United States Department of State
and the Broadcasting Board of Governors

Office of Inspector General

MAR 29 2012

MEMORANDUM

TO: RM – James L. Millette

FROM: OIG – Harold W. Geisel

SUBJECT: Report on *Management Letter Related to the Audit of the U.S. Department of State FY 2011 Financial Statements* (AUD/FM-12-06)

The subject report is attached for your review and action. The report contains informal recommendations that will not be subject to the Office of Inspector General (OIG) formal compliance process, but the recommendations will be verified during the audit of the FY 2012 financial statements.

OIG incorporated your comments as appropriate within the body of the report and included them in their entirety as Appendix B.

OIG appreciates the cooperation and assistance provided by your staff during this audit. If you have any questions, please contact Evelyn R. Klemstine, Assistant Inspector General for Audits, at (202) 663-0372 or Gayle Voshell, Director, Financial Management Division, at (703) 284-2681 or by email at voshellg@state.gov.

Attachment: As stated.

cc: RM/DCFO – (b) (6) [redacted]
RM/EX – (b) (6) [redacted]
Kearney & Company, P.C. – (b) (6) [redacted]

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MANAGEMENT LETTER
AUD/FM-12-06

To the Secretary and the Inspector General of the U.S. Department of State

We (Kearney & Company, P.C.) have audited the consolidated financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2011, and have issued our report thereon dated November 14, 2011.[1] In planning and performing our audit of the Department's consolidated financial statements, we considered the Department's internal control over financial reporting and compliance in order to determine our auditing procedures for the purpose of expressing an opinion on the consolidated financial statements and not to provide assurance on internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control related to financial reporting and compliance. We have not considered the Department's internal control since the date of our report on the FY 2011 financial statements.

During our audit, we noted certain matters related to internal control over financial reporting and compliance that we considered to be material weaknesses or significant deficiencies under standards established by the American Institute of Certified Public Accountants. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our report on internal control noted two material weaknesses. Specifically, we noted areas of concern related to financial reporting and Foreign Service National after-employment benefits. Our report also described five matters related to internal control that we considered to be significant deficiencies. Specifically, we noted areas of concern related to property and equipment, budgetary accounting, unliquidated obligations, certain accrual processes, and information technology.

Our procedures were designed primarily to enable us to form an opinion on the Department's consolidated financial statements and therefore may not have identified all internal control weaknesses that may exist. However, we would like to use the knowledge we gained during our audit of the Department to provide comments and suggestions that we hope can be useful to the Department.

[1] *Independent Auditor's Report on the U. S. Department of State 2011 and 2010 Financial Statements* (AUD/FM-12-05, Nov. 2011).

Although not considered to be significant deficiencies, we noted certain other matters involving internal control and operations. These findings and recommendations, which are summarized in Appendix A, are intended to assist the Department in improving internal control or to result in other operating efficiencies. These findings and recommendations have been discussed with appropriate Department officials. Comments by Department management on this report are presented as Appendix B.

We appreciate the assistance provided by the Department's personnel during our audit.

This letter is intended solely for the information and use of Department management, those charged with governance, and others within the Department and the Office of Inspector General and is not intended to be and should not be used by anyone other than these specified parties.

Kearney & Company

March 29, 2012
Alexandria, Virginia

MANAGEMENT LETTER COMMENTS

COMMENTS REPEATED FROM PRIOR YEAR

During the audit of the U.S. Department of State's (Department) FY 2010 financial statements, we (Kearney & Company, P.C.) identified matters that we reported in a management letter.[1] The findings described in the management letter related to the FY 2010 financial statement audit remain open. These findings were updated with information obtained during the audit of the Department's FY 2011 financial statements.

I. General Issue

Finding:
Documentation Not Provided in a Timely Manner

As part of the financial statement audit, we made requests for data and documentation in order to validate and substantiate account balances and transactions that support the Department's financial statements. In general, the data we requested should be an integral component of the Department's internal control structure and therefore should have been readily available.

The Department did not always provide documentation in a timely manner. Table 1 provides an overall summary of audit documentation requests and the length of time the requests were overdue (based on the provided-by-client list [PBC] containing 721 requests that were due on or before October 31, 2011).

Table 1. Response Time for Audit Requests

	Total Requests Due by 10/31/2011	Received by Due Date	Received One Week or Less After Due Date*	Received Between One and Two Weeks after Due Date*	Received Between Two and Three Weeks After Due Date*	Received More Than Three Weeks After Due Date*
PBC Requests	721	385	139	77	40	79
Percent	100	53	19	11	6	11

*We considered 1 week to be 5 business days.

We found that delays in providing documentation may have been caused by a number of factors. For instance, we noted that the Department sometimes had difficulties in obtaining information timely from overseas posts. We also found that the Department did not initiate action on PBC requests with long lead times until the due date was approaching. In some cases, the Department did not respond or provided inadequate responses to our requests for information until formal

[1]*Management Letter Related to the Audit of the U. S. Department of State FY 2010 Financial Statements* (AUD/FM-11-04, Feb. 2011).

notices of findings and recommendations were provided. Additionally, the Department's records management practices were not standardized to properly store and maintain information for management review.

We noted instances where the Department's quality control process delayed the flow of data because of the centralized review of every PBC request. The review process seemed to be universally applied to all requested items, including actual source documents that were not subjective in nature and could not be edited or altered.

