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**Management Letter Related to the
International Cooperative Administrative Support
Services' Financial Statements**

Independent Auditor's Report

September 30, 2003 and 2002

AUD/FM-05-39, August 2005

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March 30, 2005

To the ICASS Executive Board:

Under auditing standards generally accepted in the United States of America, 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 International Cooperative Administrative Support Services' (ICASS) Statements of Financial Position, Statements of Operations and Changes in Net Position, and Statements of Cash Flows as of September 30, 2003 and 2002 and for the years then ended, we considered the Department of State's internal control in determining the nature, timing, and extent of the audit tests applied in connection with our audit. Additionally, 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 internal control to prevent or detect all errors and irregularities.

ICASS 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.

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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 its 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, discussed in the attachment, do not affect our report, dated March 30, 2005, on the ICASS financial statements referred to above.

This report is intended solely for the use of the Department and ICASS management. This restriction is not intended to limit the distribution of this report, which is a matter of public record. The Department agreed with the findings in this report, and its comments on the draft are included in their entirety as Attachment 2.

Very truly yours,

Attachments: As stated.

U.S. Department of State
International Cooperative Administrative Support Services
Audit of Financial Statements
September 30, 2003 and 2002

Internal Control Weaknesses - ICASS

1. Timeliness of Financial Reporting

The ICASS financial statements were not prepared in a timely manner after the end of the fiscal year.

We recommend that the Department implement such procedures as are necessary to ensure that the ICASS financial statements are prepared in a timely manner.

2. Computer Security – ICASS

An information technology vulnerability assessment of the ICASS application indicated that the specific security features associated with ICASS appeared to function correctly and were well managed. The OpenNet segment that supports the ICASS application needed some improvements but was sufficiently secure to satisfy most system requirements. There were a number of vulnerabilities detected during the technical vulnerability assessment. Most of these pertained to system configuration issues that could be corrected without impacting overall network performance or availability.

OIG made recommendations to address the identified weaknesses in *Information Technology Vulnerability Assessment for the International Cooperative Administrative Support Services System* (AUD/FM-03-03, December 2002). Many of these issues were also noted during vulnerability assessments of other applications, which suggests that these problems are not limited to the ICASS application and should be addressed Department-wide.

Internal Control Weaknesses - General

The following weaknesses in internal control were disclosed in conjunction with our audit of the Department's Principal Financial Statements as of and for the year ended September 30, 2003. ICASS uses the Department's financial management systems for processing and recording transactions, and thus, these weaknesses have an impact on ICASS.

1. Contingency Planning

The Department is highly dependent on automated data processing as part of its basic mode of operation. Currently, the Department lacks the following automated data processing safeguards: backup capability at the Foreign Affairs Data Processing Center at Main State;

backup financial and payroll systems at the Financial Service Centers in Bangkok, Thailand, and Charleston, South Carolina; and documented and tested information systems contingency planning guidance. Although progress has been made since this weakness was first reported in connection with our audit of the Department's Consolidated Statement of Financial Position as of September 30, 1996, the Department still needs to test contingency plans for all corporate systems and develop plans for long-term disaster recovery.

We recommend that the Department complete testing of its contingency plans and develop plans for long-term disaster recovery.

2. Payroll Documentation

The Department did not have authorizations on file to support payroll deductions for life insurance for all employees. Further, the Department had health benefit enrollment forms on file that did not agree with the respective individual employee master pay history. The Department has represented that it is possible that the life insurance enrollment forms were never in the Department's possession because the individuals may have transferred to the Department from other agencies. Irrespective of the cause, the Department should have, on file, documentation authorizing all payroll deductions. Further, the health benefit enrollment forms on file should agree with elections contained on all individual employees' master pay history.

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

3. Federal Employees' Compensation Act Deposits

The Federal Employees' Compensation Act (FECA) requires federal agencies to deposit, with the Department of the Treasury, funds appropriated for FECA within 30 days after the funds are available. The Department did not deposit the sums appropriated within 30 days after the funds were available.

We recommend that the Department ensure that deposits for FECA liabilities are made in accordance with the requirements of FECA.

4. Overstated Accounts Receivable

Our testing of accounts receivable indicated that the ending account balance, as of September 30, 2003, was overstated by approximately \$5.2 million (or 1 percent of total receivables).

We recommend that the Department continue its efforts to ensure that the accounts receivable balances are properly stated.

5. Accounts Receivable - General

Our review of accounts receivable as of September 30, 2003, disclosed that significant adjustments (approximately \$59 million) had to be made to the preelimination balance for financial statement presentation purposes.

We recommend that the Department implement procedures to reduce the extent of adjustments to the CFMS accounts receivable balance for financial statement presentation.

6. Unreconciled Differences in Fund Balance With Treasury

The absolute value amount of the unreconciled difference between the adjusted Treasury balance and the adjusted CFMS balance decreased during FY 2003. However, as of September 30, 2003, the amount was still significant at approximately \$87 million.

