement is not expected between the Federal government and the recipient when carrying out the activity contemplated in the agreement. As noted in 31 U.S.C. § 6305, a cooperative agreement shall be used when substantial involvement is expected between the Federal government and the recipient when carrying out the activity contemplated in the agreement. As the distinction between grants and cooperative agreements is not relevant for present purposes, this report refers to these instruments collectively as "grants." As a general rule, an agency solicits grant proposals and issues grants awards after competitive bidding. Upon award, the agency commits to paying the grantee a lump sum for carrying out the project. The grantee is expected to work diligently to achieve the intended aim of the grant but is not legally bound to achieve that aim. In contrast, a contract is a legally binding instrument that an agency uses to acquire property or services for the direct benefit or use of the U.S. Government. After awarding a contract, the agency pays the contractor via reimbursements for providing deliverables or achieving milestones specified in the contract.

<sup>2</sup> International places of performance on recent demining grants have included: Afghanistan, Albania, Armenia, Angola, Bosnia-Herzegovina, Bulgaria, Burma (Myanmar), Burundi, Cambodia, Colombia, Croatia, the Democratic

**Table 1. Annual Awards for FY 2012 – FY 2014**

<b>Fiscal Year</b>	<b>Number of Awards</b>	<b>Amount</b>
2012	167	\$105,661,420
2013	70	44,116,390
2014	134	83,131,384
<b>Total</b>	<b>371</b>	<b>\$232,909,194</b>

Source: USASpending.gov.

## Federal and Department Guidance for Grants Management

The Department of State (Department) and its award recipients must comply with Federal regulations and Department guidelines on managing grants and cooperative agreements. All of the grant projects reviewed in this audit had project period start dates between FY 2012 – FY 2014 and project period end dates during FY 2014. During that period, Department grants were subject to requirements set forth by the Office of Management and Budget (OMB)<sup>3</sup> and the Grant Policy Directives (GPDs) issued by the Department’s Bureau of Administration, Office of the Procurement Executive.

OMB circulars provide the principles for determining whether costs associated with grants awarded to non-profit organizations are allowable, reasonable, and allocable. To be allowable, OMB policy states that a cost must be necessary and reasonable for the performance of the award<sup>4</sup> and that the cost must “be adequately documented.”<sup>5</sup> OMB circulars also provide detailed guidance for a number of specific types of costs—such as equipment, training, and travel—that award recipients must follow.<sup>6</sup> In particular,

- OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, sets forth cost principles for non-profit organizations.
- OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, sets forth requirements for Federal agencies in the administration of grants. Circular A-110

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Republic of Congo, Georgia, Honduras, Iraq, Kenya, Kyrgyzstan, Kosovo, Laos, Lebanon, Palestinian Territories, Palau, Serbia, Somalia, South Sudan, Sri Lanka, Syria, Tajikistan, and Vietnam.

<sup>3</sup> Title II of the Code of Federal Regulations, Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* was issued in December 2013 and went into effect in December 2014. The Code of Federal Regulations consolidated eight OMB circulars into one authoritative document relating to grants management; the consolidated document made no substantial changes to guidance in the OMB Circulars. Because Title II, Part 200 of the Code of Federal Regulations did not go into effect until the first quarter of FY 2015, it was not the authoritative guidance for the grants tested as a part of this audit, which were limited to FY 2012 – FY 2014 (see Appendix A: Purpose, Scope, and Methodology for more details on the grants selected for testing).

<sup>4</sup> OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, Attachment A, Section A, Subpart 2, Item a.

<sup>5</sup> OMB Circular A-122, Attachment A, Section A, Subpart 2, Item g.

<sup>6</sup> OMB Circular A-122, Attachment B; OMB Circular No. A-21, Section J.

establishes requirements for retention of records, stating that “financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years.”<sup>7</sup> Circular A-110 also requires that award recipients maintain financial management systems that are capable of documenting accounting records, including cost accounting records supported by source documentation.<sup>8</sup> Lastly, it requires award recipients to provide unrestricted and timely access of such records to Inspectors General and their authorized representatives.<sup>9</sup>

The Department’s Bureau of Administration, Office of the Procurement Executive, issues grants management policy and provides quality assurance, among other things. Until March 2015, the bureau provided guidance for administering and monitoring grants in its GPDs. The GPDs collectively identified the Department’s internal control policies and guidance for managing grants from pre-award through closeout. For example,

- GPD 42, *Monitoring Assistance Awards*,<sup>10</sup> described the responsibilities of management officials in monitoring assistance awards.
- GPD 43, *Pre-Award Responsibility Determination*, established guidelines for determining a prospective organization’s capacity to perform proposed Federal assistance activities.

The GPDs were consolidated into the Department’s Federal Assistance Policy Directive on March 13, 2015.<sup>11</sup> The Federal Assistance Policy Directive did not substantially change the requirements set forth in the GPDs. However, because the sample grants were awarded and implemented before the effective date of the Federal Assistance Policy Directive, independent public accounting firm Kearney & Company, P.C. (Kearney) used the GPDs—not the Directive that superseded them—as criteria while conducting this audit.

## Roles and Responsibilities for Overseeing Grants

Department guidance describes the roles and responsibilities of government personnel assigned responsibility for awarding, administering, and overseeing grants. The two individuals with primary oversight and monitoring responsibilities with respect to any grant are the Grants Officer and Grants Officer Representative (GOR). The Grants Officer is authorized to award, amend, and terminate a Federal assistance agreement. Department policy requires that the

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<sup>7</sup> OMB Circular A-110, *Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Non-Profit Organizations*, Subpart C, Section 53(b).

<sup>8</sup> OMB Circular A-110, Subpart C, Section 21(b)(2).

<sup>9</sup> OMB Circular A-110, Subpart C, Section 53(e).

<sup>10</sup> The Federal Assistance Policy Directive replaced GPD 42 with Section 3.01, *Monitoring and Performance Reporting*. Independent public accounting firm Kearney & Company, P.C., used the criteria in Section 3.01 for the purpose of making recommendations.

<sup>11</sup> A revised version of the Federal Assistance Policy Directive has since been issued, effective January 14, 2016. The Department also released a companion to the Federal Assistance Policy Directive, the *Federal Assistance Procedures Desk Guide* (December 31, 2015).

Grants Officer designate a GOR for all grants exceeding \$100,000.<sup>12</sup> GPD 16 states that “the GOR assists the Grants Officer in ensuring that the Department exercises prudent management and oversight of the award through the monitoring and evaluation of the recipient’s performance.”<sup>13</sup> The program office (such as PM) may assign program officers or field staff to help with onsite monitoring and oversight of assistance awards if the Grants Officer and GOR cannot travel to the place of performance.

