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MANAGEMENT LETTER
AUD-FM-14-11

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

Kearney & Company, P.C. (referred to as "we" hereafter), has audited the consolidated financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2013, and has issued our report thereon dated December 12, 2013.[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 the Department's compliance with certain provisions of laws, regulations, contracts, and grant agreements. Our auditing procedures were designed for the purpose of expressing an opinion on the consolidated financial statements and not to provide assurances on internal control or compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting or on the Department's compliance with certain provisions of laws, regulations contracts, and grant agreements.

During our audit, we noted certain matters related to internal control over financial reporting that we considered to be significant deficiencies and certain matters relating to compliance that we considered to be reportable under auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements.* These items are not repeated in this letter, as they are explained in detail in our report on the Department's FY 2013 financial statements.

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 and instances of noncompliance that may exist. Although not considered to be material weaknesses, significant deficiencies, or reportable instances of noncompliance, we noted certain other matters involving internal control, operations, and compliance. These findings and recommendations, which are summarized in Appendix A, are intended to assist the Department in strengthening internal controls and improving operating efficiencies.

We appreciate the courteous and professional assistance provided by Department personnel during our audit. These findings and recommendations have been discussed with appropriate Department officials. Department management did not have formal comments on this letter.

[1] *Independent Auditor's Report on the U. S. Department of State 2013 and 2012 Financial Statements* (AUD-FM-14-10, Dec. 2013).

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

Alexandria, Virginia
April 2, 2014

MANAGEMENT LETTER COMMENTS

COMMENTS REPEATED FROM PRIOR YEAR

During the audit of the U.S. Department of State's (Department) FY 2012 financial statements, Kearney & Company, P.C. (referred to as "we" hereafter) identified matters that were reported in an internal control report[1] and a management letter.[2] The severity of issues reported in the FY 2012 internal control report related to Foreign Service National (FSN) after-employment benefits had decreased and the two open issues related to this area are included in the management letter rather than the FY 2013 report on internal control. Four issues from the FY 2012 management letter remained open and were updated with information obtained during the audit of the Department's FY 2013 financial statements.

I. Foreign Service National After-Employment Benefits

Inaccurate Personnel Data for Foreign Service National Employees

The Department's workforce includes Civil Service, Foreign Service, and FSN employees. FSN employees are generally paid in local currency, and their salary and benefits are based on local prevailing practice, which is documented in each post's local compensation plan. Human resource information for FSNs, such as date hired, transfers, grade increases, and date of separation, is maintained in the Department's WebPass application. When a personnel action is initiated for an FSN, the post enters the information into WebPass. The FSN personnel information is then submitted to a Global Financial Service Center (GFSC) where officials manually enter the information into the FSN Payroll (FSNPay) application or the Global Foreign Affairs Compensation System (GFACS).[3]

We assessed the completeness of employee information in WebPass, FSNPay, and GFACS for all overseas posts that provide voluntary severance or supplemental lump sum after-employment benefits. We used automated audit techniques to compare the total number of employees and the names of individuals in WebPass, FSNPay, and GFACS. We found that 22,388 employees were included in both WebPass and the applicable payroll application. However, we also found

- 248 individuals in WebPass that were not in FSNPay or GFACS.
- 280 individuals in FSNPay or GFACS that were not in WebPass.

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[1] *Independent Auditor's Report on the U.S. Department of State 2012 and 2011 Financial Statements* (AUD/FM-13-08, Nov. 2012).

[2] *Management Letter Related to the Audit of the U.S. Department of State FY 2012 Financial Statements* (AUD/FM-13-09, Mar. 2013).

[3] The Department began implementing GFACS in FY 2013. The Department intends to convert all posts from FSNPay to GFACS by June 2015.

For the 22,388 FSN employees included in both systems, we performed additional testing to identify data inconsistencies related to the date of birth, service computation date, and annual salary, and we found

- 843 instances in which an employee's date of birth was not consistent.
- 2,644 instances in which an employee's service computation date was not consistent.
- 2,662 instances in which an employee's annual salary was not consistent.

