Management Letter Related to the Audit of the Department of State's Restated 2006 and 2005 Financial Statements

AUD/FM-07-11, June 2007

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December 12, 2006

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

Under generally accepted auditing standards, auditors are encouraged to report on "significant deficiencies in the design or the operation of the internal control structure that, in the auditor's judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements." In addition, auditors are encouraged to report, in a separate management letter, less material issues.

In performing an audit of the Department of State's (Department) restated Consolidated Balance Sheets, restated Consolidated Statements of Net Cost, restated Consolidated Statements of Changes in Net Position, Combined Statements of Budgetary Resources and restated Combined Statements of Financing as of and for the years ended September 30, 2006 and 2005, we considered the Department's internal control in determining the nature, timing, and extent of the audit tests applied in connection with our audit. Additionally, in accordance with Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*, for those significant internal control policies and procedures that were properly designed and placed in operation, we performed sufficient tests to justify a low assessed level of control risk consistent with *Statement on Auditing Standards* No. 55, promulgated by the American Institute of Certified Public Accountants. Our consideration of internal control did not entail a detailed study and evaluation of any of its elements and was not made for the purpose of making detailed recommendations or evaluating the adequacy of the internal controls to prevent or detect all errors and irregularities.

The Department's management is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures.

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with the comprehensive basis of accounting described in OMB Bulletin No. A-136, *Financial Reporting Requirements.*

Because of inherent limitations in any internal controls, errors or irregularities may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that it may become inadequate because of changes in conditions or deterioration in operating effectiveness.

Although the purpose of our consideration of internal control was not to provide assurances thereon, matters came to our attention that we want to report to you. These matters are discussed in Attachment 1. They do not affect our report dated December 12, 2006, on the Department's financial statements referred to above. We are also including internal control issues reported by the Department during its annual assessment of internal control over financial reporting required by OMB Circular A-123, *Management's Responsibility for Internal Control*, in Attachment 2. We believe that it is important for the Department to address these weaknesses, and so we plan to track the Department's progress in making the necessary improvements.

This report is intended solely for the use of the Department's management. This restriction is not intended to limit the distribution of this report, which is a matter of public record. The Department's comments on this report appear as Attachment 3.

Very truly yours,

Leonard G. Birnbaum and Company, LLP

Attachments: As stated.

U.S. Department of State
Audit of Restated Financial Statements
September 30, 2006 and 2005

Observations and Conclusions

1. Fund Balance With Treasury

The absolute value amount of the unreconciled difference between the adjusted Treasury balance and the adjusted Central Financial Management System (CFMS) balance increased. As of September 30, 2006, the amount of this difference was approximately $78 million.

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

2. Accounts Receivable – General

Our review of accounts receivable disclosed that the amounts presented on the balance sheet included amounts from fund 3200, which is reserved as the repository for accounts receivable related to expired funds. Such receivables, if deemed collectible, are properly reported by the Department of the Treasury.

We recommend that the Department implement such procedures as are necessary to preclude the presentation of receivables related to expired funds as departmental assets.

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 ensure that its planned conversion from CFMS to the Global Financial Management System include establishment of an overseas accounts payable subsidiary ledger.

4. Payroll Accruals

Although we understand the logic behind the Department's payroll accrual methodology, the amounts accrued for payroll as of September 30, 2006 and 2005, were approximately 20 percent less than the amount which should have been accrued.

We recommend that the Department reexamine its process for accruing payroll to enhance the accuracy of payroll accruals. Consideration might be given to continuing to calculate automated accruals and to making an adjustment, via a Hyperion journal voucher, for categories of pay that are not included in the automated accruals.

5. Payroll Documentation

Our tests disclosed that the Department did not have all required documentation in all employees' official personnel files, including SF-50s, Federal Employee Health Benefit forms, life insurance election forms for employees electing such coverage, or SF-2817s for employees electing no life insurance.

We recommend that the Department take appropriate steps to ensure that copies of required authorizations for all payroll deductions are maintained in personnel files.

