

**Management Letter Related to the  
Audit of the U.S. Department of State  
2007 and 2006 Financial Statements**

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November 14, 2007

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

We have audited the financial statements of the U.S. Department of State for the years ended September 30, 2007 and 2006, and have issued our report thereon dated November 14, 2007. In planning and performing our audit of the Department's financial statements, we considered the Department's internal control over financial reporting to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. We have not considered internal control since the date of our report.

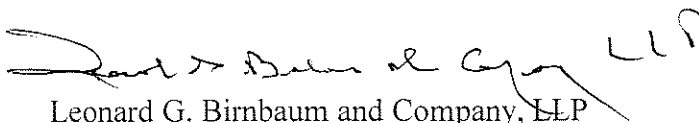
During our audit, we noted certain matters involving internal control over financial reporting that we considered to be material weaknesses and significant deficiencies under the standards established by the American Institute of Certified Public Accountants. We reported those deficiencies in the report referenced.

Our audit procedures were designed primarily to enable us to form an opinion on the financial statements and therefore may not identify all weaknesses in internal control that may exist. However, we would like to take this opportunity to use our knowledge of the Department gained during the audit to provide comments and suggestions that we hope will be useful to you.

Although not considered to be material weaknesses or significant deficiencies, we noted certain matters involving internal control and other operational matters that are presented in Attachment 1 of this letter for your consideration. These observations are intended to improve the Department's internal control or result in other operating efficiencies. Internal control issues identified as a result of the Department's annual assessment required by Office of Management and Budget Circular A-123 are presented in Attachment 2.

This report is intended solely for the information and use of the Office of Inspector General, Department management, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties. The Department did not provide written comments on this management letter.

Very truly yours,

  
Leonard G. Birnbaum and Company, LLP

Attachments: As stated.

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**Observations and Conclusions**

1. Fund Balance With Treasury

The absolute value amount of the unreconciled difference between the adjusted Treasury balance and the adjusted Global Financial Management System (GFMS) balance increased during FY 2007. As of September 30, 2007, the amount of this difference was approximately \$95 million.

*We recommend that the Department continue its efforts to reduce unreconciled differences between the adjusted Treasury balance and the adjusted GFMS balance.*

2. Accounts Receivable

Accounts receivable were overstated by approximately \$83 million. The error amounts were, in large part, due to inadequate supporting documentation and several longstanding balances that we did not believe to be collectible.

*We recommend that the Department evaluate the validity and collectibility of its older accounts receivable balances.*

The Department was unable to prepare a detailed reconciliation between the Domestic Accounts Receivable Tracking System and GFMS because of issues associated with the conversion from the Central Financial Management System (CFMS) to GFMS.

*We recommend that the Department resume the reconciliation process to ensure that the process can be effectively accomplished in the future.*

The Department did not include receivables recorded against Fund 3200, Collections of Receivables From Canceled Accounts, in its financial statements. While the 2006 management letter recommended that these receivables be excluded, a revision to Treasury Financial Manual Bulletin No. 2006-05 now requires that receivables related to canceled funds be included in agencies' financial statements.

*We recommend that accounts receivable related to canceled funds be included in the Department's financial statements.*

3. Accounts Payable

The Department does not maintain an overseas accounts payable subsidiary record. Rather, the amounts appearing in the general ledger accounts, and ultimately the financial statements, represent the results of all transactions (posting of payables, liquidations, and adjusting entries) on a rolling database basis.

*We recommend that the Department establish an overseas accounts payable subsidiary ledger.*

4. Payroll Accruals

Payroll accruals continue to be calculated inaccurately. While we commend the Department for automating its payroll accruals, the exclusion of certain types of payroll from the calculation process yields significant inaccuracies.

*We recommend that the Department reexamine its process for accruing payroll to increase the accuracy of payroll accruals.*

5. Payroll Documentation

Tests disclosed that employees' official personnel files did not contain all required documentation, including SF-50s, Federal Employee Health Benefit forms, Thrift Savings Plan forms, life insurance election forms for employees electing such coverage, SF-2817s for employees electing no life insurance, and Forms W-4 (and state/local equivalent where applicable).

*We recommend that the Department take appropriate steps to ensure that copies of required documents are maintained in personnel files.*

6. Heritage Assets

The Department classified artwork that was not framed or was undergoing preservation treatment as "inactive," and consequently, the inventory count of artwork was reduced by items deemed to be inactive. We believe that the Department should include all artwork in the count of heritage assets unless the artwork is formally removed, missing, or damaged beyond repair.

*We recommend that the Department include all artwork, including "inactive" property, in its count of heritage assets.*

7. Deferred Maintenance

The Department has not fully complied with the requirements of Statement of Federal Financial Accounting Standard (SFFAS) No. 14, *Amendments to Deferred Maintenance Reporting*, in that the Required Supplementary Information section of the Agency Financial Report does not (1) identify each major class of asset for which maintenance has been deferred, (2) include a description of the requirements or standards for acceptable operating condition, and (3) include deferred maintenance for heritage assets other than real property and furniture and fixtures associated with real property. In addition, the Department's system is inadequate for purposes of developing the amount of deferred maintenance presented as supplementary information to the financial statements.