The Department tested a judgmental sample of the discrepancies we noted and reported that WebPass contained more accurate information on employees' dates of birth and service computation dates and FSNPay or GFACS contained more accurate salary information. We re-performed the Department's testing and confirmed its conclusions regarding the most accurate sources of FSN employee information.

We found that posts were processing personnel actions inconsistently. In certain instances, posts were not notifying the responsible GFSC in a timely manner about personnel actions that had been processed. Additionally, we noted instances where data submitted to the responsible GFSC was not updated in the applicable payroll application to reflect changes made in WebPass. We also found instances where approved personnel actions were not accurately entered into the applicable payroll application once the information was provided to the GFSC due to data entry error. The Department did not have a control in place to ensure that all post-approved personnel actions included in WebPass were also entered into either FSNPay or GFACS, such as a process to regularly reconcile the data between the applications.

Without accurate and complete FSN personnel data, the Department may not be able to efficiently or accurately calculate its annual liability for after-employment benefits. The Department was able to adjust its liability estimation methodology to address the discrepancies identified during our testing through manual manipulation of data in either FSNPay or GFACS and WebPass. These manual calculations required additional time and effort and were more prone to inaccuracies.

In addition, the risk of improper payments exists if personnel actions are not processed properly or timely or when payroll and benefit payments are calculated based on inaccurate data. The lack of reconciliation between the payroll applications and WebPass may result in errors and inconsistencies remaining undetected and uncorrected for long periods of time.

This issue was initially reported in our FY 2012 report on internal control.

Recommendation:

We recommend that the Department

- Standardize requirements for processing personnel actions at posts, including the establishment of deadlines for submitting information to the responsible Global Financial Service Center.
- Validate the employee data populated in the Global Foreign Affairs Compensation System for each post (to include date of birth and service computation dates) as the system is implemented across the remaining posts.
- Periodically perform reconciliations between WebPass and the payroll applications to identify data discrepancies.
- Refine the process used to calculate the Foreign Service National after-employment liability estimate based on the results of any data remediation or validation efforts.

Insufficient Controls over Foreign Service National After-Employment Benefits

The Department provides some FSN employees with after-employment benefits through a variety of arrangements, including annuity-based defined benefit retirement plans, defined contribution retirement plans, lump-sum retirement payments, and separation benefits to FSNs who voluntarily resign or otherwise leave the workplace. The Department estimates liabilities relating to FSN after-employment benefits for financial reporting purposes.

We found that during FY 2013 the Department completed several corrective actions related to FSN after-employment benefits, which reduced the risk of significant misstatements in the financial statements. Specifically, the Department took additional steps to confirm the nature of several posts' benefit plans and refined its estimation and reporting processes. However, the Department continued to lack formalized processes and controls relating to FSN after-employment benefits. In addition, the Department lacked a centralized inventory of benefit plans as well as controls to ensure that any newly established or updated benefit plans are approved and inventoried. During our audit, we also identified several items that the Department did not include in its liability calculation.

The corrective actions taken by the Department in FY 2013 were executed real time as we worked with the Department to ensure that the most significant risks and issues noted during our prior audits were addressed. Additional steps are needed to fully implement routine and repeatable processes and controls relating to FSN after-employment benefits.

The lack of formalized, routine processes to inventory, monitor, and account for FSN benefit plans may lead to future funding and financial reporting challenges. Benefits may exist and not be reflected in the Department's financial statements, while the nuances of other benefit plans may be misinterpreted in the Department's estimation models and assumptions. Budgeting and financial planning decisions may be made without a complete understanding of the short and long-term obligations relating to FSN benefit plans. In addition, we estimated that the FSN after-employment liability was understated by $24.1 million.

This issue was initially reported in our FY 2011 report on internal control.