6. Prompt Payments

The Department is paying approximately 85 percent of its domestic invoices on time while the governmentwide goal is that 98 percent of invoices be paid in a timely manner. 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 as required by the Prompt Payment Act, the percentage of invoices not paid in a timely manner 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 in a timely manner.

7. 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 the Department should include all artwork in the count of heritage assets unless it 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.

On the basis of our examination of controls in embassies, we noted the following areas of concern:

- At one post we visited, a number of heritage assets, including paintings, were missing identification codes.

We recommend that the Department ensure that all heritage assets are appropriately labeled for tracking purposes.

- The Department indicated that Embassy Bangkok has no heritage property.

We recommend that the Department confirm this. If the embassy does have heritage property, we recommend that it be properly recorded.

- We noted confusion at several posts about heritage assets. One post had items that were not recorded as heritage assets, which we believe should have been.

We recommend that the Department reinforce the existing policies on heritage assets with posts. In addition, the Department needs to develop a better process to identify and report heritage assets on its annual financial statements.

8. 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 Performance and Accountability Report (1) does not identify each major class of asset for which maintenance has been deferred, (2) does not include a description of the requirements or standards for acceptable operating condition, and (3) does not include deferred maintenance for heritage assets other than real property and furniture and fixtures associated with real property.

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

9. OMB Circular A-123

During FY 2006, the Department undertook an extensive effort to document its internal controls as required by OMB Circular A-123. Although this effort met the requirements of the circular and resulted in comprehensive coverage of controls and recommended avenues of remediation that are practical and economical, the Department has not yet developed a corrective action plan. (See Attachment 2 for a detailed listing of findings.)

We recommend that the Department develop a corrective action plan, including milestones, to implement the remedial activity recommended by its assessment of internal controls.

We noted that the assessment documentation for Fund Balance With Treasury, Foreign Service Retirement and Disability Fund, Contributions to International Organizations, Grants, and Financial Reporting – Proprietary included a section on the methodology used to identify the subcycles and accounting applications, to gain an understanding of the processes, and to assess the effectiveness of the internal controls. We believe that the assessment documentation for the other cycles could be improved if the Department included a similar description of the methodology used.

We recommend that the Department provide additional information on methodology for the following cycles: Cash Receipts and Revenues; Cash Disbursements and Expenses; Budgetary Resources; Procurement; Payroll and Benefits; Business Type Funds; Property, Plant, and Equipment; and Financial Reporting – Budgetary.

10. Controls Over Cash and Cash Receipts – Posts

Our review of cash and cash receipts at overseas posts disclosed a number of issues that the Department should address. For instance, we found a number of issues related to security over cash, such as inadequately secured cashier booth doors, cash drawers, or cash boxes in Tokyo, Tel Aviv, Lima, and Seoul. In addition, we found that the safe combinations had not been changed every 12 months as required in Tokyo. We also found either inadequate or nonexistent, locally developed cashiering procedures at Tokyo, Tel Aviv, Brasilia, Lima, and Seoul. We also questioned the training provided to either cashiers or supervisors in Tokyo, Tel Aviv, Cairo, Brasilia, and Seoul. In addition, the accountable consular officer and consular cashiers had not been formally designated in writing in Tokyo, Lima, and Seoul. We also found that:

- random cash count documentation had not been reviewed by the financial management officer in Embassy Tokyo;
- the OF-158s were not provided to the accountable consular officer in a timely manner in Tel Aviv; and
- the accountable consular officer was not reviewing the exception and logging activity reports every week in Seoul.

We recommend that the Department ensure that posts strengthen controls over cash and cash receipts.

11. State and Federal Income Tax Withholding

During testing of state and federal income tax withholding, the Department was unable to provide us with a copy of the W-4 for 12 out of 25 employees tested. We also noted that the amount of federal income tax withheld from three of the 25 employees and state income tax withheld for 11 of the 25 employees did not meet the requirements. In many cases the differences were immaterial; however, this is an issue that the Department should assess.

We recommend that the Department ensure that it has a copy of the W-4 for all employees. In addition, it should develop a process to review the amount of withholdings for state and federal income taxes.

12. Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A) does not follow the guidance contained in OMB Circular A-136, *Financial Reporting Requirements*. For instance, the MD&A does not address the possible future effects of existing events and conditions. In addition, the MD&A did not include an explanation of plans and timelines to make improvements when performance targets were not met. Also, it did not include an evaluation of the significance of underlying factors that may have affected reported performance.

We recommend that the Department follow the guidance contained in OMB Circular A-136 in developing its MD&A.

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

Our actuary provided a number of suggestions on how the Department could improve its actuarial report related to the Foreign Service Retirement and Disability Fund, as follows:

- The report could have shown results before and after the actuarial assumption changes.
- The report could have shown the development of the normal cost percentage.
- The report could have shown the actuarial gain or loss from the assumption changes.
- The report could have information about future cash flows or future benefit payments or both.
- The report could have shown the rate of return of assets.
- Additional details regarding the method used to determine the amortization of unfunded liability would help users.

We recommend that the Department consider the suggestions provided by the independent actuary during future actuarial assessments.

U.S. Department of State
Audit of Restated Financial Statements
September 30, 2006 and 2005

Circular A-123 Findings

Cycle	Application	Finding/Control Weakness
Financial Reporting – Proprietary	Journal Voucher (JV) Processing	The Department does not have formal desk procedures to ensure sufficient control over the JV process.
	JV Processing	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.
	Intragovernmental	The Department does not have assurance that all intragovernmental transactions have been properly identified for financial presentation and disclosure because CFMS does not provide sufficient detail to ensure proper identification during the intragovernmental process.
	Intragovernmental	Data used in the intragovernmental process are not reconciled to the trial balance to ensure proper summarization.
	Intradepartmental Eliminations and Financial Statement Preparation	The supervisory review process overseeing the preparation of supporting schedules, financial statements, and disclosures lacks a sufficient audit trail to provide evidence: edit checks performed, revisions made, and review by management.
	Allocation Transfers	The Department received no assurance from child agencies that the trial balances are accurate and valid.
	Allocation Transfers	The Department receives no assurance from the International Boundary and Water Commission (IBWC) that the trial balances are accurate and valid.
	Allocation Transfers	There is no documented history supporting management's decisions of what allocation transfer accounts to include in or exclude from the Department's reporting entity.

Cycle	Application	Finding/Control Weakness
Budgetary Resources	Apportionment of Budgetary Resources, Processing of Treasury Documents, Allotments	The Department does not have specific guidance for recording certain accounting transactions in compliance with the Foreign Affairs Manual and Handbook.
Procurement	Procurement	A majority of the Department's bureaus do not routinely review obligation transactions or unliquidated obligation balances to ensure accuracy and continued validity.
Fund Balance With Treasury	SF-6652 Reconciliation	The Department's reconciliation of domestic transactions reported to and recorded by Treasury is not completely effective because significant unmatched items remain unresolved beyond the 90-day timeframe established by Treasury.
	SF-6655 Reconciliation	The Department's reconciliation of receipt accounts is inadequate because differences identified between the Department's balances and Treasury's are not researched and resolved.
	SF-6655 Reconciliation	The Department does not have policies and procedures that fully document the process to reconcile special fund deposits reported by Treasury (on the SF-6655) with the deposits reported by the Department.
	SF-224 Payroll	The Department does not have documented policies and procedures for its SF-224 Payroll reporting.
International Organizations (IO)	IO's Obligations & Expenses	IO does not have written standard operating procedures for financial transactions that are comprehensive and up-to-date.
	Liability Accruals	Specific procedures related to IO's liability accruals are not up-to-date and do not reflect current practices.
	Liability Accruals	IO and the Bureau of Resource Management do not sufficiently coordinate to determine if the liability valuation accrual is reasonable.