The inability to produce documentation supporting financial transactions can lengthen processing times for analyses and reconciliations, as well as increase the possibility of undetected errors. This situation may also be indicative of inaccurate or incomplete information. Delays in providing accurate financial information can lengthen financial reporting cycle times, which decreases the relevance of financial information to end users. Providing timely and accurate information to the financial statement auditors could potentially lead to cost savings in performing the audit.

Recommendation:

We recommend that the Department

- Enhance its procedures to ensure that information is provided to the financial statement auditor in a timely manner.
- Streamline the quality control process to ensure that review efforts are not duplicative and are judgmentally applied to relevant items, such as subjective analyses.
- Encourage direct access to Department personnel performing specific functions so information can be obtained in a more efficient manner.
- Ensure that standards for records management and retention are in place and are enforced.
- Proactively seek clarity on any unclear audit requests in order to facilitate the most efficient and effective means of gathering required documentation.

II. Fund Balance with Treasury

Finding:
Fund Balance with Treasury Reconciliation Process Not Sufficient

Agencies are required to promptly reconcile Fund Balance with Treasury (FBWT) information in order to identify and resolve differences between the agency financial records and the Department of the Treasury (Treasury) fund balances. The Department maintains two cash reconciliation reports: the Global Financial Services–Charleston Cash Reconciliation Report and the Financial Reporting Analysis (FRA) Cash Reconciliation Report. These reports document final balances for each Treasury Account Fund Symbol for the applicable accounting period.

We obtained and reviewed the FRA Cash Reconciliation Report as of September 30, 2011, and identified 137 instances in which a variance existed between Treasury and Department fund balances. These variances amounted to approximately $15 million.

The Department does not reconcile FBWT at the transaction level and investigate individual differences. The Department's internal policy requires balances to be reconciled at the transaction level only if the aggregate variance is more than 2 percent of the total fund balance. The Department monitors the difference from Treasury for reasonableness only. Additionally, the Department does not have a complete history of transactions that it can compare with Treasury information, as data from previous financial systems are not available to the staff performing the reconciliations. These data restrictions continue to prevent the Department from fully reconciling the FBWT account.

Failure to implement timely and effective reconciliation processes could

- Increase the risk of fraud, waste, and mismanagement of funds.
- Affect the Government's ability to effectively monitor budget execution.
- Affect the Department's ability to accurately measure the full cost of its programs.
- Result in violations of the Antideficiency Act.
- Result in erroneous financial statements.

Recommendation:

We recommend that the Department enhance its Fund Balance with Treasury reconciliation process by

- Establishing procedures to ensure that reconciling items are researched and cleared completely.
- Completing a thorough review to identify older reconciling items and take the appropriate actions to clear these items.

III. Other Assets

Finding:
Value Added Tax Receivable Estimation Process Flawed

The Department operates in over 172 countries. Many foreign governments assess a value added tax (VAT) on the goods and services purchased overseas by the Department. Depending on the specific country and type of purchase, the Department may periodically request full or partial reimbursement for VAT payments. The Department's Office of Foreign Missions (OFM) is responsible for formulating and implementing tax reciprocity policies and programs. Overseas posts are responsible for tracking refundable VAT payments and for submitting reimbursement requests timely to local governments. Because of limitations with the overseas accounting system, posts track the reimbursement requests outside the system. As a result, the Department estimates a VAT receivable quarterly for financial reporting purposes.

We reviewed supporting documentation related to the Department's quarterly VAT receivable estimate as of June 30, 2011. The Department's estimation methodology is based on expenditure activity for certain overseas allotment codes. However, the Department was unable to provide support for excluding expenditure activity for other overseas allotment codes.

We found that the process and parameters used for calculating the estimate are based on a 2008 analysis that has not been subsequently validated or updated to reflect current conditions. During our overseas fieldwork, we compared the VAT information used by the Department with actual conditions at post and found discrepancies at five of the seven posts. The results are shown in Table 2.

Table 2. Comparison of VAT Information Used in Department Estimate With Current VAT Conditions Identified During Audit Site Visits

Country	VAT Information Used in Department Estimation Methodology	Current VAT Conditions Found During Audit Site Visits
Belgium	VAT paid in full and subsequently reimbursed	Exempt from all VAT payments except for utility payments, which are nonreimbursable
Canada	VAT paid in full and subsequently reimbursed	Fully exempt from VAT payments except in Quebec, where local VAT is paid and Embassy is eligible for reimbursement
Haiti	VAT paid in full and subsequently reimbursed	Fully exempt from VAT payments
Jamaica	VAT paid in full and subsequently reimbursed	Fully exempt from VAT payments
Philippines	VAT paid in full and subsequently reimbursed	Fully exempt from VAT payments

In addition to the inconsistencies noted during our overseas fieldwork, we found that the information used by the Department to estimate its VAT receivable was not always consistent with data maintained by OFM.

The Department does not have a process to periodically review and validate its VAT receivable estimation methodology in light of changing conditions. The Department also does not maintain sufficient documentation to support key underlying assumptions and parameters of the methodology. The Department's use of accounting estimates without documented procedures, assumptions, and parameters increases the risk of misstatements in the financial statements.