Recommendation:

We recommend that the Department

- Continue to confirm and validate its inventory of Foreign Service National after-employment benefits.
- Update its estimation techniques and supporting data as benefit plans and plan stipulations are confirmed.
- Document and formalize its processes to inventory and account for Foreign Service National after-employment benefits.

II. General Issue

Untimely Responses to Audit Requests

As part of the financial statement audit, we made requests for data and documentation to validate and substantiate account balances and transactions that support the Department's financial statements. In general, the data we requested should have been 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. As of December 7, 2013, we had issued 815 audit requests with due dates prior to December 6, 2013. Of the total requests, four responses had not been received by December 7, 2013. Table 1 provides an overall summary of the response times for the 811 items that had been received.

Table 1. Response Times for Audit Requests

	Total Items Received as of 12/7/2013	Received by Due Date*	Received 1 Week or Less After Due Date*	Received Between 1 and 2 Weeks After Due Date*	Received Between 2 and 3 Weeks After Due Date*	Received More Than 3 Weeks After Due Date*
Audit Requests	811	520	166	45	26	54
Percent	100	64	20	6	3	7

*We considered one week to be five business days.

For comparative purposes, in FY 2012, the Department provided 68 percent of audit requests on time, and 17 percent of items were provided 1 week or less after the due date, which was fairly consistent with the response times for FY 2013.

We found that delays in providing documentation were caused by a number of factors. For instance, we noted that the Department sometimes had difficulties in obtaining information in a timely manner from overseas posts or other organizations. Additionally, the Department's records management practices were not standardized to properly store and maintain information for management review.

The inability to produce documentation supporting financial transactions can lengthen processing times for analyses and reconciliations, as well as increases the possibility of undetected errors. 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.

This issue was initially reported in our FY 2010 management letter.

Recommendation:

We recommend that the Department

- Enhance its procedures to ensure that information is provided to the financial statement auditor in a timely manner.
- Ensure that standards for records management and retention are in place and are enforced.

III. Fund Balance with Treasury

Insufficient Fund Balance with Treasury Reconciliation Process

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. Because of the disaggregated nature of the Department's operations, the FBWT reconciliation process involves the reconciliation of disbursements and collections processed both domestically and overseas as well as through third parties.

A suspense account is a temporary account used by agencies to record transactions with discrepancies until a determination is made on the proper disposition of the transaction. For instance, the Department will record unreconciled differences identified during the FBWT reconciliation process in a suspense account until the discrepancies are resolved. Treasury allows entities with a justifiable business need to submit a request to use suspense accounts, which are only to be used as a temporary holding place for transactions that must be cleared within 60 days. The Department received a waiver from Treasury for continued use of its suspense accounts.

We obtained and reviewed the FRA Cash Reconciliation Report as of June 30, 2013, and identified 141 instances in which a variance existed between Treasury and Department fund balances. These variances amounted to a net difference of approximately $6.5 million. However, when the absolute value of all variances was considered, the variance totaled approximately $72.9 million.

We also found that the Department had balances in several suspense accounts that had not been researched and resolved within 60 days as required. Specifically, we identified six suspense accounts in which the balance remained unchanged during FY 2013.

The Department reconciled disbursements and collections at the transaction level monthly; however, the Department did not have a threshold to investigate and resolve variances either in absolute or relative terms. In addition, the Department did not have a complete history of transactions that it could compare with Treasury information, as data from previous financial systems were not available to the staff performing the reconciliations. These data restrictions continued to prevent the Department from fully reconciling the FBWT account. The Department also did not have appropriate controls in place to ensure all suspense activity was researched and resolved within the required 60 days.

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.

Because the Department performed its reconciliation based on net value rather than absolute value, the Department could significantly understate the total outstanding FBWT variance. In addition, by not resolving suspense account activity within the required 60 days, the Department was not in compliance with Treasury requirements.

This issue was initially reported in our FY 2009 management letter.