## Unliquidated Obligations

According to the Department’s Foreign Affairs Manual (FAM),<sup>14</sup> obligations incurred are amounts of orders placed, contracts awarded, services rendered, and similar transactions during a given period that will require payments during the same or a future period. Obligations remain open until they are fully reduced by a disbursement, they are deobligated, or the appropriation funding the obligations is cancelled. As payments are made, obligations are liquidated by the amount of the payments. ULOs represent the cumulative amount of orders, contracts, and other binding agreements for which the goods and services ordered have not been received, or the goods and services have been received but payment has not yet been made.<sup>15</sup> Regular monitoring of ULOs helps the bureau verify that funds that could be used for other purposes do not remain on unneeded obligations.

The FAM<sup>16</sup> requires that all offices responsible for managing, tracking, and obligating allotted funds must implement procedures for reviewing obligations and available fund balances on a monthly basis. Within PM, the program managers are delegated the responsibility to oversee funds management, with final review completed by the Grants Officer.

## AUDIT RESULTS

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### Finding A: Some Grant Expenditures Are Unsupported or Unallowable

As a result of its sample-based testing, Kearney found that \$2.8 million (18 percent) of \$15.8 million in grant expenditures tested, related to 14 (78 percent) of 18 PM Federal assistance

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<sup>12</sup> GPD 16, rev. 3, *Designation of Grants Officer Representatives*.

<sup>13</sup> GPD 16, rev. 3.

<sup>14</sup> 4 FAM 087.1 “Definition of Obligations Incurred.”

<sup>15</sup> For example, when property is ordered, the Department’s financial system creates an “obligation,” the accounting entry to ensure that funds are available when the vendor submits a request for payment. Sometimes an order is not filled or is only partially filled. In these cases, the difference between the obligation and the actual disbursement is known as an unliquidated obligation.

<sup>16</sup> 4 FAM 225 (a), “Accounting Controls and Obligation Management.”



awards reviewed during the audit, were unsupported<sup>17</sup> or unallowable<sup>18</sup> (that is, were questioned costs),<sup>19</sup> as defined by Federal policies. These questioned costs occurred, in part, because PM's grants monitoring process was not sufficiently designed to prevent or detect unallowable and unsupported costs. Specifically, PM did not independently verify that all award recipients have sufficient financial management controls in place to prevent unsupported and unallowable costs. Further, during site visits, PM did not review recipient expenditures as recommended by Department guidance. Without comprehensive reviews of recipient expenditures, it is difficult for PM to ensure grantees are performing the activities that are being funded. Further, the funds expended on questioned costs may have been put to better use.

### ***\$2.8 Million in Award Recipient Expenditures Were Unsupportable or Unallowable***

Kearney selected 18 PM grants, totaling approximately \$50.9 million, from a universe of 53 grants and cooperative agreements, totaling approximately \$61.7 million, to test. Kearney then selected a random statistical sample of 1,227 expenditures, totaling approximately \$14.9 million from the 18 awards. During the initial evaluation of the expenditures for each of the 18 awards, Kearney noted that 4 awards contained large payroll expenditures relative to other expenditures. To ensure that samples were representative of the populations, Kearney segregated the payroll expenditures from the remaining expenditures for the four awards. Kearney then selected a judgmental sample of payroll expenditures from the four awards totaling \$877,661, which was separate from the statistical samples. Kearney also selected a random statistical sample of the non-payroll expenditures for the four awards. When combined, the judgmental samples and random statistical samples of all 18 awards totaled approximately \$15.8 million. Based on a review of the documents provided, Kearney identified \$2.8 million (18 percent) in questioned costs that were unallowable or unsupported as a result of our testing. Table 2 provides a breakdown of the questioned costs by award.

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<sup>17</sup> According to OMB Circular A-110, Subpart C, Section 21 (b)(7), costs related to Federal awards must be supported by source documentation. Source documentation is an original record containing the details to substantiate a transaction entered in an accounting system.

<sup>18</sup> According to OMB Circular A-122, Attachment A, Section A 2, for a cost to be allowable it must be reasonable, conform to limitations set in the principles, be consistent with policies and procedures, accorded consistent treatment, in accordance with generally accepted accounting principles, not included in cost sharing, and adequately documented.

<sup>19</sup> According to Title II of the Code of Federal Regulations, Part 200, Subpart A, § 200.84, a questioned cost is a cost that is a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds. Additionally, the Inspector General Act of 1978 defines a questioned cost for OIG reporting purposes as a finding that, at the time of the audit, such cost is not supported by adequate documentation; or a finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable (Pub. L. No. 95-452 § 5(f)(1)).

Table 2: Questioned Costs Identified

Award Number	Award Amount	Sample Amount	Questioned Costs	Unsupported Costs	Unallowable Costs
S-PMWRA-11-GR-0035	\$5,090,000	\$319,914	\$20,247	\$20,247	\$0
S-PMWRA-12-GR-0024	1,317,534	69,164	0	0	0
S-PMWRA-11-GR-1027 <sup>a</sup>	6,956,958	1,563,333	859,749	627,274	232,475
S-PMWRA-12-GR-1030	2,600,000	216,930	34,504	34,504	0
S-PMWRA-12-GR-1046	1,984,903	667,528	169,593	169,593	0
S-PMWRA-12-GR-1055	1,030,000	235,236	34,966	34,966	0
S-PMWRA-12-GR-1060 <sup>b</sup>	2,599,996	867,226	217,423	217,423	0
S-PMWRA-12-GR-1076 <sup>c</sup>	3,396,584	1,153,306	249,169	249,169	0
S-PMWRA-13-GR-1005	1,430,228	387,672	26,245	26,245	0
S-PMWRA-13-GR-1006 <sup>d</sup>	3,750,000	1,307,920	1,112,624	1,112,624	0
S-PMWRA-13-GR-1012	1,500,000	374,062	0	0	0
S-PMWRA-13-GR-1013	1,776,411	554,729	271	0	271
S-PMWRA-13-GR-1014	1,330,000	172,541	0	0	0
S-PMWRA-13-GR-1016	1,603,426	126,380	24,720	2	24,718
S-PMWRA-13-GR-1017	1,416,000	169,572	1,403	0	1,403
S-PMWRA-13-GR-1018	1,500,000	442,263	82,682	82,682	0
S-PMWRA-13-GR-1020	1,752,935	574,272	0	0	0
S-PMWRA-13-GR-1068	9,900,000	6,614,308	0	0	0
<b>Total</b>	<b>\$50,934,975</b>	<b>\$15,816,356</b>	<b>\$2,833,596</b>	<b>\$2,574,729</b>	<b>\$258,867</b>

<sup>a</sup> The sample amount for this award includes \$404,578 related to a judgmental sample of payroll expenditures that was selected separately from the remaining expenditure population, from which a statistical sample was selected. The entire \$404,578 of payroll expenditures was questioned as an unsupported cost.