Recommendation:

We recommend that the Department develop policies, procedures, and system enhancements to facilitate consistent tracking and collection of refundable value added taxes payments. This would also enable the Department to report its actual receivables in its financial statements. If the Department continues to report its value added taxes receivable based on an estimation technique, the Department should validate its estimation process and assumptions.

IV. Accounts Payable

Finding:
Improvements in Intragovernmental Accounts Payable Accrual Process Needed

Federal agencies should record liabilities for all goods and services received, but not paid, as of the financial statement date. Agencies may need to estimate liability amounts for goods and services received for which they have not obtained an invoice. Agencies must accumulate sufficient, relevant, and reliable data on which to base accrual estimates, and management should ensure that adequate documentation is available to support the estimates. The Department's intragovernmental transactions totaled approximately $2.5 billion as of September 30, 2011, and could represent a material component of the Department's accounts payable (AP) accrual.

In response to issues noted during the audit of the FY 2010 financial statements, the Department took steps to develop a standardized process to estimate its intragovernmental accounts payable. Although the Department had developed an approach for estimating the intragovernmental accounts payable before the completion of the FY 2011 audit, the process needed to be refined and standardized and sufficient controls needed to be put into place to ensure that the process was implemented consistently and the results were repeatable.

In addition, the Department did not implement its approach in a timely manner. It did not completely develop and implement the estimation process until October. If issues had been identified during implementation, it would have been too late for the Department to successfully adjust the methodology to address the deficiencies identified by the deadlines for completing the financial statement audit.

The lack of a sufficient process to estimate intragovernmental payables increases the risk that the intragovernmental accounts payable amount will not be reasonable and supported.

Recommendation:

We recommend that the Department

- Refine and formalize the process to estimate intragovernmental accounts payable. The process should include details on the methodology to calculate the payable amount, planned procedures for implementing the methodology, and details on how the results will be documented.

- Establish and implement a timeline for the intragovernmental accounts payable estimation methodology.

V. Acquisition and Vendor Payment

Finding:
Acquisition and Vendor Payment Process Inadequate

Agencies obtain goods and services from vendors and other Federal agencies as part of normal business operations. The administrative approval of invoices for goods or services from vendors is a critical point in the acquisition and payment cycle. An agency should identify employees who are authorized to receive goods or services or administratively approve invoices for which receipt of goods and services does not apply (for example, utility bills). In addition, these employees should sufficiently document their acceptance of goods and services or administrative approval on the appropriate documentation. Another critical point in the acquisition and payment cycle is processing and recording the vendor payment, which includes properly documenting receipt of vendor invoices and retaining documentation to support the accuracy of information contained in the voucher.

During our testing of transactions to support disbursements, we identified exceptions related to the acquisition and vendor payment process. From a sample of 116 transactions, we found

- Four instances in which the documentation provided did not substantiate invoice approval or certification of goods and services received.
- 87 instances in which documentation was not provided to support that the person who signed the invoice was a designated approving/certifying official.
- 10 instances in which invoices were not dated upon receipt.
- Three instances in which the Department was unable to provide sufficient supporting documentation; therefore, we were unable to satisfy certain testing attributes related to these three sample items.

The Department did not have an adequate process in place to ensure that its employees were complying with policies and procedures related to documenting that goods or services were received and payments were properly certified. In addition, vendor invoices were not always stamped or annotated as being received, and proper receiving documentation was not created or maintained to confirm that individuals who received goods or services were authorized to do so. Additionally, the Department's records management practices were not standardized to properly store and maintain information for management review.

Limited adherence to procedures for receiving goods or services from a vendor and for overseeing the vendor payment process increases the likelihood that improper payments could be made or that waste, fraud, and abuse could occur and go undetected. Ineffective oversight could create circumstances in which goods and services are acquired that are not needed or in which payment is made for goods and services that are not received. In addition, without adequate documentation, the Department cannot ensure that invoices are paid accurately and is unable to efficiently monitor vendor payments or research issues related to the payments.

Recommendation:

We recommend that the Department strengthen controls to ensure that receipt of goods and services is documented and vendor payments are processed and recorded properly. Specifically, the Department should

- Develop and implement a process to monitor the execution of its policies and procedures, particularly related to invoice processing.
- Reemphasize to all personnel with invoice processing responsibilities the importance of complying with Department policies.
- Fully develop, document, and enforce records management and retention policies for all current and future disbursement transactions, including standardizing procedures to ensure that documentation files are sufficient to constitute a complete history of the transaction and provide a complete audit trail.

VI. Payroll

Finding:
Controls Over Personnel Records Insufficient

The Department has almost 30,000 full-time employees located domestically and overseas. Ensuring the sufficiency of controls over personnel-related activities is a key responsibility of managers. We identified control deficiencies related to maintaining personnel records, processing employee separations, and approving time and attendance (T&A) documents and hiring personnel actions.

Insufficient, Inconsistent, or Incorrect Personnel Record Documentation

The Office of Personnel Management (OPM) requires agencies, including the Department, to maintain up-to-date, complete, and correct personnel records for each employee. These personnel folders should include all benefit election forms, as well as any elections resulting in deductions to an employee's pay. In addition, the Department is required to review T&A submissions for accuracy. Maintaining up-to-date personnel folders and reviewing T&A submissions for accuracy help ensure that employees are compensated only for actual hours worked and benefits earned. Ineffective maintenance of employee personnel folders could result in improper payments to employees or for wages and benefits not earned or incorrectly calculated.