*We recommend that the Department continue its efforts to comply with the requirements of SFFAS No. 14.*

8. Foreign Service Retirement and Disability Fund's (FSRDF) Actuarial Liability

Our actuary made several suggestions to make the report on the FSRDF actuarial liability more informative. Specifically, the actuary suggested that the report:

- (1) show the development of the normal cost percentage,
- (2) provide information about future cash flows or future cash payments or both,
- (3) show the rate of return of assets, and
- (4) provide additional details regarding the method used to determine the amortization of unfunded liability to help users.

*We recommend that the Department consider implementing the suggestions for making the FSRDF report more informative.*

9. Non-Personnel Expenses

Non-personnel expenses were overstated by approximately \$95 million. The error amounts were, in large part, due to expenses being recorded in an improper period. Further, documentation to establish the validity of the expenses in our sample was inadequate.

*We recommend that the Department take steps to correctly allocate expenses in their proper period and maintain adequate documentation to establish the validity of expenses.*

10. The Improper Payments Information Act

Although the Department identified certain transactions as being susceptible to improper payments in FY 2006 and earlier, these transactions were not tested in FY 2007. These

transactions include the following:

- INL-Law Enforcement, Eradication, Aviation Support, and Support to the Military. The susceptibility to improper payments for this activity was first identified in FY 2004. In the FY 2006 report, this program was projected to have an error amount for FY 2007 in excess of \$185,750. Further, the Department projected this amount to increase in FYs 2008 and 2009.
- Vendor Payments for Structures and Equipment. The susceptibility to improper payments for this activity was first identified in FY 2004. For FY 2005, improper payments were projected to be \$235,000. For FY 2006 and beyond, the Department projects no additional improper payments. However, the actual improper payment amount (or confirmation that there are no further improper payments) was not disclosed.
- Grantee Payments. In cases where Federal Financial Assistance funds were disbursed to a grantee, the Department did not extend the improper payment testing to the grantee level to obtain documentation to support whether the funds were spent in accordance with the grant agreement.

*We recommend that the Department cover all programs that are susceptible to improper payments, including programs identified in prior years that have been projected to have improper payments in the future. The Department should also expand the scope of its examination of improper payments to include disbursements made by grantees.*

11. Prompt Payments

The Department is currently paying approximately 75 percent of its domestic invoices on time as compared with the government-wide goal of 98 percent. Further, the Department is paying approximately \$750 per \$1 million in interest payments. The government-wide goal is to reduce this amount to \$300 per \$1 million in payments.

Although the Department has implemented new processes intended to enhance its performance in this area that have resulted in a marked decrease in the amount of interest paid, the percentage of invoices not paid timely has not changed significantly.

*We recommend that the Department continue to strengthen its procedures for timely payment of invoices with the aim of increasing the percentage of invoices being paid timely.*

12. Controls Over Cash and Cash Receipts at Posts

Our review of controls at posts disclosed several common areas requiring attention, including the following:

- lack of formal designation for cashiers and back-up cashiers and
- lack of documentation demonstrating cashier training.

*We recommend that the Department reemphasize to staff at posts the need to comply with established internal control procedures over cash and cash receipts.*

13. Information Technology Security

Although the Department has developed and implemented an improved information technology security program, issues pertaining to potential access remain.

*We recommend that the Department continue its efforts to enhance security over its information technology.*

14. Indirect Cost Allocation for Construction in Progress

During our test of indirect cost allocations related to construction in progress, we noted an error made by the Department related to calculating the direct cost base. This error will cause an incorrect amount of indirect cost allocation among projects.

*We recommend that the Department reassess its methodology for calculating the indirect cost base related to construction in progress.*

15. Personal Property

We identified controls over personal property as a material weakness in our report on the Department's FY 2007 and 2006 financial statements. However, because this issue is significant, we are providing additional details in this management letter on issues that were identified as follows:

- Although the Department continues to improve its oversight of property in the hands of contractors, additional work is needed to ensure that the Department is correctly reporting this information.

*We recommend that the Department enhance its processes for obtaining appropriate supporting documentation for assets and for identifying and training property administrators.*

- We noted a significant number of acquisitions recorded in FY 2007 that had actually been acquired in prior years. In addition, we noted a number of disposals recorded in FY 2007, especially related to vehicles that had actually been disposed of during prior years.
- We found that the acquisition cost of some items had not been entered correctly and that the sale proceeds for some items were not recorded properly.
- The salvage value listed on the disposal report does not always match the salvage value in the GFMS.
- Some posts did not prepare the Property Management Report properly.
- We noted, during our work at overseas posts, a number of instances in which the number of motor vehicles included in the inventory system was not accurate.