<sup>b</sup> The sample amount for this award includes \$76,907 related to a judgmental sample of payroll expenditures that was selected separately from the remaining expenditure population, from which a statistical sample was selected. The entire \$76,907 of payroll expenditures was questioned as an unsupported cost.

<sup>c</sup> The sample amount for this award includes \$75,062 related to a judgmental sample of payroll expenditures that was selected separately from the remaining expenditure population, from which a statistical sample was selected. The entire \$75,062 of payroll expenditures was questioned as an unsupported cost.

<sup>d</sup> The sample amount for this award includes \$321,114 related to a judgmental sample of payroll expenditures that was selected separately from the remaining expenditure population, from which a statistical sample was selected. The entire \$321,114 of payroll expenditures was questioned as an unsupported cost.

**Source:** Kearney's analysis of invoices and documentation provided by award recipients.

### *\$2.6 Million in Award Recipient Expenditures Lacked Adequate Supporting Documentation*

OMB Circular A-110 establishes requirements for retention of records by award recipients, stating that "financial records, supporting documents, statistical records, and all other records pertinent to an award shall be retained for a period of three years."<sup>20</sup> OMB Circular A-110 further requires that award recipients' financial management systems provide accounting records

<sup>20</sup> OMB Circular A-110, Subpart C, Section 53 (b).

supported by source documentation.<sup>21</sup> OMB Circular A-110<sup>22</sup> also requires award recipients to provide unrestricted and timely access of such records to the Office of Inspector General (OIG) and their authorized representatives.

Of the \$2.8 million in questioned costs, Kearney determined that \$2.6 million (93 percent) related to insufficient supporting documentation for both payroll and non-payroll expenditures (that is, unsupported costs). For example, the award recipient for four awards was unable to provide documentation to adequately support \$877,661 in sampled payroll expenditures. The award recipients for 3 of the 18 awards did not provide employee timesheets that may have supported \$232,020 in labor expenditures. Without the requested timesheets, Kearney was unable to reasonably validate that employees worked the hours that were billed.

Circular A-110 states that recipients' financial management systems shall provide for "effective control over and accountability for all funds" and assure funds "are used solely for authorized purposes."<sup>23</sup> A key control for the accountability of funds is proper authorization of financial transactions by an appropriate level of management.<sup>24,25</sup> Without proper authorizations, the grantee cannot appropriately support an expenditure. During the audit, Kearney identified 3 of 18 awards, totaling \$42,600, with expenditures that lacked evidence of adequate authorization. For example, for award S-PMWRA-12-GR-1060, Kearney found six transactions, totaling \$40,616, for which the award recipient did not have evidence of the review and approval of the expenditures—such as a signature confirming that the disbursing officer reviewed the invoices to ensure that they were allowable and in line with the terms and conditions of the grant.

#### *\$258,867 in Award Recipient Expenditures Were Unallowable*

Kearney determined that \$258,867 of award recipient expenditures did not adhere to the guidance set forth in either the OMB circulars or the grant-specific guidance. For example, for award S-PMWRA-13-GR-1016, Kearney found three expenditures for equipment and supplies—such as tents and gloves—totaling \$24,339 that were made on the final day of the award's period of performance. According to OMB Circular A-122,<sup>26</sup> "only materials and supplies actually used for the performance of a Federal award may be charged as direct costs." However, the supporting documentation provided for these expenditures indicates that the equipment and supplies were not requested by the award recipient until the last 2 weeks of the period of the performance, and were not received by the award recipient until a matter of days before the end

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<sup>21</sup> OMB Circular A-110, Subpart C, Section 21 (b)(2).

<sup>22</sup> OMB Circular A-110, Subpart C, Section 53 (e).

<sup>23</sup> OMB Circular A-110, Subpart C, Section 21 (b)(3).

<sup>24</sup> Committee of Sponsoring Organizations of the Treadway Commission, *Integrated Framework*, Control Activities Principle 10 (May 2013).

<sup>25</sup> According to Title II of the Code of Federal Regulations, Part 200, Subpart A, § 200.303, award recipients are required to establish and maintain internal controls over the award that are in compliance with guidance in the *Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission or the "Standards for Internal Control in the Federal Government" issued by the Comptroller General of the United States.

<sup>26</sup> OMB Circular A-122, Attachment B, Section 28, Subpart C.

of the period of performance. Given the timing, it is unlikely that the equipment and supplies were used much, if at all, to benefit the award, and the cost likely should have been partially or entirely allocated to other projects.

For award S-PMWRA-13-GR-1017, Kearney identified an expenditure of \$1,485, which was made in an expense account for stationery. However, the supporting documentation revealed that \$1,403 of the expenditure was for non-stationery items, such as IT-related equipment and software. This expenditure was made only 2 months prior to the end of the award's period of performance. Accordingly, it is unlikely that the entire cost of the equipment and supplies, particularly the software licenses, was fully allocable to the award. However, the cost did not appear to be allocated to any other projects for which the equipment and supplies may be used.

### ***Insufficient Financial Oversight***

These unsupported and unallowable costs went undetected and were paid because, in part, PM's grant monitoring processes, both pre- and post-award, were not sufficient to prevent or detect unallowable or unsupported costs.

For example, PM does not independently validate that all award recipients have financial management controls in place to prevent unallowable or unsupported costs. OMB Circular A-110 states that recipients' financial management systems must provide "Accurate, current and complete disclosure of the financial results of each federally-sponsored project or program," as well as "effective control over and accountability for all funds, property and other assets."<sup>27</sup> During discussions regarding their pre-award process, PM officials stated that they do not assess the financial management systems or controls of potential award recipients.

GPD 42, *Monitoring Assistance Awards*, suggests that the Department make site visits to review the recipients' financial policies and procedures, financial management controls, and supporting documentation for a selection of expenditures. Although PM officials conducted site visits to all 18 award recipients Kearney tested, Kearney found that the focus of these site visits was on the award recipients' programmatic performance and not on financial management, as recommended by the GPD. One PM official stated that site visits to grantees did not generally include a review of financial-related information or an assessment of financial management controls.