To verify the accuracy of employee salaries and benefits, we assessed the completeness of personnel records for a sample of 78 employees. We noted the following discrepancies during our testing:

- Four instances in which the employee's timesheet was not provided.
- Eight instances in which the documentation was not approved by the appropriate officials.

- One instance in which support showing the authorization for leave taken was not provided.
- Six instances in which the Federal Employees' Group Life Insurance (FEGLI) election selected on the Life Insurance Election Form (Standard Form [SF]-2817) was not the same as the election on the employee's Notification of Personnel Action (SF-50).
- 18 instances in which we were unable to compare the FEGLI election on the SF-2817 with the election on the employee's Earnings and Leave Statement (ELS) because the SF-2817 was not provided.
- Two instances in which the Federal Employees Health Benefits (FEHB) election selected on the Health Benefits Election Form (SF-2809) was not the same as the election on the employee's ELS.
- Seven instances in which we were unable to compare the FEHB election selected on the SF-2809 with the election on the employee's ELS because the SF-2809 was not provided.
- Two instances in which the Thrift Savings Plan election form was not provided.
- Five instances in which support for hours worked other than standard hours was not provided.

As part of our contractual agreement with the Office of Inspector General, we chose an additional 35 employees for testing to assist OPM in its financial statement audit (OPM Agreed-Upon Procedures). We noted the following discrepancies during our testing:

- Two instances in which the Optional FEGLI Elections on the SF-2817 did not match the elections on the SF-50.
- Two instances in which we were unable to recalculate the FEGLI amount withheld on the ELS based on the Optional FEGLI Elections on the SF-2817.

The Department did not sufficiently oversee and review the documentation maintained in personnel files and/or T&A reports. Poor administrative control over the payroll cycle and lack of sufficient and updated supporting documentation in the Official Personnel File may lead to errors in employee pay, improper benefit elections, or increased benefit costs. Incomplete personnel records prevent the timely receipt of sufficient and accurate documentation when requested and hinder the prompt identification and remediation of errors.

Improper and Untimely Processing of Employee Separations

Effective personnel policies and procedures help ensure that existing employees are compensated only for actual hours worked and benefits earned. Ineffective policies and procedures could result in improper payments to employees or for wages and benefits not earned or incorrectly calculated. As a measure to prevent improper payments, a separated employee should be removed from the applicable pay systems in the pay period following the effective date on the SF-50 for his or her separation.

We tested 45 employee separations from FY 2011 to determine whether the employees were removed from payroll, T&A, and personnel systems timely. We also verified that the SF-50 was approved by the pay period following the proposed separation effective date. We noted the following instances of untimely deactivation and approvals:

- 19 employees were not deactivated in the personnel system in the pay period following the SF-50 separation effective date.
- One of the 19 employees, who was not deactivated timely, was paid incorrectly after the SF-50 separation effective date.
- 16 SF-50s were approved after the pay period following the proposed separation effective date.

Each bureau and post has been delegated the authority to approve employee separations and to enter the information into the personnel systems. We found that the bureaus and posts were processing employee separation personnel actions inconsistently. The Department does not have a centralized process to ensure that bureaus and posts are approving employee separations and entering the information into the personnel system in a timely manner.

By not processing employee separations timely, the Department is increasing the risk of potential overpayments. We noted that one employee we tested was paid incorrectly after the employee's separation date. In addition, the lack of proper oversight of personnel actions may result in errors remaining undetected and uncorrected for long periods of time.

<u>Improper and Untimely Approvals of Time and Attendance and Hiring Actions</u>

Effective personnel policies and procedures help ensure that existing employees are compensated only for actual hours worked and benefits earned. Ineffective policies could result in improper payments to employees or for wages and benefits not earned or incorrectly calculated. The Department's policies and The Guide to Processing Personnel Actions, issued by OPM, require that all SF-50s be approved before their effective date. Additionally, the policies require that all T&A reports and leave requests be approved by a supervisor before they are submitted to the main timekeeper. If SF-50s are not approved properly and timely, personnel actions may be processed late or retroactively, which could lead to supplemental payments to employees and inaccurate payroll information as of a single pay period.

Department employees who are U.S. direct hires report their T&A in the Consolidated American Payroll Processing System. We selected a sample of 123 employees to test controls over T&A and hiring actions. For each of the sample items selected, we reviewed the SF-50 for proper and timely approvals. Additionally, for the sample items selected for T&A testing, we reviewed timesheets, including any leave taken, for proper approval and accurate processing. As a result of the testing, we noted instances of improper and untimely approvals, as shown in Table 3.

Table 3. Improper and Untimely Approvals

Testing Area	Number of Items Tested	Improper and Untimely Approvals
General T&A	78	8
New Hire Actions	45	11

The Department does not consistently process and approve SF-50s at the bureau level. For instance, some bureaus have the authority to process and approve SF-50s, while others do not. The Department has not clearly defined accountability and responsibility for the different processes. In addition, the Department does not have a centralized monitoring process to ensure that forms are processed and approved timely. In some cases, offices may not have sufficient personnel to ensure the segregation of duties or to provide timely approval of payroll documentation.