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

7. Personal Property Tracking System

Our examination of personal property disclosed that not all the missions and bureaus prepared the certified property management report as required. In addition, detailed listings of personal property do not accompany certified property management reports received from missions. Nor do the missions maintain these listings. Accordingly, we were unable to trace individual items of property as recorded on the Department's records to the certified property management reports.

We recommend that the Department either require missions to submit detailed property listings with certified property management reports or require that such listings be maintained at the missions.

8. Lack of Accounts Payable Subsidiary Record

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

We recommend that the Department establish an accounts payable subsidiary record.

9. Domestic Accounts Payable

Our testing of domestic accounts payable indicated that significant adjustments (approximately \$57 million) had to be made to the domestic accounts payable balance in CFMS (approximately \$1.2 billion before intradepartmental eliminations) for financial statement presentation purposes. A large portion of these adjustments represented reductions of obligations to international organizations; the balance principally consisted of subsequent disbursements that should have been reported as accounts payable as of September 30, 2003.

We recommend that the Department reexamine its process for recording domestic accounts payable and related disbursements. The Department must reduce the large amount of accounts payable improperly recorded in later periods.

10. Computer Security

Although the Department has expended considerable effort in the area of computer security, weaknesses still exist in several of the computer systems. The weaknesses in each system that were not sufficiently corrected by September 30, 2003, are detailed below.

- Consolidated American Payroll Processing System (CAPPS) [OIG issued a separate report, titled *Computer Security Reviews of Paris Accounting & Disbursement System and Consolidated American Payroll Processing System* (Audit Report 00-FM-014), which provides complete details regarding these weaknesses.]

- In the Department's main data center where CAPPS is housed, there is no separation of duties and functions between the computer operator, tape librarian, and production control, as the computer operator performs all three functions.

In its response, the Department indicated that it believes that automated tools being used will provide adequate compensating controls.

- CFMS

Access Control

- Personnel files are not automatically matched with system users to remove terminated or transferred employees from the system.

In response, the Department has initiated the following programs:

1. Automatically suspend access to anyone who has not accessed CFMS in the last 60 days and delete access to anyone who has not accessed CFMS in the last 90 days.
2. Terminate all access on August 1. In May, bureau coordinators are provided with a listing of all users and their security profiles for verification. Only those users who have their access renewed will have access.
3. The Department is investigating whether CAPPs can be downloaded and crosschecked with CFMS periodically to identify terminated or transferred employees who still have access.

Service Continuity

- Physical controls have not been implemented to mitigate disasters such as floods, earthquakes, etc.

In response, the Department stated that a real-time data mirror exists. Therefore, the possibility of losing data has been drastically reduced.

OIG made computer security and access control recommendations in *Information Technology Vulnerability Assessment at the Charleston Financial Service Center* (01-FMA-R-078, September 2001) and *Information Technology Vulnerability Assessment for the Central Financial Management System* (AUD/FM-02-15, March 2002). Collectively, the weaknesses in information technology cited above evidence the lack of a comprehensive framework for establishing and ensuring the effectiveness of controls over information resources, as required by the Government Information Security Reform Act. OIG issued *Senior Management Attention Needed to Ensure Effective Implementation of the Government Information Security Reform Act* (01-IT-M-082, September 2001), which separately addresses this issue.

We recommend that the Department continue its efforts related to computer security in order to correct each of the weaknesses noted above.

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United States Department of State

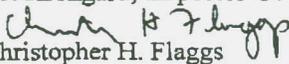
Deputy Chief Financial Officer

Washington, D.C. 20520

AUG 1 - 2005

MEMORANDUM

TO: OIG – Howard J. Krongard, Inspector General

FROM: RM/DCFO – Christopher H. Flaggs 

SUBJECT: Draft Audit Report on the International Cooperative
Administrative Support Services' (ICASS) 2003 and 2002
Financial Statements and Management Letter

Thank you for the opportunity to review and comment on the subject draft report. In relation to internal control, the report identifies two reportable conditions: (1) weaknesses in information system security that could be exploited to have a detrimental effect on the information used to prepare ICASS' financial statements, and (2) the inadequacy of the Department's financial and accounting system; since the financial statements for the ICASS Program are prepared using the Department's system.

We are pleased to report that significant progress has been made since 2002 to strengthen our controls in each of the areas identified above. For example, the Department's work towards improving information systems security was considered sufficiently advanced by the end of FY 2003 to allow the auditor to reduce this previously reported material weakness to a reportable condition. Our comments on the issues described above are contained in our responses to the draft audit reports relating to the FY 2003 and 2004 Department-wide Principal Financial Statements included in our Performance and Accountability Reports for those years.

We wish to thank your staff for the cooperative manner in which the audit was conducted. If you have any questions concerning our response to the audit report, please contact Sheila Conley, Managing Director, Financial Policy, Reporting and Analysis Directorate, on 202-663-1447.

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CC: RM - Sid L. Kaplan, Acting
Leonard G. Birnbaum - Leslie Leiper
RM/GFS - James L. Millette
RM/ICASS - Ismail Asmal
RM/BP - Eric L. Hembree
RM/EX - Phil Schlatter, Acting

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