### ***Unallowable and Unsupported Costs May Be in Other Grants***

Because of PM's lack of oversight of grantees, it is difficult for PM to ensure that award recipients are using funds to support PM's overall mission and programs. When Kearney's finding from our statistical sample—\$2.0 million in questioned costs in 14 grants—is extrapolated to cover all expenditures under these 14 grants, Kearney estimates an additional

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<sup>27</sup> OMB Circular A-110, Subpart C, Section 21 (b)(1) and (3).

\$2.6 million in statistically projectable costs (for a total of \$4.6 million<sup>28</sup>) may be unallowable or unsupported, with an additional \$877,661 in questioned costs related to payroll expenditures.<sup>29</sup> While Kearney did not review the remaining PM awards, the same issues identified in its testing are likely to exist in some of the other awards as well.<sup>30</sup> Unallowable costs found are Federal funds that award recipients could have used to accomplish the goals of their grant agreements while complying with Federal and Department requirements.

**Recommendation 1:** OIG recommends that the Bureau of Political-Military Affairs develop and implement a process to independently validate that all award recipients have adequate financial management controls in place, as prescribed by Office of Management and Budget Circular A-110.

**PM Response:** PM concurred with this recommendation, stating that it ensures that award recipients have adequate financial controls in place by reviewing and following up on findings identified in independent audit reports on grantees that receive more than \$750,000 from the Government annually. In addition, PM stated that it conducts site visits during which PM officials examine recipients' financial controls.

**OIG Reply:** Although PM concurred with the recommendation, OIG considers this recommendation unresolved. According to PM, it plans to continue to perform the same steps it performed at the time of audit fieldwork, specifically reviewing and following up on findings identified in independent audit reports on grantees. As described in the audit finding, PM's existing efforts were not sufficient to identify financial management control deficiencies at its grantees. In its response, PM did not detail any pre-award validation procedures that it planned to implement. While reviewing independent audit reports for grantees is a useful source of information, the review is not an independent validation of the adequacy of financial management controls and should not be the only tool used during a pre-award assessment. Further, as PM acknowledged, these audits are not conducted for all award recipients. Additional procedures, in conjunction with PM's existing reviews, will provide PM with assurance that an adequate control environment is in place throughout the life of an award. This recommendation will be resolved when PM provides a plan of action for implementing the recommendation. This recommendation will be closed when OIG receives and accepts documentation demonstrating that PM has developed and implemented a process to independently validate the adequacy of award recipients' financial management controls.

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<sup>28</sup> See Appendix A: Purpose, Scope, and Methodology for information on the sampling methodology as well as the error projections.

<sup>29</sup> Although Kearney identified \$2.8 million in questioned costs, \$877,661 related to questioned costs that could not be extrapolated, as they were not a part of the statistical sample selected. Specifically, the \$887,661 in questioned costs was related to payroll expenditures that were judgmentally selected, as described previously as well as in Appendix A: Purpose, Scope, and Methodology.

<sup>30</sup> Statistical samples are designed to be representative, with the stated confidence that the "true" population misstatement is measured by the confidence interval.

**Recommendation 2:** OIG recommends that the Bureau of Political-Military Affairs develop and implement a process to monitor award recipients' financial activities, including reviewing the recipients' financial policies and procedures, financial management controls, and supporting documentation for a selection of expenditures, during site visits to award recipients, as recommended by the Federal Assistance Policy Directive and the Federal Assistance Procedures Desk Guide.

**PM Response:** PM concurred with this recommendation, stating that it had updated its Grants Management Review standard operating procedures to include a requirement that, during site visits, Grants Officers review supporting documentation for a sample of expenditures. The standard operating procedures also require Grants Officers to review grantees' financial policies and procedures and financial management controls.

**OIG Reply:** OIG considers this recommendation closed. The standard operating procedures that PM revised in response to this recommendation include a requirement to review supporting documentation for expenditures, financial policies and procedures, and management controls. The new policy was issued in August 2016.

**Recommendation 3:** OIG recommends that the Bureau of Political-Military Affairs (a) determine whether the \$2.8 million in questioned costs identified in this report, and the \$2.6 million statistically projected questioned costs, are allowable or supported; and (b) recover any costs determined to be unallowable or unsupported.

**PM Response:** PM stated that it will review the \$2.8 million in identified questioned costs and also review costs for the grants that were not specifically audited to determine if costs are allocable and reasonable under the grant award. PM stated that it will disallow and seek reimbursement for any costs that are not reasonable and allocable. After completing the reviews and following up with recipients, PM will provide feedback to OIG on the results on any disallowed costs.

**OIG Reply:** Although PM plans to take action on this recommendation, OIG considers this recommendation unresolved until PM makes a final determination with respect to the validity of the identified questioned costs.<sup>31</sup> This recommendation will be resolved when OIG receives and accepts PM's determination regarding the allowability of the \$2.8 million in questioned costs and the \$2.6 million in statistically projected questioned costs identified in the report. This recommendation will be closed when OIG receives and accepts documentation demonstrating that PM has recovered all costs that PM determined to be unallowable or unsupported.

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<sup>31</sup> Inspector General Act, as amended, Pub. L. 95-452, § 5(a)(8).

## Finding B: No Invalid Unliquidated Obligations Were Identified

The FAM<sup>32</sup> requires that all officers responsible for managing, tracking, and obligating allotted funds must implement procedures for reviewing obligations and available fund balances on a monthly basis. In addition, PM's own procedures require reviews of ULOs on a monthly basis and, in cases where a ULO is found to be unnecessary, either because the program has been completed or the program can no longer be executed, the obligation will be promptly adjusted.

Kearney obtained a ULO report as of October 31, 2015, which contained 181 PM ULOs for grants and cooperative agreements totaling \$74.6 million. PM self-identified 17 of the ULOs, totaling \$618,643, as invalid, meaning that they needed to be adjusted. Because PM was in the process of making adjustments to these 17 ULOs, Kearney excluded the ULOs from the universe.<sup>33</sup> Kearney selected a random statistical sample of 49 (30 percent) of the remaining 164 ULOs, totaling \$19.2 million (26 percent) out of \$73.9 million. Kearney determined the 49 ULOs were valid<sup>34</sup> based on the programs' periods of performance and other information showing that the obligations were currently active and there were bona fide needs. According to PM officials, PM had no invalid ULOs because Program Managers, who have direct knowledge of award status, review ULOs monthly. In addition, the Grants Officer verifies the status of all ULOs. In cases where a grant's period of performance has ended, PM will promptly adjust the obligation.