*We recommend that the Department take appropriate action to improve controls over personal property, both in domestic bureaus and at overseas posts.*



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**OMB Circular A-123 Findings**

Cycle	Application	Finding/Control Weakness
Financial Reporting – Proprietary	Journal Voucher (JV) Processing	<p>The Department does not have formal desk procedures to ensure sufficient control over the JV process.</p> <p><i>The Department should develop procedures for processing JVs.</i></p>
	JV Processing	<p>A JV that is both entered and approved by the same person is not always verified for accuracy and propriety after being posted to the accounting system.</p> <p><i>The Department should independently review, in a timely manner, a JV that undergoes input and approval by the same accountant.</i></p>
	JV Processing	<p>The Department did not have adequate controls in place to oversee the preparation and recording of JVs, which increased the likelihood that financial statement adjustments could be recorded improperly.</p> <p><i>To improve the operational effectiveness of the JV process, the Department should (1) develop formal procedures for the JV process and (2) ensure that staff accountants receive training outlining the proper procedures to follow when preparing and recording JVs.</i></p>
	Intragovernmental	<p>The Department does not have assurance that all intragovernmental transactions have been properly identified for financial presentation and disclosure because the accounting system does not provide sufficient detail to ensure proper identification during the intragovernmental process.</p> <p><i>The Department should strengthen the accounting system's business rules to accurately identify the Federal/non-Federal attribute and trading partner so that accurate data are captured when transactions are recorded.</i></p>
	Intragovernmental	<p>Data used in the intragovernmental process are not reconciled to the trial balance to ensure proper summarization.</p> <p><i>The Department should reconcile intragovernmental amounts to the trial balance.</i></p>













Cycle	Application	Finding/Control Weakness
Grants	Expenses	<p>One bureau did not use appropriate obligating documents to establish obligations. The obligations were recorded based upon e-mail correspondence.</p> <p><i>The Department should use proper obligating documents when processing obligation transactions.</i></p>
	Expenses	<p>One bureau did not obtain a voucher to support the validity of travel costs related to financial assistance provided to a speaker.</p> <p><i>The Department should require travelers to provide vouchers to support travel costs.</i></p>
Payroll Expenses	FSN Payroll Processing and Accounting	<p>Bi-Weekly FSN payroll and benefit amounts are not reconciled to subsidiary records to ensure accuracy.</p> <p><i>FSN payroll amounts should be verified. Specifically, the dollar value of FSN payroll-related transactions should be reconciled to amounts recorded in subsidiary records to ensure accuracy.</i></p>
	American Payroll - Time and Attendance	<p>The Department needs to improve the operating effectiveness of controls over time and attendance (T&amp;A).</p> <p><i>To ensure the completeness and accuracy of payroll expenses, the Department should ensure that (1) supervisors review and approve T&amp;A reports to ensure accuracy, (2) T&amp;A and leave slips are retained for 6 years, and (3) leave is properly approved.</i></p>
	Payroll Processing and Accounting	<p>The Department does not clear all payroll transactions from the suspense account in a timely manner.</p> <p><i>The Department should establish a benchmark that defines acceptable clearance rates and use this benchmark to determine effectiveness and indicate when further actions to clear transactions are needed.</i></p>
Cash Receipts and Revenue	Reimbursable Agreements-Transaction Recording	<p>The Department recognizes earned revenue at the time the reimbursable agreement is approved rather than when the services or goods are provided.</p> <p><i>The Department should recognize earned revenue when the services or goods are provided.</i></p>
	Fee Collections	<p>The current procedure used to monitor collections processed by lockbox banks is ineffective because reconciling items are not resolved prior to posting collections in the accounting system.</p> <p><i>The Department should identify and resolve reconciling items with the bank in a timely manner.</i></p>



Cycle	Application	Finding/Control Weakness
	Reimbursable Agreements-Transaction Recording	<p>The Department processed an invalid IPAC collection based on an incomplete analysis of supporting documentation.</p> <p><i>The Department should ensure that billings are fully supported prior to executing IPAC transactions. In addition, the Department should determine whether outstanding accounts receivable are related to IPAC differences identified as part of the SF-6652 reconciliation.</i></p>
<b>Property, Plant, and Equipment</b>	Personal Property- Contractor Held	<p>The Department did not have adequate controls in place over accounting for personal property. Specifically, the Department did not have a fully effective system to identify and record property in the hands of contractors. The controls over accounting for aircraft, vehicles, and other personal property were not fully effective.</p> <p><i>The Department should develop a plan to address these issues.</i></p>
	Real Property	<p>Posts do not update the real property system for errors discovered by the Bureau of Overseas Buildings Operations (OBO).</p> <p><i>Posts should record corrections when notified by OBO.</i></p>
	Personal Property - Internal Use Software	<p>The Department did not have adequate controls over reporting internal use software as follows: (1) the data needed for accounting entries were not integrated, (2) there were no standardized business rules to establish acceptance, (3) indirect costs were not being applied to the cost of the software development, (4) costs representing operating expenses were often grouped together with capitalized costs on contract line items, and (5) billings were not project specific and bureaus did not maintain crosswalks to detail what invoice amounts related to which project.</p> <p><i>The Department should develop a methodology to ensure the complete and accurate recording and reporting of capitalized software.</i></p>