It is important for an organization to ensure that employees are compensated only for actual hours worked and benefits earned. Although we did not find that any of the employees we tested were paid incorrectly, the lack of proper review by responsible officials may result in incorrect employee pay and inaccurate leave balances. These errors in payroll could go undetected for long periods of time, which would increase the effort required for correction. In addition, if SF-50s are not approved properly and timely, personnel actions may be processed late or retroactively, which could lead to supplemental payments.

Recommendation:

We recommend that the Department strengthen its controls over personnel-related documentation. Specifically, the Department should

- Clearly define procedures and responsibilities for processing and approving employees' personnel and payroll records.
- Institute mandatory training sessions for staff who work with personnel records.
- Increase accountability for employees who process personnel actions at bureaus and posts.
- Develop centralized monitoring procedures, including periodic reviews of personnel-related documentation, to ensure that bureaus and posts are complying with policies for processing and approving personnel and payroll records.

NEWLY IDENTIFIED COMMENTS

During the audit of the Department's FY 2011 financial statements, some additional matters came to our attention that had not been reported in the prior management letter.

VII. Property

Finding:
Operating Lease Disclosure Inaccurate

The Department manages approximately 8,900 real property leases throughout the world, including office and functional properties and residential units. The Department also manages additional leases on behalf of other agencies conducting business overseas. The majority of the Department's leases are short-term operating leases. Federal accounting standards require agencies to disclose the minimum future payments for operating leases in the notes to the annual financial statements. Staff at over 200 overseas posts enter lease information into the Real Property Application (RPA), which is used to prepare the required financial statement disclosure. Minimum future lease payments relating to the Department's operating lease obligations amounted to over $1.3 billion as of September 30, 2011. Other agencies' leases are excluded from the Department's financial statement disclosure.

We tested the accuracy and completeness of the Department's lease inventory and financial statement disclosure. Our testing noted several errors as follows:

- 20 of 83 operating leases tested had incorrect annual lease payment amounts or lease terms in RPA.
- Three of 21 excluded operating leases tested were improperly excluded from the Department's financial statement disclosure.
- An operating lease in London, United Kingdom, was not included in the operating lease listing because it was incorrectly designated as Restricted Government-Owned in RPA.
- Three leases were incorrectly designated as capital leases rather than operating leases.
- The Department's schedule used to calculate the future minimum lease payments contained an incorrect formula.

Short-term leases are renewed or amended frequently and often require payment amounts that escalate over the term of the lease. The RPA system does not have an automated functionality to reflect escalating lease payments. Operating lease information is entered by staff at overseas posts with varying skill sets and responsibility awareness. Schedules used to calculate minimum future lease disclosures are manually created and updated, leaving the disclosure susceptible to human error. In addition, the Department did not have a sufficient process in place to identify capital leases.

The net effect of the errors noted was an overstatement in minimum future lease payments of approximately $25 million. In addition, inaccurate or outdated lease inventory data can lead to mismanagement of budgets and operations.

Recommendation:

We recommend that the Department strengthen controls to ensure that future minimum payments for operating leases are accurately disclosed in the Department's financial statements. Specifically, the Department should

- Increase training to emphasize the execution of standard operating procedures and the responsibilities of post personnel.
- Validate the accuracy of the lease information provided by posts by reviewing applicable supporting documentation and ensure that information is provided in a timely manner.
- Improve the process to identify capital leases.
- Improve reviews of the accuracy of the calculations supporting the future minimum lease payment disclosure.
- Improve the functionality of the Real Property Application to automatically document escalating lease payments.

VIII. Revenue

Finding:
Machine Readable Visa Fee Analysis Not Meeting Control Objectives

The Department's Bureau of Consular Affairs (CA) is responsible for issuing nonimmigrant visas, referred to as Machine Readable Visas (MRV), to foreign nationals at embassies and consulates around the world. CA encourages posts to collect the MRV fees off site to limit the Department's cash collection responsibilities. For FY 2011, the Department reported $1.3 billion in revenue related to MRV fees, approximately 80 percent of which was collected at off-site locations. Posts must maintain proper internal controls to ensure that the off-site locations properly execute their duties on behalf of the Department by collecting fees when issuing MRV fee receipts and remitting all fees collected to the Department. To achieve this objective, CA directs each post to perform, at least weekly, an MRV fee analysis by comparing the fees collected with the number and type of services provided, as identified by records other than the fee receipts. The MRV fee analysis should ensure that the cumulative amount of fees collected by the off-site location meets or exceeds the cumulative number of MRV applications processed by the post. The collections made at off-site locations directly affect revenue reported by the Department.

We tested the operating effectiveness of the MRV fee comparison during site visits and noted exceptions at three of the seven posts visited. At U.S. Embassy Ottawa, Canada, we found that the documentation of the comparison was unavailable and that there were indications that the comparison was not performed in a timely manner. At U.S. Embassy Kingston, Jamaica, we found that the comparison was not performed in accordance with guidance provided by CA. At U.S. Embassy Lima, Peru, we found that the comparison was not performed in an effective manner and variances were not sufficiently documented.

CA does not have an effective control in place to ensure that posts perform the MRV fee comparison appropriately and in a timely manner. In directing posts to perform the comparison, CA does not require a secondary review to ensure the MRV fee analysis is completed. One individual at the post performs the analysis with limited or no backup. Therefore, there is no monitoring of the execution of the control at the bureau or post level.