Cycle	Application	Finding/Control Weakness
	Bureau of Population, Refugees and Migration's (PRM) – Obligations & Expenses	PRM's written standard operating procedures related to the processing of financial assistance transactions are not up-to-date.
FSRDF	Contributions, Annuity Payments, Purchases & Redemptions, Interest Income	The Department does not maintain a current policy manual describing FSRDF accounting procedures.
	Purchases & Redemptions, Interest Income	Investment transactions are not approved by management before recording in the general ledger.
	Actuarial Liability	The Department does not have sufficient procedures in place to fully verify the reliability of personnel data to be used to calculate the actuarial liability.
Cash Disbursements and Expenses	Vendor Payments – Overseas	CFMS general ledger balances that reflect overseas accounting transactions are not reconciled to subsidiary ledgers, such as the Regional Financial Management System (RFMS), to ensure accuracy.
	Vendor Payments – Overseas	Procedures and automated systems do not exist to ensure compliance with significant provisions of the Prompt Payment Act for payments processed at overseas posts.
	Reimbursable Agreements – Obligations	A majority of bureaus do not routinely review obligation transactions or unliquidated obligation balances to ensure accuracy and continued validity.
	Reimbursable Agreements – Expenses	Reimbursable expense transactions recorded based upon Interagency Payment, Accounting and Collection System transactions are not routinely reviewed by cognizant officials to ensure validity.
	Purchase Cards	The Department cannot completely ensure the validity and accuracy of domestic purchase card transactions because all offices do not provide reconciled individual statements to the Office of Claims.
Grants	Grant Advances	The Department does not record grant-advance transactions in accordance with federal accounting standards.

Cycle	Application	Finding/Control Weakness
Financial Reporting – Budgetary	SF-133 Preparation	Summary-level adjustments made to budgetary balances are not sufficiently supported by transaction-level detail. These adjustments are necessary because the Department's accounting system does not post all budgetary accounting events in accordance with Standard General Ledger guidance.
	Statement of Budgetary Resources (SBR) Preparation	The Department has not updated its procedures manual to reflect the current process for preparing the SBR.
	SBR Preparation	The Department does not receive any supporting documentation with the SF-133s from IBWC and child agencies.
Cash Receipts and Revenue	Fee Assessment and Recording – Domestic	The current procedure used to monitor collections processed by lockbox banks is ineffective because reconciling items are not resolved before posting collections in CFMS.
	Reimbursable Agreements – Transaction Recording	The Department recognizes earned revenue at the time the reimbursable agreement is approved rather than at the time provided.
Property, Plant, and Equipment	Real Property – Overseas Construction in Progress	Responsible parties at the posts do not always notify the Bureau of Overseas Buildings Operations (OBO) about completed projects in a timely manner.
	Real Property – Overseas Construction in Progress	OBO does not report completed overseas construction in progress during quarterly data calls.
	Real Property – Domestic	Domestic real property is not recorded within Momentum Fixed Assets. As a result, posting domestic real property transactions, such as acquisitions, disposals, and depreciation, in the general ledger is a manual process and more prone to error.
	Real Property – Overseas Capital Leases	Posts do not update the real property system for errors discovered by OBO.

Cycle	**Application**	**Finding/Control Weakness**
	Personal Property – Acquisitions & Disposals (Security Equipment)	The Department's policies and procedures – "Asset Management – Posts Abroad Standard Operating Procedures" and "Guidelines for Tracking Diplomatic Security Program Property Overseas" – are not updated.
	Personal Property – Acquisitions & Disposals (Security Equipment)	Inservice dates are recorded when the equipment is received and not when installed and put in service.
	Personal Property – Acquisitions/Transfers/Disposal (Aircraft)	A systematic process does not exist to record the acquisition, disposal, and transfer of aircraft to host countries.
	Personal Property – NEPA/WEBNEPA, ILMS, LRA/TSCM, Charleston Recording and Reporting	The Department has errors in reporting personal property data (i.e., acquisition costs, fiscal strip data, acquisition dates, and inservice dates) in the property systems. The property system data are recorded in CFMS through the interface program.
	Personal Property – NEPA/WEBNEPA, ILMS, LRA/TSCM, Charleston Recording and Reporting	Posts and bureaus make changes to acquisition costs, inservice dates, acquisition dates, and fiscal strip data resulting in incorrect property records.
	Personal Property – Acquisitions NEPA/WEBNEPA, ILMS, LRA/TSCM	Incorrect inservice dates lead to errors in the calculation of depreciation.
	Personal Property – Acquisitions & Disposals (Overseas Vehicles)	Posts do not report acquisition and disposal of vehicles acquired overseas in a timely manner.
	Personal Property – Contractor Held	A systematic process does not exist to record capitalized property in the hands of contractors.
	Personal Property – ILMS, NEPA/WEBNEPA, LRA/TSCM Equipment	There are significant discrepancies between physical inventories of property conducted by posts and bureaus and inventories as recorded in property systems.
	Personal Property – Charleston Reporting and Recording	Interfaces between property systems and between the property and accounting systems generate an excessive number of errors.
	Personal Property – Charleston Reporting and Recording	The Integrated Logistics Management System contains multiple cost row records not being properly processed in Momentum Fixed Assets.