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<sup>32</sup> 4 FAM 225 (a), "Accounting Controls and Obligation Management."

<sup>33</sup> Kearney confirmed that PM deobligated all 17 of these ULOs.

<sup>34</sup> 4 FAM 087.2, "Obligation Validity Criteria."

## RECOMMENDATIONS

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**Recommendation 1:** OIG recommends that the Bureau of Political-Military Affairs develop and implement a process to independently validate that all award recipients have adequate financial management controls in place, as prescribed by Office of Management and Budget Circular A-110.

**Recommendation 2:** OIG recommends that the Bureau of Political-Military Affairs develop and implement a process to monitor award recipients' financial activities, including reviewing the recipients' financial policies and procedures, financial management controls, and supporting documentation for a selection of expenditures, during site visits to award recipients, as recommended by the Federal Assistance Policy Directive and the Federal Assistance Procedures Desk Guide.

**Recommendation 3:** OIG recommends that the Bureau of Political-Military Affairs (a) determine whether the \$2.8 million in questioned costs identified in this report, and the \$2.6 million statistically projected questioned costs, are allowable or supported; and (b) recover any costs determined to be unallowable or unsupported.



## APPENDIX A: PURPOSE, SCOPE, AND METHODOLOGY

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The Office of Inspector General (OIG) for the Department of State (Department) initiated this performance audit to determine the extent to which (1) the Bureau of Political-Military Affairs (PM) grantees claimed expenses that were allowable, allocable, reasonable, supported, and made in accordance with Federal requirements; and (2) the unliquidated obligations (ULO) associated with PM's grants and cooperative agreements remain valid. An external audit firm, Kearney & Company, P.C. (Kearney), acting on behalf of the OIG, performed this audit.

Kearney conducted fieldwork for this performance audit from August 2015 to March 2016 in the Washington, DC, metropolitan area. Kearney limited its audit to expenditures for PM grants and cooperative agreements with project period start dates during FY 2012 – FY 2014<sup>1</sup> and with project period end dates during FY 2014, as well as ULOs as of October 31, 2015. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that Kearney plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objective. Kearney believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objective.

To obtain background information, Kearney researched and reviewed Federal laws and regulations as well as prior OIG and Government Accountability Office audit reports. Kearney also reviewed the United States Code, Office of Management and Budget (OMB) Circulars, the Grant Policy Directives (GPD), the Department's Foreign Affairs Manual and Foreign Affairs Handbook, and PM policies and procedures.

Kearney gained an understanding of the processes and procedures to monitor grant and cooperative agreement expenses and reviewed procedures for ULOs. Kearney obtained a complete listing of awards and ULOs during the scope period with the assistance of PM officials. In addition, Kearney coordinated directly with PM award recipients to acquire expense detail and reviewed documentation provided by award recipients. For each award selected for testing, Kearney contacted award recipients to obtain the general ledger detail related to the award selected. Kearney obtained and reviewed supporting documentation provided by the award recipients to determine if the expenses were allowable, allocable, reasonable, supported, and made in accordance with the terms and conditions of the grant agreement.

### Prior Reports

OIG issued a Management Alert<sup>2</sup> that stated that the management and oversight of grants pose heightened financial risk to the Department. OIG and other oversight agencies have identified a number of significant deficiencies in the grant-management process. The Management Alert

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<sup>1</sup> Kearney noted one grant (S-PMWRA-11-GR-1035) was awarded during FY 2011, but all expenditures on the award were made during the scope period. Since the period of performance of the award was complete at the time of fieldwork, and all relevant data was readily accessible, Kearney included this award in the sample.

<sup>2</sup> OIG, *Management Alert – Grant Management Deficiencies* (MA-14-03, September 2014).

stated that nearly 40 percent of OIG inspections since 2010 identified specific grant-management deficiencies in the inspected entity and emphasized that one of the most significant grant-management challenges faced by the Department is insufficient oversight, caused primarily by too few employees managing a large number of grants. Audits conducted by OIG have reported similar deficiencies, including insufficient oversight caused by too few staff managing too many grants, insufficient training of grant officials, and inadequate documentation and closeout of grant activities.

## Work Related to Internal Controls

Based upon the information obtained during preliminary audit procedures, Kearney performed a risk assessment that identified audit risks related to the audit objectives. Kearney conducted meetings and observed processes to identify controls in place to address those risks. The lack of internal controls related to recipient expenditures is included in the "Audit Results" section of this report. While Kearney identified certain limited controls related to ULOs, Kearney chose not to rely on or specifically test those controls to support the validity of ULO balances. However, Kearney designed procedures that would enable it to obtain sufficient and appropriate evidence to conclude upon the audit objectives.

## Use of Computer-Processed Data

Throughout the audit, Kearney used computer-processed data. For example, Kearney obtained a list of Federal assistance awards from PM to identify the universe of awards with project period start dates between FY 2012 – FY 2014 and project period end dates during FY 2014. PM uses the State Assistance Management System (SAMS)<sup>3</sup> to internally track awards. To confirm the completeness and accuracy of the PM-provided award agreement population, Kearney used the information in USASpending.gov.<sup>4</sup> Specifically, Kearney independently extracted a population of PM awards from USASpending.gov for the same time period and verified all awards provided by PM were also reported in USASpending.gov. However, Kearney noted awards in USASpending.gov that were not provided by PM. This occurred because PM only tracks awards that are active. Any awards that are closed out are removed from the PM-maintained universe of awards; no similar removal process occurs in USASpending.gov. Kearney appended the PM universe of active awards with the additional awards included in USASpending.gov. PM officials validated the information from USASpending.gov and confirmed the awards population was complete based on their knowledge. As a result of Kearney's analysis of the information in USASpending.gov, Kearney was able to create a population of PM awards with project period start dates between FY 2012 – FY 2014 and project period end dates during FY 2014 that was reasonably complete and accurate for the purposes of this audit.

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<sup>3</sup> SAMS was designed to standardize the Department's assistance-related business processes from solicitation through award and close-out.

<sup>4</sup> USASpending.gov provides data on entities and organizations that receive Federal funds. USASpending.gov is updated with information from SAMS on a daily basis.