<u>Recommendation</u>:

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

- Identifying older reconciling items and taking the appropriate actions to clear these items.
- Standardizing its internal reconciliation policy to require consideration over the absolute and relative value of variances including the application of a percentage threshold for investigating variances at individual fund levels rather than at the FBWT level.
- Researching and resolving all balances in suspense accounts within 60 days.

IV. Payroll

Inadequate Control Over Personnel Records and Actions

The Department has almost 30,000 full-time employees located domestically and overseas, including Civil Service, Foreign Service, and FSN staff. Civil Service and Foreign Service employees are paid according to standard Federal Government pay scales using the Consolidated American Payroll Processing System (CAPPS). FSN employees are paid using the FSN Payroll system.

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 personnel actions and calculating benefits, and processing employee separations.

This issue was initially reported in our FY 2009 management letter.

Insufficient, Inconsistent, or Incorrect Personnel Record Documentation

The Office of Personnel Management 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 time and attendance submissions for accuracy. Maintaining up-to-date personnel folders and reviewing time and attendance submissions for accuracy helps ensure that employees are compensated only for actual hours worked and benefits earned.

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

- Twenty-two employee timesheets were not provided.
- One employee timesheet was not approved.
- Nine Request for Leave or Approved Absence Forms (Standard Form [SF]-71) were not provided.
- One SF-71 was not approved.
- Twelve Federal Employees' Group Life Insurance (FEGLI) Election Forms (SF-2817) were not provided.
- Three FEGLI elections selected on the SF-2817 did not match the election on the employee's Notification of Personnel Action Forms (SF-50).
- Five Thrift Savings Plan elections selected on the Thrift Savings Plan Election Form (TSP-001) did not match the election on the employee's Earnings and Leave Statement (ELS).
- Four health benefits elections selected on the Health Benefit Election Form (SF-2809) did not match the election on the employee's ELS.

As part of our contractual agreement with OIG, we chose an additional 35 employees for testing to assist the Office of Personnel Management in its financial statement audit. We found the following discrepancies during our testing:

- Two FEGLI elections on the SF-2817 did not match the elections on the SF-50.
- One health benefits election selected on the SF-2809 did not match the election on the employee's ELS.

The Department did not sufficiently oversee and review the documentation maintained in personnel files and time and attendance (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 Personnel Actions

The Department processes personnel actions when an employee is hired by the Department or an existing employee has a change in personnel status. These personnel actions are documented either on the SF-50 or on the Joint Form (JF) 62A (Personal Services Contracting Action).

We selected a sample of 78 payroll disbursements, 45 separated employee personnel actions, and 45 new hire personnel actions from CAPPS. We also selected a sample of 100 payroll disbursements, 35 separated employee personnel actions, and 50 new hire personnel actions from FSN Payroll to test controls over T&A, personnel actions, hiring, and separations. We did not test payroll disbursements made from GFACS because only three posts were being paid using GFACS at the time of testing. For each of the sample items selected, we reviewed the SF-50 or JF-62A for proper and timely approvals.

During our testing of the CAPPS transactions, we found that

- Four of 78 personnel actions in our payroll disbursement sample were not approved in the pay period following the effective date on the personnel action.
- Five of 45 personnel actions in our separated employee sample were not approved in the pay period following the effective date on the personnel action.

During our testing of the FSN Payroll transactions, we found that 16 of 100 personnel actions in our payroll disbursement sample were not approved in the pay period following the effective date on the personnel action.

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

Although we did not note any instances of improper payment in our testing, the potential for improper payments exists if personnel actions are not processed properly or timely. In addition, the lack of proper oversight of personnel actions may result in errors remaining undetected and uncorrected for long periods of time. Untimely personnel actions are often processed retroactively, leading to supplemental payments being processed manually and increasing the risk of human error and decreasing efficiency.

Recommendation:

We recommend that the Department strengthen controls over personnel records and actions. Specifically, the Department should

- Increase accountability for employees processing personnel actions at the bureaus and posts.
- Develop a process to conduct periodic reviews over personnel records.
- Institute mandatory training sessions on controls over personnel records for employees who process personnel actions.
- Develop centralized monitoring procedures that will ensure bureaus and posts are complying with policies for timely and appropriately approving personnel actions, including periodic reviews of documentation.