Cycle		Application		Finding/Control Weakness
		Personal Property – Software in Development		Data needed to prepare internal use software accounting entries are not integrated within CFMS.
		Personal Property – Software in Development		There were no standardized business rules to establish the acceptance of software in development.
		Personal Property – Software in Development		Indirect costs (overhead) are not being applied to the cost of the software development.
		Personal Property – Software in Development		The contracting process results in the lack of an audit trail because costs representing operating expenses are often grouped together with capitalized costs on contract line items.
		Personal Property – Software in Development		Billings are not project-specific and bureaus do not maintain crosswalks to detail what invoice amounts relate to which project.

United States Department of State

Washington, D.C. 20520

MAY 16 2007

UNCLASSIFIED
MEMORANDUM

TO: OIG/AUD – Mr. Mark W. Duda

FROM: RM/DCFO – Christopher H. Flaggs CHF

SUBJECT: Response to FY 2006 Draft Management Letter

We have reviewed the draft management letter for the Department's Principal Financial Statements for Fiscal Year (FY) 2006. The attachment, which is keyed to the paragraphs in the letter, provides comments on and/or status of each recommendation.

As described in the attachment, we believe the Department is making progress in implementing corrective actions. Our commitment to strong internal controls will continue, particularly as evidence in our compliance with the OMB circular A-123 Appendix A requirements in FY 2006.

If you have any questions concerning this status summary, please contact me at (202) 261-8620.

Attachment: As stated.

cc: RM/EX – Mr. Philip J. Schlatter, Acting
RM/GFS – Mr. James L. Millette
Birnbaum and Company – Mr. Leslie Leiper

U.S. DEPARTMENT OF STATE
RESPONSE TO FY 2006 MANAGEMENT LETTER
Recommendations

1. Fund Balance with Treasury

We recommend that the Department continue its efforts to reduce unreconciled differences between the adjusted Treasury balance and the adjusted Central Financial Management System (CFMS) balance.

Response: We agree with the recommendation. We have taken a project approach to the issues and committed funding and staff to a two-year comprehensive analysis and reconciliation effort. We have made permanent adjustments to our reconciliation procedures including: 1) Greater emphasis on root cause analysis and identification of long-standing systemic issues; 2) Improved collaboration with other financial operations and financial systems offices; and 3) Coordination of analysis with the Treasury Statement of Differences project. This revised approach more correctly takes into account issues that contributed to original and current imbalances with Treasury. There is a high degree of linkage with the Statement of Differences project as adjustments made years ago to correct Statement of Differences created fund imbalances and fund adjustments through the 224 reporting mechanism created Statement of Differences balances.

Our original estimate for the completion of both projects, Fund Balance with Treasury and Treasury Statement of Differences was June 30, 2008. We are on track to meet those dates and will accelerate the process if possible. Reconciliation of the cash differences sometimes requires the complex creation of original reporting and recording point-in-time information, development of analytical databases and reports, and accessing large volumes of Department of State and Department of Treasury data. Adjustments to one period or fund may adversely affect another, requiring additional research. We have applied the right resources to meet the reconciliation objectives in a reasonable timeframe and are working closely with Treasury to identify anything else that could be done.

U.S. DEPARTMENT OF STATE
RESPONSE TO FY 2006 MANAGEMENT LETTER
Recommendations

2. Accounts Receivable

We recommend that the Department implement such procedures as are necessary to preclude the presentation of receivables related to expired funds as departmental assets.