The Consular Section Chief at every post is required to annually certify that the controls at post are operating in accordance with the requirements; however, CA does not have a process in place to validate the post certifications. During the audit, CA officials stated that CA was working to strengthen the self-certification control by requiring each post to submit the fee and service comparison report for review and validation. However, we found that this control had not been implemented during our overseas testing.

Without proper controls, cash collected at off-site locations could be misappropriated and not be deposited into the Department's accounts. In addition, the Department may not be able to detect inaccuracies in recording MRV fee collections.

Recommendation:

We recommend that the Department

- Develop a process to ensure that each post is performing a Machine Readable Visa fee analysis in accordance with Department guidance.
- Require a second individual at each post, who has sufficient knowledge of consular operations, to periodically review the Machine Readable Visa fee analysis.
- Ensure that properly trained backup personnel are designated at each post for completing and reviewing the Machine Readable Visa fee analysis.

Finding:

Controls To Ensure Passport Fee Collections Are Properly Recorded Insufficient

When American citizens apply for a passport, they must pay a fee to the Department. CA collects passport fees on behalf of the Department. When an individual applies for a passport in person at a Passport Agency, CA collects the fee using an on-site cashier. When an individual applies for a passport through the mail, CA collects the fee using a lockbox system, which is a service offered by a bank to receive and deposit payments on behalf of the Department.

CA records all passport applications in the Travel Documents Issuance System (TDIS). On a daily basis, prior to depositing the fees collected at a Passport Agency with the Treasury, each Passport Agency ensures that the amount collected matches the number of passport applications recorded in TDIS for that location. Lockbox collections are deposited directly into the Treasury's accounts. The Treasury's CA$HLINK system provides a daily report of lockbox collections to the responsible Passport Agency, which reconciles the collections in the report to the applications recorded in TDIS.

The Department provides a portion of the passport fees collected to the Treasury at year end and retains the remaining fees as Department revenue. In its financial statements, the Department reports revenue for both types of fees and reports a liability for the fees to be remitted to the

Treasury at year end. The Bureau of Resource Management (RM) receives the CA$HLINK reports for all collections and uses the information in the reports to manually record revenue in the Global Financial Management System (GFMS). In FY 2011, the Department recorded revenue of approximately $1.8 billion for domestic consular fees.

Although CA had designed operational controls that compare the amount of passport fees collected with the number of passport applications, the Department did not have a process in place to ensure that the amount of passport fees collected was accurately recorded in GFMS. As a result of our preliminary finding regarding this issue, CA developed a new control, the Revenue to Workload Comparison, which compared the revenue recorded in GFMS with information in TDIS. We reviewed the preliminary comparison performed on June 30, 2011, and noted that key aspects of a fully functioning control were missing. Specifically, the comparison lacked preparer and reviewer signoffs and sufficient support and explanations for variances higher than 10 percent, as required by standard operating procedures. Additionally, the Department performed the Revenue to Workload Comparison for the fees retained by the Department, but it did not perform the comparison for the fees that will be provided to the Treasury at year end. While the Department understands the importance of ensuring that all passport fees collected are deposited with the Treasury, the Department has put less focus on ensuring that these collections are properly recorded in GFMS.

Inaccuracies in recording passport revenue may go undetected without properly designed and executed internal controls. The lack of effective reconciliations between CA collection activity, Treasury reports, and GFMS data could result in misstatements in the Department's financial statements.

Recommendation:

We recommend that the Department continue to refine the Revenue to Workload Comparison to ensure that the passport fees collected agree with the revenue reported in the Global Financial Management System. Specifically, the Department should

- Implement the newly designed comparison control in accordance with the standard operating procedures.
- Prepare supporting documentation for the comparison that includes preparer and reviewer signoffs and detailed explanations of variances higher than the 10 percent threshold established in the standard operating procedures.
- Perform the comparison for all fees collected, both those retained by the Department of State and those that will be provided to the Department of the Treasury at year end.

IX. Accounts Receivable

Finding:
Validation and Monitoring Controls Over Aged Unbilled Federal Accounts Receivable Lacking

Unbilled accounts receivable (AR) arise as revenue is recognized for services rendered that exceed the amount that has been billed. The Department enters into reimbursable agreements (RA) with other Federal entities to agree to terms, conditions, and costs for services to be provided. Unbilled Federal AR transactions are created through the normal course of business when administrative timing issues exist; however, these transactions are also generated when necessary billing information is unavailable or when the cost of services exceeds the RA and the customer is not willing or is unable to cover those costs. According to Department policy, receivables over 90 days old are considered past due and should be escalated for further review.

We identified unbilled Federal AR amounting to $171 million on the Department's March 31, 2011, trial balance. Although the Department's policy is to process undisputed bills for payment in 15 business days or to resolve disputes in 30 days, we found that $50.3 million of the $171 million in unbilled AR was over 6 months old, as shown in Table 4.

Table 4. Aging of Unbilled Federal Accounts Receivable Over 6 Months Old

Time Period	Number of Transactions	Amount (in millions)
Over 3 years	264	$23.0
Between 2 and 3 years	81	8.0
Between 1 and 2 years	79	12.8
Between 6 months and 1 year	111	6.5
Total Over 6 months	**535**	**$50.3**

RM officials stated that they had reviewed the unbilled AR during the second quarter of FY 2011 and had identified 64 transactions, valued at $2.7 million, that they considered to be invalid. The remaining unbilled AR were deemed valid. The documentation supporting the Department's determination of validity was limited, and accordingly, we performed substantive tests of the second quarter items that the Department had identified as valid to confirm the statuses of the transactions. These tests confirmed that additional unbilled AR balances were invalid, unsupported, or otherwise uncollectible.