V. Revenue

Inadequate Controls Over Machine Readable Visa Fee Analysis

The Bureau of Consular Affairs (CA) is responsible for issuing non-immigrant visas, referred to as Machine Readable Visas (MRV), to foreign nationals at 270 embassies and consulates. CA encourages posts to collect the MRV fees offsite to limit the Department's cash collection responsibilities. Posts must maintain proper internal controls to ensure that the offsite 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 the cumulative amount of fees collected by the offsite location meets or exceeds the cumulative number of MRV applications processed by the post. The collections made at offsite locations directly affect revenue reported by the Department.

We assessed the operating effectiveness of the weekly MRV fee analysis at eight posts and noted exceptions at seven of eight posts. These eight posts included sites visited during the FY 2013 financial statement audits and sites we identified as having exceptions during the FY 2012 financial statement audit. Specifically, at Embassy Madrid, Mission Germany, Mission India, Mission Japan, Embassy Lima, Embassy Lisbon, and Mission Thailand a cumulative deficit was identified, which occurs when the cumulative number of fees collected is less than the cumulative number of visa applications processed. For example, we found that Mission Germany had 17 weeks of cumulative deficits and Mission Japan had 16 weeks of cumulative deficits, although the deficits were addressed by June 30, 2013. One of eight posts tested, Mission India, had a cumulative deficit as of June 30, 2013.

Although seven of eight posts tested had a cumulative deficit during FY 2013, it was not possible for us to fully analyze the operating effectiveness of the fee analysis because CA requested posts to eliminate any cumulative balances at the beginning of FY 2013. As a result, we could not assess the actual, long-term cumulative balances at posts.

In response to our FY 2011 finding related to MRV fee reconciliations, during FY 2012 CA implemented the use of a SharePoint site that allowed CA to review completed MRV Fee Analysis Worksheets from each post. During FY 2013, CA took additional steps to standardize the reconciliation process, including requesting each post to eliminate all cumulative balances at the beginning of FY 2013 to ensure consistency.

Although CA may have been monitoring and investigating deficit balances at posts, any review that was being performed was not documented and was not effective as evidenced by the long periods that some posts reported cumulative deficits. In addition, some post officials stated that deficits were not always investigated quickly because of a belief that the deficit would clear itself in time.

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

This issue was initially reported in our FY 2011 management letter.

Recommendation:

We recommend that the Department

- Continue monitoring the Machine Readable Visa (MRV) fee analyses prepared by posts.
- Ensure that cumulative deficit balances are not eliminated from the MRV reconciliation process.
- Update the design of the centralized controls over the MRV fee reconciliation to evidence the monitoring and investigation of cumulative deficits.
- Develop and implement a requirement to formally assess and document the cause of cumulative deficits that remain after a certain period of time.

NEWLY IDENTIFIED COMMENTS

During the audit of the Department’s FY 2013 financial statements, some additional matters came to our attention that had not been reported in the FY 2012 internal control report or management letter.

I. Property, Plant, and Equipment

Insufficient Process to Account for Improvements to Domestic Leased Property

The Department capitalizes significant improvements to its overseas leased facilities that exceed $1 million. The costs of the significant improvements are captured in the Construction-in-Progress account during the design and construction stage and upon completion are transferred to the Leasehold Improvement account. The Department also leases or otherwise occupies dozens of domestic properties through varying types of agreements with the General Services Administration (GSA). In the event that the Department funds a renovation or improvement to these leased facilities, a Reimbursable Work Authorization is established with GSA to transfer funding for the cost of the requested improvement project.

We reviewed domestic expense transactions as of June 30, 2013, and found six disbursements to GSA relating to renovation and improvement projects. Through review of the Reimbursable Work Authorizations, we found that the Department had requested and was responsible for the full cost of these improvements. The costs relating to these projects were recorded as expenses, rather than as Construction-in-Progress or Leasehold Improvements depending upon the status of the project.