Response: We will preclude the reporting of receivables related to cancelled funds as Departmental assets in FY 2007. They will either be excluded or reported (net of allowance) as nonentity assets. However, any collections of receivables from cancelled funds will be reported as distributed offsetting receipts in accordance with the provisions in the OMB circular A-136.

3. Accounts Payable

We recommend that the Department ensure that its planned conversation from CFMS to the Global Financial Management System include establishment of an overseas accounts payable subsidiary ledger.

Response: We concur with the intent of the recommendation, which is to establish an overseas accounts payable subsidiary ledger. After the Global Financial Management System (GFMS) is implemented and the process for creating an accounts payable subsidiary is operational, RM plans to expand the use of this process to the Regional Financial Management System (RFMS) to create an overseas accounts payable subsidiary.

4. Payroll Accruals

We recommend that the Department re-examine its process for accruing payroll to enhance the accuracy of payroll accruals. Consideration might be given to continuing to calculate automated accruals and to making an adjustment, via a Hyperion journal, for categories of pay that are not in the automated accruals.

Response: The variance was explained during the audit. However, as we do with all of our accrual processes, we will continue to monitor and revise accordingly the methodology for preparing the accrual. As suggested by the auditor, we will adjust, as needed, for categories of pay that are non-recurring in nature (e.g., overtime) and therefore not in the automated accruals.

U.S. DEPARTMENT OF STATE
RESPONSE TO FY 2006 MANAGEMENT LETTER
Recommendations

5. Payroll Documentation

We recommend that the Department take appropriate steps to ensure that copies of required authorizations for all payroll deductions are maintained in personnel files.

Response: Employees' SF-50s, SF-2817, Federal Employee Health Benefit forms and life insurance forms are part of the employee's electronic official personnel folder and maintained by the Bureau of Human Resources. Authorized payroll staff has access to review the employees' electronic official personnel folder.

Payroll maintains paper files for the actions sent to payroll for processing. The vast majority of employees no longer submit paper documents to payroll for changes. Employees have found it more efficient to make on-line changes to their allotments, taxes, Thrift Savings Plan and Health Benefits through a secure on line system.

6. Prompt Pay

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 in a timely manner.

Response: The Department has improved its on-time payment rate for domestic invoices to approximately 90 percent, against the government-wide standard of 98 percent of invoices to be paid in a timely manner. The Department has identified the primary operational causes for late payments and technical issues in the automated on-time calculations, which may have undercounted the number of claims paid on time. As a result, the Department has narrowed its efforts to focus on the root operational causes of the payment delays. In addition, the Department is transitioning to the Global Financial Management System and has revised the basis for collecting Prompt Payment data, which significantly improves the quality of automated data used to calculate on-time percentages.

U.S. DEPARTMENT OF STATE
RESPONSE TO FY 2006 MANAGEMENT LETTER
Recommendations

7. Heritage Assets

- We recommend that the Department include all artwork, including "inactive" property, in its count of heritage assets.
- We recommend that the Department ensure that all heritage assets are appropriately labeled for tracking purposes.
- We recommend that the Department confirm this (this refers to Embassy Bangkok having no heritage assets). If the embassy does have heritage property, we recommend that it be properly recorded.
- We recommend that the Department reinforce the existing policies on heritage assets with posts. In addition, the Department needs to develop a better process to identify and report heritage assets on its annual financial statements.

Response: RM will work with the Bureau of Administration, which is responsible for 14 FAM on asset management, and the owning organizations of the heritage assets to clarify and reinforce, as necessary, the guidance on heritage assets. Concerning OIG's recommendation about identification codes on heritage assets, we would note that an acceptable alternative to placing a barcode on a heritage asset is to photograph the asset and place the barcode on the asset.

GFS reviewed the most current WebNEPA file from Embassy Bangkok and was able to verify that there are no heritage assets currently recorded. GFS is corresponding with the Embassy to confirm date and details of changes to WebNEPA and will record the corresponding adjustment to the Department's records.

8. Deferred Maintenance

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

Response: In order to meet the intent of this recommendation, we will provide additional detail in our FY 2007 Required Supplementary Information section of the Performance and Accountability Report concerning deferred maintenance.