In addition, Kearney obtained a universe of award expenditures electronically from the Global Financial Management System (GFMS), the Department's core financial system, to determine the amount spent on each award. Kearney performed procedures to evaluate the accuracy and completeness of the information in GFMS during the audits of the Department's FY 2012 - FY 2014 financial statements and concluded that the data was sufficiently reliable. Kearney then requested from the award recipients their detailed population of expenditures paid with award funds since the award's inception from their general ledgers.<sup>5</sup> Kearney reconciled the populations of expenditures provided by the award recipients to GFMS expenditures by award. In some instances, Kearney noted immaterial differences between the award recipient-provided expenditures population and GFMS. Kearney worked with the award recipients to reconcile the differences. Kearney concluded that the data from the award recipients was sufficiently reliable for sample selection.

Kearney obtained a ULO report, dated October 31, 2015, containing all PM Federal assistance-related obligations from the PM Grants Officers. PM reviews the report for the status of each obligation. Kearney identified 181 ULOs for grants totaling approximately \$74.6 million. To confirm completeness of the ULO population, Kearney used the September 30, 2015, Department-wide ULO database from the FY 2015 Department financial statement audit to verify there were no missing ULOs. Kearney noted 10 PM ULOs not included in the October 31, 2015, population provided by PM. Kearney confirmed that these 10 obligations were deobligated during October 2015, and, therefore were properly excluded from the October 31, 2015, report. Kearney concluded that the ULO report was sufficiently reliable for sample selection.

## Detailed Sampling Methodology

Kearney's sampling objectives were to test grantees' claimed expenses to determine if they were allowable, allocable, reasonable, and supported, and whether ULOs associated with PM's grants and cooperative agreements remain valid.

### *Universe of PM Awards*

PM provided Kearney with an internally created spreadsheet from SAMS of PM Federal assistance awards with award period start dates between FY 2012 – FY 2014 and project period end dates during FY 2014. Kearney combined the PM population with the Kearney extracted population from USASpending.gov, identified duplicate award numbers, and removed the duplicates so that each Federal assistance award was included in the consolidated population only once. Kearney further excluded awards that fell outside the scope period. Table A.1 summarizes the final award population.

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<sup>5</sup> A general ledger is the master set of accounts that summarize all transactions occurring within an entity.

**Table A.1: Kearney-Created PM Award Population**

<b>Source</b>	<b>Awards Count</b>	<b>Award Amount</b>
SAMS	18	\$23,712,000
USASpending.gov	35	\$37,986,762
<b>Total</b>	<b>53</b>	<b>\$61,698,762</b>

**Source:** Prepared by Kearney based on award obligation amount included in the respective system. Kearney did not perform procedures to validate the accuracy of the award amounts.

### *Sample of Expenditures*

Kearney asked PM to provide the GFMS obligation numbers for each of the 53 awards, which is needed to be able to search for expenditures in GFMS, since GFMS does not contain the award number as a reference field. Once PM provided the obligation numbers, Kearney obtained the Department's general ledger detail from GFMS and was able to extract all of the expenses incurred for the obligations from FY 2012 through FY 2014.

Based on the obligation numbers provided by PM, Kearney selected the top 18 award recipients using the total amount of expenditures extracted from GFMS during FY 2012 through FY 2014. After the awards were selected, Kearney realized that PM had not provided all of the obligation numbers for all of the awards. By performing additional analyses, Kearney ensured that it had identified all of the obligation numbers for the 18 awards selected for testing, meaning Kearney was able to identify all of the expenditures related to those 18 awards. The amount of expenditures for the 18 awards being tested totaled approximately \$51.0 million. Kearney did not perform a similar analysis to identify additional obligation numbers for the awards that were not selected for testing.

Kearney requested and obtained a detailed list of expenditures paid from award funds for the scope period from the 18 grantees selected for testing. Prior to selecting a sample from the award recipient expenditure populations, Kearney excluded items such as accruals,<sup>6</sup> credit amounts,<sup>7</sup> zero balances, and indirect costs.<sup>8</sup> Using IDEA Data Analysis Software,<sup>9</sup> Kearney ran a

<sup>6</sup> An accrual allows an entity to record expenses and revenues for which it expects to expend cash or receive cash, respectively, in a future period.

<sup>7</sup> A credit amount on the general ledger relates to an amount that is either a refund of an expense or an offset of an expense already recorded. Credit amounts are not actual expenditures and therefore were excluded.

<sup>8</sup> An indirect cost is a cost that is not directly traceable to a department, product, activity, or customer. These costs are allocated to the applicable cost center. Kearney was not able to remove all indirect costs, as they were not always easily identifiable. In one instance, a sampled expense included indirect costs. These costs were excluded after the sample was received and they were not taken into consideration.

<sup>9</sup> IDEA is a computer program used to analyze data and, based upon the parameters input by the user, select a sample to aid in evaluating the results of the sample.

monetary unit sampling<sup>10,11</sup> selection on each general ledger listing of expenditures to arrive at samples of expenditures for each of the 18 grants selected for testing ranging from 50-75 expenditures as shown in Table A.2.

For awards S-PMWRA-12-GR-1027, S-PMWRA-12-GR-1060, S-PMWRA-12-GR-1076, and S-PMWRA-13-GR-1006, all of which were administered by the same award recipient, Kearney noted that the expenditure detail contained payroll transactions that were larger, relatively, than those seen in the other awards tested. These large payroll expenditures skewed the initial statistical samples to have mostly payroll expenditures given the nature of the monetary unit sampling. From discussions with the award recipient, Kearney learned that the award recipient recorded its payroll transactions as one monthly lump sum expenditure, resulting in the larger dollar-value expenditures. To ensure that the statistical samples were representative of the populations, Kearney segregated the payroll expenditures from the remaining expenditures. Kearney then selected a judgmental sample of 10 payroll expenditures across the 4 awards, totaling \$877,661, to test the costs associated with payroll. These were analyzed separately from the non-payroll expenditures, but the results are included as part of the questioned costs in Table 2, which is included in Finding A of this report. Kearney also selected a statistical sample from the remaining population of all other expenditures from this grantee in the same manner as the other 14 awards tested. The combined sample amounts from both the judgmental and statistical samples are included in Table A.2.

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<sup>10</sup> Monetary unit sampling is a statistical sampling technique used to select a sample based on the proportionate unit size of the sample to the overall population. For purposes of this audit, the unit is the dollar value of the transactions. This means that every dollar in the population has an equal chance of being selected. If a particular dollar unit is selected, the entire transaction that is associated to the dollar unit will be selected for testing. Monetary unit sampling determines the number of samples required to obtain the planned level of accuracy, precision, or confidence level, and determines the unit intervals necessary to generate the total number of samples needed for testing. Misstatements, whole or partial, in the sample population are projected over the population based on the proportion of the misstatement in the selected sample. This sampling technique is used when overstatements or low misstatements are expected in the population.