In addition, the Department had not taken action to appropriately address the aged unbilled AR, either by processing bills for payment, working with the customer to resolve disputes related to the receivable, or writing off items that were not collectible.

RM officials stated that they had a quarterly process to review aged unbilled AR. For the second quarter of FY 2011, the Department defined significantly aged unbilled AR to be anything that occurred prior to FY 2011. Each quarter, staff in RM's Office of State Programs, Operations, and Budget assess whether the aged unbilled AR are valid, and they communicate this information to RM's Office of the Deputy Chief Financial Officer. The Department takes action to correct any transaction identified as invalid.

Although the Department has a process in place to review aged unbilled AR, we concluded that the process was not effectively designed to validate and monitor these Federal receivables. Specifically, the Department's process did not require supporting documentation for the assertion of validity made during the quarterly review. The Department did not independently review the analysis or substantiate the assertions made during the quarterly review. Additionally, the Department did not perform the review process in a timely manner. In addition, the Department's review process did not include actions to process bills for payment for items identified as valid, resolve disagreements related to receivables with the other Federal agency, or assess whether unbilled AR were collectible.

The collection of outstanding AR represents a source of funds for an organization. By not managing the aged unbilled AR in a timely and effective manner, the Department is not collecting funds from other Federal agencies that it could use for Department priorities. The chance of collecting a receivable decreases the longer the receivable remains outstanding. Additional administrative efforts are needed to track and validate the items that have remained outstanding for a long period. In addition, by not identifying which unbilled AR items are uncollectible, the Department is overstating its assets. Based on the results of this audit finding, the Department wrote off $43 million of unbilled AR as of September 30, 2011.

Recommendation:

We recommend that the Department strengthen controls to ensure that unbilled accounts receivable are valid and are resolved in a timely manner. Specifically, the Department should

- Develop standards for obtaining and maintaining supporting documentation during the quarterly assessment of receivables.
- Develop procedures to confirm the validity assertions made during the quarterly assessment process.
- Execute the quarterly assessment in a timely manner.
- Clear invalid transactions by the subsequent reporting period.
- Take action to either collect aged unbilled accounts receivable or write off items that are not collectible.

X. Budgetary Resources

Finding:

Controls Over New Obligations Made Against Expired Funds and Activity on Canceled Funds Inadequate

When the Department receives funding through appropriation legislation, the funding is specifically classified as no-year, multi-year, or single-year funding. No-year funds are available to the Department indefinitely or until rescinded. Multi-year funds are available for a specific period of time, and single-year funds are available only for the year in which they are appropriated. The Department may obligate funds for execution of Department programs and operations only during the period of the fund's availability. Once the appropriated funds are no longer available, the Department cannot record new obligations; however, increases and decreases to existing obligations are permitted for 5 years. During this 5-year period, the funds are considered expired. At the end of the 5 years, the funds are canceled, and any unspent amounts are returned to the Treasury.

A significant portion of the funds related to the Bureau of International Narcotics and Law Enforcement Affairs (INL) are exempt from the requirements related to expired and canceled funds.[2] INL funds remain available for an additional 4 years from the expiration date of the appropriation as long as the funds were initially obligated before the appropriation expired.

We reviewed unliquidated obligations from all bureaus except INL as of September 30, 2011. We identified 534 obligations, totaling $107.3 million, that were potentially established against expired funds. As of the end of fieldwork, the Department had not provided documentation to support the validity of these obligations.

In addition, we analyzed obligations related to unexpended appropriations made from October 1, 2010, through June 30, 2011, and identified two transactions that were potentially recorded to a canceled appropriation. The Department also did not provide documentation to support the validity of these transactions.

The Department did not have a process in place to review obligations to ensure that they were not made against expired funds. Information necessary to support the validity of obligations was not readily available. In order to implement this process, the Department would need accurate and readily available information on the dates the obligations were established. In addition, we did not find any system controls that prevented a user from recording a new obligation against expired funds. Department officials also stated that the control within the financial system to prevent activity on canceled appropriations did not work effectively.

Weak control over expired and canceled funds increases the risk of waste and abuse. In addition, the Department may not be complying with appropriations law and the Antideficiency Act.

Recommendation:

We recommend that the Department

- Develop a system-generated report that accurately reflects the date all outstanding obligations were established.
- Implement a control within the financial system that prevents the creation of obligations against expired funds.

[2] Pub. L. No. 111-117 §7011.

- Improve the system control that prevents activity against canceled appropriations.

XI. Financial Reporting

Finding:
GFRS Closing Package Not Submitted in a Timely Manner

The Government Management Reform Act requires the Treasury, in coordination with the Office of Management and Budget, to annually prepare audited financial statements for the Executive Branch of the Government. To prepare the Government-wide financial statements, significant entities, such as the Department, must provide audited reclassified financial statements and notes, known as special-purpose financial statements, by 5 p.m. on November 15 of each year. Agencies submit information using the Governmentwide Financial Report System (GFRS). The financial data that agencies enter should link to the agencies general-purpose financial statements, which are also due by November 15 of each year.