U.S. DEPARTMENT OF STATE
RESPONSE TO FY 2006 MANAGEMENT LETTER
Recommendations

9. OMB Circular A-123

We recommend that the Department develop a corrective action plan, including milestones, to implement the remedial activity recommended by its assessment of internal controls.

Response: The Department will prepare formal corrective action plans for any reportable conditions during FY 2006 as agreed to by the Senior Assessment Team. For the other deficiencies listed in OIG's attachment, we will follow up during our FY 2007 work to identify corrective actions taken and test any new controls that have been implemented.

We concur with the recommendation to include a methodology section in the cycle documentation and will add that narrative during the FY 2007 work.

10. Controls over Cash and Cash Receipts – Post

We recommend that the Department ensure that posts strengthen controls over cash and cash receipts.

Response: RM/GFS/S accepts recommendation #10 and will draft an ALDAC reiterating post's responsibilities, in accordance with 4 FAH and the Cashier User Guide, to strengthen controls over the issues addressed in this recommendation.

11. State and Federal Income Tax Withholding

We recommend that the Department ensure that it has a copy of the W-4 for all employees. In addition, it should develop a process to review the amount of withholdings for state and federal income taxes.

Response: The Department agrees that a paper W-4 for each employee should be part of the original paperwork signed by a new employee when they enter the work force. This information is sent to the payroll office and is maintained as part of the payroll folder. Employees may elect to change their W-4 election at anytime. If an employee submits a change to payroll, the change is made and the paperwork is filed. Employees now have become adept at making on-line W-4 changes.

U.S. DEPARTMENT OF STATE
RESPONSE TO FY 2006 MANAGEMENT LETTER
Recommendations

We have begun an effort to ensure that employees are aware of the basis for our income tax withholdings. At the conclusion of this effort and in combination with the electronic filing, we expect to greatly improve our tax withholding documentation.

12. Management's Discussion and Analysis

We recommend that the Department follow the guidance contained in OMB Circular A-136 in developing its MD&A.

Response: We appreciate the OIG's comments and recommendations regarding the completeness of Management's Discussion and Analysis (MD&A) in the FY 2006 Performance and Accountability Report (PAR). The Department of State makes every effort to comply fully with applicable OMB guidance on the PAR and will continue to do so. We acknowledge that the MD&A did not directly address the possible future effects of existing events and conditions. This information is, however, included in the Message from the Secretary, which appears before the MD&A in the PAR. For example, the Secretary discusses the impact of the conflict against terrorists and violent extremists on diplomatic readiness and deployment, foreign assistance programming, and strategic partnering. In the future, we will ensure that information of this nature is included in the MD&A as well.

We also acknowledge that the MD&A lacks specific plans and timelines for making improvements when targets were not met. However, the discussion of Performance Management in the MD&A describes the Mission Strategic Plans and Senior Policy, Performance and Resource Reviews, which are annual performance review processes that integrate performance planning into diplomatic and assistance programs. The Department included performance targets and detailed plans and timelines for improving program performance in the performance tables of the Performance Section of the PAR. Measures that were rated below or significantly below target, for example, include extra fields that describe the reason for shortfall and steps the Department will take to improve performance. In the future, we will ensure that this information is also reflected in the MD&A to the extent possible.

Similarly, we acknowledge that the MD&A does not include an evaluation of the significance of underlying factors that may have affected reported performance.

U.S. DEPARTMENT OF STATE
RESPONSE TO FY 2006 MANAGEMENT LETTER
Recommendations

The wide range of Department activities made it extremely difficult to identify a limited number of underlying factors that may have affected performance on individual initiatives. As a result, this information was included in the Performance Section, where specific initiatives have dedicated indicators that discuss the impact of internal and external factors that may have affected performance. In the future, we will ensure that this information is also reflected in the MD&A to the extent possible.

13. Foreign Service Retirement and Fund's Actuarial Liability

We recommend that the Department consider the suggestions provided by the independent actuary during future actuarial assessments.

Response: We will consider the report's recommendations in making future actuarial assessments.