<sup>11</sup> In selecting the sample, Kearney utilized a 95 percent confidence level, with a tolerable error rate of 5 percent and an expected error rate of 0.5 percent. A confidence level is the level of certainty to which an estimate can be trusted. The degree of certainty is expressed as the chance, usually in the form of a percentage, that a true value will be included within a specified range, called a confidence interval. The tolerable error is the rate of deviation set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population. The expected error is the rate of error in the population that Kearney expected to find, based on various considerations researched prior to testing the sample.

Table A.2: PM Expense Sample by Award

Award Number	Reported Expenses	Excluded Expenses	Final Expenses	Sampled Expenses
S-PMWRA-11-GR-0035	\$5,087,531	\$210,766	\$4,806,843	\$319,914
S-PMWRA-12-GR-1024	1,317,534	129,038	1,142,741	69,164
S-PMWRA-12-GR-1027	6,956,958	22,260	6,934,698	1,563,333
S-PMWRA-12-GR-1030	2,600,000	227,500	2,261,408	216,930
S-PMWRA-12-GR-1046	1,984,903	330,950	1,732,038	667,528
S-PMWRA-12-GR-1055	1,030,000	82,664	904,859	235,236
S-PMWRA-12-GR-1060	2,600,137	88,751	2,511,386	867,226
S-PMWRA-12-GR-1076	3,396,584	(14,618)	3,411,202	1,153,306
S-PMWRA-13-GR-1005	1,430,228	178,370	1,251,858	387,672
S-PMWRA-13-GR-1006	3,750,022	193,221	3,556,801	1,307,920
S-PMWRA-13-GR-1012	1,500,000	(12,726)	1,515,789	374,062
S-PMWRA-13-GR-1013	1,776,411	(9,258)	1,787,115	554,729
S-PMWRA-13-GR-1014	1,360,000	0	1,360,000	172,541
S-PMWRA-13-GR-1016	1,603,426	144,011	1,459,415	126,380
S-PMWRA-13-GR-1017	1,416,000	49,093	1,366,907	169,572
S-PMWRA-13-GR-1018	1,500,000	149,779	1,350,221	442,263
S-PMWRA-13-GR-1020	1,752,935	3,720	1,757,213	574,272
S-PMWRA-13-GR-1068	9,900,000	627,335*	9,272,665	6,614,308
<b>Total</b>	<b>\$50,962,669</b>	<b>\$2,400,856</b>	<b>\$48,383,159</b>	<b>\$15,816,356</b>

\* During our preliminary review of the award recipient's general ledger detail, Kearney noted \$627,335 in expenses that were recorded into the grantee's financial system after the end of the project's period of performance. Kearney excluded these expense transactions from the population of expenses subject to sampling, and evaluated them separately. After discussions with both PM and the award recipient, Kearney concluded that these expenditures were made during the period of performance of the award and were reasonable.

**Source:** Prepared by Kearney based upon award recipient-provided expenditure information.

### *Testing of Expenditures*

Kearney tested expenditures to determine whether the expenditures were allowed by Federal<sup>12</sup> and Department guidance. Any discrepancies were discussed with the award recipient and additional information was requested. If a sufficient explanation could not be provided, Kearney questioned the costs. The questioned costs for the items that were statistically selected were input into IDEA to obtain a projection of questioned costs over the population subject to sampling. Table A.3 provides information on the projected questioned costs on the 18 awards selected for testing.

<sup>12</sup> OMB Circular A-21, "Cost Principles for Educational Institutions," and OMB Circular A-122, "Cost Principles for Non-Profit Organizations," provide guidance on what grant expenses are allowable.

Table A.3: Projected Questioned Costs

Award Number	Value of Sampled Population	95 Percent Lower Bound <sup>a</sup>	Projected Questioned Costs	95 Percent Upper Bound <sup>a</sup>
S-PMWRA-11-GR-0035	\$4,806,483	\$62,372	\$133,523	\$407,950
S-PMWRA-12-GR-1024	1,142,741	0	0	45,569
S-PMWRA-12-GR-1027 <sup>b</sup>	2,726,602	905,382	1,203,054	1,500,725
S-PMWRA-12-GR-1030	2,261,408	346,787	587,604	828,421
S-PMWRA-12-GR-1046	1,732,038	252,020	321,944	471,812
S-PMWRA-12-GR-1055	904,859	50,743	87,305	156,725
S-PMWRA-12-GR-1060 <sup>b</sup>	1,390,858	270,827	326,917	441,810
S-PMWRA-12-GR-1076 <sup>b</sup>	2,118,331	320,826	407,133	578,072
S-PMWRA-13-GR-1005	1,251,858	36,772	87,768	171,480
S-PMWRA-13-GR-1006 <sup>b</sup>	1,449,030	992,491	1,110,033	1,227,575
S-PMWRA-13-GR-1012	1,515,789	0	0	61,772
S-PMWRA-13-GR-1013	1,787,115	48,009	24,821	114,728
S-PMWRA-13-GR-1014	1,360,000	0	0	55,423
S-PMWRA-13-GR-1016	1,459,415	21,641	81,116	179,010
S-PMWRA-13-GR-1017	1,366,907	38,026	18,070	83,430
S-PMWRA-13-GR-1018	1,350,221	188,447	243,293	364,810
S-PMWRA-13-GR-1020	1,757,213	0	0	71,119
S-PMWRA-13-GR-1068	9,272,665	0	0	359,656
<b>Total</b>	<b>\$39,653,533</b>	<b>\$3,534,343</b>	<b>\$4,632,581</b>	<b>\$7,120,087</b>

<sup>a</sup> A confidence interval is a range around the mean (average) defined by the upper and lower bounds. The percent confidence conveys the certainty that the auditor has that the universe mean is within the range. For the purposes of this table, the universe mean is what Kearney expects to be the true questioned costs in the population. Therefore, there is a 95 percent chance that the true questioned cost for each award falls between the stated upper and lower bounds.

<sup>b</sup> In evaluating these awards, Kearney separated the payroll expenditures from the remaining expenditures and then selected a sample from each sub-population, with the payroll sample being judgmentally selected while the remaining expenditures sample was statistically selected. Because the information in the table only pertains to the statistical sample, the value of the payroll expenditure populations is not included in the "Value of Sampled Population," and the questioned costs related to payroll for these grants were not taken into consideration for the error projections.