The Department did not enter all required information into GFRS until after the 5 p.m. deadline, requiring the Department to request an extension from the Treasury. In addition, the Department did not provide a clear crosswalk between the general-purpose agency financial statements and the special-purpose financial statements. We noted similar issues during prior financial statement audits.

The Department was unable to meet the deadline because it continued to make adjustments to the general-purpose financial statements on the date that the financial statements were due. Data from the general-purpose financial statements is needed to complete the special-purpose financial statements. The GFRS data entry process is labor intensive and can take a significant amount of time to perform. Certain financial information must be reported differently in GFRS than in the general-purpose financial statements, which takes time to calculate.

If the Department is unable to finalize its general-purpose financial statements to allow data to be entered into GFRS in a timely manner, it should implement changes in the process to improve efficiency. For example, the Department could provide us with real-time access to data as it is being entered into GFRS. Each time a change is made in the general-purpose statements, the changed items must be manually crosswalked to the impacted line items of the special-purpose financial statements, which must then be reentered into GFRS. The Department did not allow the audit team to review data as it was entered into the system. Instead the Department provided hard-copy documentation after the data had been reentered.

The manual nature of the data entry process and the delays in obtaining the general-purpose financial data increase the risk that incorrect information will be entered into GFRS. The current process also increases the risk that the auditor will not identify incorrect data that may have been entered info GFRS. Unless the Department improves its process for providing special-purpose financial information to the auditor, it runs the risk of continuing to miss the deadline for submitting its special-purpose financial data.

Recommendation:

We recommend that the Department

- Refine procedures and controls to streamline manual processes and to ensure the accuracy and timeliness of the reclassification and submission of data to the Governmentwide Financial Report System (GFRS).
- Provide the financial statement audit staff with real-time access to the special-purpose data as it is entered into GFRS.
- Enhance its crosswalk from the general-purpose financial statements and notes to the special-purpose financial statements and notes to provide a clear and comprehensive bridge between the two sets of statements.

XII. Foreign Service National After-Employment Benefits

Finding:
Impact of Foreign Service National Defined Benefit Plans Needs Full Reporting in Financial Statements

Based on local prevailing wage practices, the Department provides Foreign Service National (FSN) employees with after-employment benefits through a variety of arrangements, including defined benefit pension (DBP) plans. For DBP plans, an employer promises a specified benefit on retirement that is predetermined by a formula based on the employee's earnings history, tenure of service, and age rather than on investment returns.

Employees of other agencies that conduct business overseas also participate in these DBP plans. These agencies are considered to be "employer entities," meaning that they employ workers, thereby generating the employee costs. The Department is considered to be the "administrative entity" for the funds, meaning that the Department is responsible for accounting for the DBP plans.

We noted that the Department, as the administrative entity of the DBP plans, did not include several required elements in its financial statements. Specifically, the Department did not report

- Assets and liabilities attributable to the other agencies' FSN employees who participated in the DBP plans.
- Annual plan contributions made on behalf of FSNs from other agencies as revenue.
- Benefit expenses when pension benefit payments were made to DBP members and beneficiaries.

In addition, the Department did not include, in its financial statements, other required information applicable both to itself and to other agencies such as interest return on plan assets and impact on budgetary accounts.

Prior to the Department's FY 2011 financial statements, the Department had not implemented Statement of Federal Financial Accounting Standards (SFFAS) No. 5, "Accounting for

Liabilities of the Federal Government," for the FSN DBP plans because the Department did not consider the guidance to be appropriate for the unique characteristics of the overseas pension plans.

Because of issues noted during the audit of the FY 2011 financial statements, the Department partially implemented the SFFAS No. 5 requirements. Specifically, the Department separately reported investment and liability information related to the Department's FSN employees in the FY 2011 financial statements. However, the Department did not include all required information because, according to Department officials, the Department believed that the amounts would not be significant to the financial statements. In addition, some of the information needed to report the other elements, such as details on investment returns, was not readily available.

Until the Department fully implements the SFFAS No. 5 accounting requirements, plan assets, liabilities, revenues, benefit expenses, investment income, and related budgetary accounts will be understated.

Recommendation:

We recommend that the Department continue to develop and execute a process to effectively manage and report Foreign Service National defined benefit pension plans in accordance with Statement of Federal Financial Accounting Standards No. 5. Specifically, the Department should

- Develop a process to track and report the data necessary to report all required information.
- Perform an analysis to quantify the significance of any required elements considered to be immaterial that were omitted from the financial statements.

United States Department of State

Chief Financial Officer

Washington, D.C. 20520

UNCLASSIFIED

MAR 23 2012

MEMORANDUM

TO: OIG – Harry W. Geisel

FROM: RM – James L. Millette

SUBJECT: Draft Management Letter Related to the Audit of the Department of State's Fiscal Year (FY) 2011 Financial Statements

This is in response to your request for comments on the Independent Auditor's Draft Management Letter (Letter) related to the audit of the Department of State's (Department) FY 2011 Financial Statements.

We thank you for the opportunity to comment on the draft Letter. We believe considerable progress on a number of matters was made over the past year as a result of Department actions and the collaborative manner in which the audit was conducted.

cc: OIG/AUD – Ms. Evelyn Klemstine
Kearney & Company, P.C. – (b) (6) [redacted]
RM/DCFO – (b) (6) [redacted]
RM/EX – (b) (6) [redacted]

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