Improvements to domestic leased facilities are infrequent in nature compared to improvements made to overseas leased property. The Department did not have a process to determine whether domestic leasehold improvements should be capitalized.

Without a process to determine whether improvements to domestic facilities should be capitalized, property may be understated and operating expenses may be overstated on the Department's financial statements. The specific transactions identified during the audit related to two domestic leasehold improvement projects and amounted to approximately $25 million for FY 2013.

<u>Recommendation</u>:

We recommend that the Department establish a process to assess significant improvements to domestic leased facilities for capitalization.

Inaccurate Accounting for Capital Leases

Capital leases are leases that transfer substantially all of the benefits and risks of ownership to the lessee. Of the 9,700 real property leases used by the Department overseas, only 28 leases were capitalized in the Department's FY 2013 financial statements. During the audit, we tested all 28 reported capital leases to ensure that the leases were correctly accounted for. We identified exceptions with the valuation of 17 of 28 capital leases. For example, we found that

- The acquisition cost of 13 leases was not recorded correctly.
- The lease liability reported for 15 leases was not correct.
- The depreciation expense and accumulated depreciation for 14 leases was incorrect.
- Four leases were recorded in the wrong fiscal year.

The Bureau of the Comptroller and Global Financial Services, which calculates the accounting information that will be reported in the financial statements for capital leases, did not receive copies of all lease agreements, amendments, and renewals timely, and was therefore unable to ensure the accuracy of the recorded lease amounts. In addition, the process to calculate the capital lease information to include in the financial statements is manual and the Department did not have a process in place to sufficiently review the calculations. As a result, the Department's FY 2013 financial statements were misstated by more than $6 million.

Recommendation:

We recommend that the Department refine the process for accounting for capital leases. Specifically, the Department should

- Develop and implement a process for the Bureau of the Comptroller and Global Financial Services to obtain the documentation needed to account for capital leases in a timely manner.
- Improve training to emphasize capital lease accounting requirements.
- Develop and implement a process to review the capital lease amounts calculated for inclusion in the financial statements.

Inaccurate Recording of Software Costs

Federal agencies use various types of software, such as applications for operating a program or administrative applications. Internal use software (IUS) is software that is purchased from commercial vendors, internally developed, or developed by a contractor solely to meet the agency's operational needs. IUS that is in the development phase is considered software-in-development (SID). When the cost of IUS exceeds the capitalization threshold, agencies are required to report IUS as general property.

During our audit, we performed testing to assess whether the Department was accurately identifying, reporting, and valuing IUS and SID in its annual financial statements. We found numerous instances where the Department did not accurately record IUS and SID. For example, we found that

- Amounts recorded did not always agree with supporting documentation.
- Projects were not always transferred in a timely manner from SID to IUS.
- Some costs associated with SID were unrecorded.
- One project was transferred from SID to IUS that was not complete.

For SID and IUS, Department managers did not enter accounting information into the Department's accounting system as transactions occurred. Instead, the Department's method for tracking and recording software costs that should be capitalized was based on a quarterly manual data call process. The effectiveness of the process relied on the responsiveness and understanding of individual project owners. Insufficient guidance was provided to the project owners to understand how to properly account for the costs associated with the IUS and SID projects. In addition, the Department did not have a process to ensure that the information provided by the project owners was accurate or complete. Further, the Department's process to review the status of projects that were nearing completion did not always ensure that the projects were correctly transferred from SID to IUS.

As a result of the control deficiencies related to SID and IUS, the Department's financial statements were misstated. Specifically, the SID balance was overstated by approximately $2.1 million, and the IUS balance was overstated by approximately $8.9 million.