**Source:** Prepared by Kearney based upon testing.

### *Selection of Unliquidated Obligations for Review*

Kearney analyzed the ULO report provided by PM containing 181 Federal award-related ULOs, totaling \$74.6 million, to identify ULOs with a higher risk for being invalid. Specifically, Kearney assessed whether existing ULOs had limited or no activity in FY 2015 or had expired periods of performance. Kearney did not find ULOs matching these criteria. Therefore, Kearney decided to test from the entire population of ULOs. Kearney then reviewed PM's internal ULO validity analysis and found that PM had identified 17 ULOs as invalid. Because PM was in the process of making adjustments to these 17 ULOs, Kearney excluded these ULOs from the universe.<sup>13</sup>

<sup>13</sup> Kearney confirmed that all 17 ULOs were deobligated.

Kearney arrived at a final population subject to sampling of 164 ULOs, totaling \$73.9 million. Kearney used IDEA to select a monetary unit sample of 49 ULOs, totaling \$19.2 million, which is 26 percent of the remaining 164 PM Federal award-related ULOs. Table A.4 lists the 49 ULOs tested.

**Table A.4: Unliquidated Obligations Tested**

<b>Obligation Number</b>	<b>Amount</b>
1039232172	\$400,000
1039430126	967
1039430086	1,141,696
1039430058	263,261
1039430056	500,000
1039332044	94,560
10395W4158	2,209,500
10395W4101	453,899
10395W4096	15,868
10395W4078	130,000
10395W4053	116,102
10395W4034	466,448
10395W4027	40,000
10395W4010	472,629
10395W4004	2,000
1039450062	6,099
1039450057	11,278
10395W6034	2,031,976
10395W4093	2,397,910
10395W4092	307,888
10395W4051	166,888
10395W4033	194,776
10395W4018	601,000
10395W4015	50,000
1039450083	272,818
10395W4118	205,850
10395W4070	304,000
1039430023	1,943
10395W4151	185,500
10395W4120	85,096
10395W4098	153,521
10395W4089	24,634
10395W4073	291,957
10395W4046	496,111
10395W4035	126,340
10395W4006	77,035
1039450060	72,705
10395W6044	700,000
10395W6037	2,319,628



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Obligation Number	Amount
10395W6036	289,750
10395W4112	200,500
10395W4095	2,784
10395W4056	98,766
10395W4054	39,675
10395W4049	176,712
10395W4017	157,566
1039450073	144,385
1039450072	14,885
10395W4144	710,850
<b>Total</b>	<b>\$19,227,756</b>

Source: Prepared by Kearney based upon testing.

## APPENDIX B: BUREAU OF POLITICAL-MILITARY AFFAIRS RESPONSE

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UNCLASSIFIED

**United States Department of State**

**Washington, D.C. 20520**

August 31, 2016

### **MEMORANDUM FOR OIG ASSISTANT INSPECTOR GENERAL FOR AUDITS, NORMAN P. BROWN**

FROM: PM – Karen Williams, Acting

SUBJECT: PM Initial Response to the OIG Draft Report *Audit of the Bureau of Political-Military Affairs Federal Assistance Awards*

The Bureau of Political-Military Affairs (PM) acknowledges receipt of the OIG draft report entitled *Audit of the Bureau of Political-Military Affairs Federal Assistance Awards* (AUD-SI-16-XX). PM submits the following response and attachment in regards to the OIG's three recommendations.

**OIG Recommendation 1:** OIG recommends that the Bureau of Political-Military Affairs develop and implement a process to independently validate that all award recipients have adequate financial management controls in place, as prescribed by Office of Management and Budget Circular A-110.

**PM Response:** PM concurs with Recommendation 1. Under OMB Circular A-133, all award recipients who expend \$500,000 or more in a fiscal year must undergo a single audit. Single audits are performed by an independent audit firm that examines an organization's financial statements as well as the organization's internal financial controls. PM ensures that award recipients have adequate financial controls in place by reviewing single audit reports and by following up with award recipients to correct deficiencies discovered during the audit.

On December 26, 2014, OMB Circular A-133 was replaced with OMB 2 CFR Part 200, and the threshold for undergoing a single audit was increased to \$750,000. For all organizations requiring a single audit, PM/WRA requires the single audit report to be submitted with all applications and in July 2015, PM/WRA began a systematic review of all award recipients' single audit reports to ensure that recipients' financial controls are sound.

In addition to reviewing single audit reports, PM/WRA conducts site visits, also known as Grants Management Reviews (GMR), during which PM/WRA examines recipients' financial controls and supporting documentation for expenditures. This process is further described below.

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**OIG Recommendation 2:** OIG recommends that the Bureau of Political-Military Affairs develop and implement a process to monitor award recipients' financial activities, including reviewing the recipients' financial policies and procedures, financial management controls, and supporting documentation for a selection of expenditures, during site visits to award recipients, as recommended by the Federal Assistance Policy Directive and the Federal Assistance Procedures Desk Guide.

**PM Response:** PM concurs with Recommendation 2. PM has a GMR standard operating procedure (SOP) (Tab 1) and a GMR Needs Assessment Worksheet (Tab 2) in place that addresses how PM prioritizes award recipients for site visits and describes the procedures that Grants Officers must take while conducting a GMR. Prior to release of the OIG audit report, this SOP primarily addressed which financial management SOPs a Grants Officer would review during a GMR. After reviewing the OIG's recommendations, this SOP has been updated to include a requirement that Grants Officers review supporting documentation for a sample of expenditures during a GMR.

**OIG Recommendation 3:** OIG recommends that the Bureau of Political-Military Affairs (a) determine whether the \$2.8 million in questioned costs identified in this report, and the \$2.6 million statistically projected questioned costs, are allowable or supported; and (b) recover any costs determined to be unallowable or unsupported.

**PM Response:** PM will review the \$2.8 million in identified questioned costs and also review costs for the grants that were not specifically audited to determine if costs are allocable and reasonable under the grant award. PM will disallow and seek reimbursement for any costs that are not reasonable and allocable. After completing the reviews and following up with recipients, PM will provide feedback to OIG on the results on any disallowed costs.

Attachments:

Tab 1 – PM/WRA Grants Management Review SOP

Tab 2 – PM/WRA Grants Management Review Needs Assessment Worksheet

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## ABBREVIATIONS

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FAM	Foreign Affairs Manual
GFMS	Global Financial Management System
GOR	Grants Officer Representative
GPD	Grant Policy Directive
OMB	Office of Management and Budget
PM	Bureau of Political-Military Affairs
SAMS	State Assistance Management System
ULO	Unliquidated Obligation

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