Recommendation:

We recommend that the Department improve its processes for tracking and recording software costs. Specifically, the Department should

- Automate the process for accounting for software-related costs.
- Develop and implement a process to ensure software-in-development and internal use software listings are complete.
- Improve monitoring activities for projects nearing substantial completion to ensure the projects are transferred to the internal use software account in a timely manner.
- Improve training on the criteria for capitalized costs for project owners.
- Develop and implement a process to review information submitted by the project owners to ensure the information is accurate.

II. Asbestos Liability

Inaccurate Supporting Data for the Asbestos Remediation Estimate

Asbestos is a mineral-based material that was widely used worldwide in construction during the 19th and early 20th century due to its affordability and resistance to fire, heat, and electrical damage. The Department owns buildings that were constructed when the use of asbestos in various building materials was common. Due to health concerns, many countries have now prohibited the use of asbestos in building materials. For operational and safety purposes, the Department's Bureau of Overseas Buildings Operations (OBO) periodically assesses overseas facilities to identify those with asbestos containing building materials (ACBM). The assessments are performed by specialized engineers and include sampling building materials that are suspected to contain asbestos. Each sampled material is analyzed by a laboratory to confirm whether or not the material contains asbestos. Upon completion of this analysis, the results for each post are recorded in OBO's Facilities Environmental Tracking System (FACETS).

Beginning in FY 2013, Federal agencies were required to report on their financial statements an estimate of cleanup costs for asbestos-related materials. The Department used data from FACETS as the starting point for the Department's asbestos remediation estimate. We performed steps to assess the validity of FACETS data for 84 overseas buildings. We were unable to confirm the physical existence of some ACBMs reported in FACETS at 27 of 84 buildings tested, as shown in Table 2.

Table 2. Exceptions Identified with FACETS Data

Post	Number of Buildings Tested	Number of Buildings with Exceptions
Bangkok	30	7
Mumbai	1	0
New Delhi	16	6
Berlin	9	3
Frankfurt	19	6
Madrid	3	3
Lisbon	6	2
Total	**84**	**27**

The Department did not have an effective process to ensure that FACETS was updated to reflect the most current conditions at overseas posts. At each overseas post tested, facility surveys were performed several years prior to our testing. The exceptions we identified related to instances where ACBMs had been removed during facility renovations. However, FACETS was not updated to reflect these renovations. The Department indicated that major renovations and abatement efforts were centrally managed and would include a FACETS update upon completion. However, minor facility renovations performed locally, such as remodeling residential properties, were not always communicated to OBO officials and reflected in FACETS.

Inaccurate or outdated underlying data regarding the presence of asbestos in its facilities may limit the Department's ability to produce a reasonable asbestos remediation estimate and could lead to an inaccurate asbestos remediation liability.

Recommendation:

We recommend that the Department strengthen its processes for maintaining accurate data to support its asbestos remediation estimate, including

- Developing procedures to ensure that facility specific data in the Facilities Environmental Tracking System (FACETS) is routinely updated as overseas posts perform renovations and asbestos abatement.
- Confirming FACETS data with overseas facility managers. Posts that have not had recent facilities surveys should be prioritized during this effort.

STATUS OF PRIOR YEAR MANAGEMENT LETTER FINDINGS

The current status of findings reported in the management letter related to the audit of the Department's FY 2012 financial statements is summarized in Table 3.

Table 3. Current Status of Prior Year Management Letter Findings

FY 2012 Management Letter Findings	FY 2013 Status
Untimely Responses to Audit Requests	Repeat
Insufficient Fund Balance with Treasury Reconciliation Process	Repeat
Inaccurate Liability Calculation for Certain Voluntary Contributions	Closed
Inadequate Control Over Personnel Records and Actions	Repeat
Lack of Validation and Monitoring Controls Over Aged Unbilled Federal Accounts Receivable	Closed
Inadequate Controls Over Machine Readable Visa Fee Analysis	Repeat
Insufficient Oversight of Financial Information Provided by the U.S. Agency for International Development	Closed
Inadequate Process to Identify and Measure Deferred Maintenance	Closed