Financial Section

Introduction to Principal Financial Statements

The Principal Financial Statements (Statements) have been prepared to report the financial position and results of operations of the U.S. Department of State (Department). The Statements have been prepared from the books and records of the Department in accordance with formats prescribed by the Office of Management and Budget (OMB) in OMB Bulletin 01-09, *Form and Content of Agency Financial Statements.* The Statements are in addition to financial reports prepared by the Department in accordance with OMB and U.S. Department of the Treasury (Treasury) directives to monitor and control the status and use of budgetary resources, which are prepared from the same books and records. The Statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity. The Department has no authority to pay liabilities not covered by budgetary resources. Liquidation of such liabilities requires enactment of an appropriation.

For 2003, the Consolidated Statement of Net Cost is significantly different than last year's Statements. Specifically, the Department is reporting net costs by strategic goal, which is consistent with OMB Bulletin 01-09, and explained more fully in Note 18 to the financial statements. The 2002 amounts have been recast consistent with the 2003 presentation.

Comparative financial statements are required for 2003 and beyond. 2003 is the first year for which comparative Statements of Changes in Net Position, Budgetary Resources, and Financing are presented.

The **Consolidated Balance Sheet** provides information on assets, liabilities, and net position similar to balance sheets reported in the private sector. Comparative data for 2002 are included, and intra-Departmental balances have been eliminated from the amounts presented.

The **Consolidated Statement of Net Cost** reports the components of the net costs of the Department's operations for the period. The net cost of operations consist of the gross cost incurred by the Department less any exchange (i.e., earned) revenue from our activities. Comparative data for 2002 are included, and intra-Departmental balances have been eliminated from the amounts presented.

The **Consolidated Statement of Changes in Net Position** reports the beginning net position, the transactions that affect net position for the period, and the ending net position. The components of net position are separately displayed in two columns: Cumulative Results of Operations and Unexpended Appropriations to more clearly identify the components of and changes to Net Position. Comparative data for 2002 are included, and intra-Departmental transactions have been eliminated from the amounts presented.

The **Combined Statement of Budgetary Resources** provides information on how budgetary resources were made available and their status at the end of the year. Information in this statement is reported on the budgetary basis of accounting. Comparative data for 2002 are included, and intra-Departmental transactions have not been eliminated from the amounts presented.

The **Combined Statement of Financing** reports the relationship between budgetary transactions and financial transactions. Comparative data for 2002 are included, and intra-departmental transactions have not been eliminated from the amounts presented.

Required Supplementary Stewardship Information provides information on the Department's Heritage Assets. **Required Supplementary Information** contains a Combining Schedule of Budgetary Resources that provides additional information on amounts presented in the **Combined Statement of Budgetary Resources**, and information on intra-governmental amounts, deferred maintenance, and the Department's Working Capital Fund.

The Department received an "Unqualified Opinion" on its financial statements for each of the seven years since 1997 from an independent public accounting firm engaged by the Department's Office of Inspector General.

Independent Auditor's Report

United States Department of State
and the Broadcasting Board of Governors

Office of Inspector General

December 24, 2003

BRIEFING MEMORANDUM

UNCLASSIFIED

TO: THE SECRETARY

FROM: OIG - Anne W. Patterson, Deputy Inspector General AWP

SUBJECT: *Audit of the U.S. Department of State 2003 and 2002 Principal Financial Statements* (Report AUD/FM-04-12)

In compliance with the Chief Financial Officers Act, as amended, the Office of Inspector General (OIG) contracted with Leonard G. Birnbaum and Company, LLP (LGB), an independent certified public accounting firm, to audit the Department's principal financial statements as of September 30, 2003, and for the year then ended.

During its audit, LGB found:

- that the financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles;
- four reportable conditions related to internal controls over information system security, the financial and accounting system, undelivered orders, and the implementation of managerial cost accounting standards.
- that the Department's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996; and
- instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management systems.

The internal control and noncompliance issues underscore the need for the Department to continue its efforts to improve its financial management systems. Although the Department was able to provide information much earlier than in previous years, the auditor's unqualified opinion was achieved for the most part

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through the extensive efforts of financial management staff to overcome system weaknesses and produce auditable information. Because of the internal control and noncompliance issues, reliable information was not readily available during the year, and there is a risk of materially misstating financial information. In addition, OIG is concerned that the Department has not implemented the processes necessary to meet the accelerated deadline for FY 2004.

LGB's report, dated December 24, 2003, is attached for your review. LGB is responsible for this report and the opinions and conclusions expressed therein. OIG is responsible for technical and administrative oversight regarding performance under the terms of the contract, including assuring the audit was performed in accordance with *Government Auditing Standards* and Office of Management and Budget Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. OIG made appropriate inquiries of LGB representatives and monitored the audit by:

- evaluating the nature, timing, and extent of the work;
- evaluating the qualifications and independence of the auditors;
- monitoring progress throughout the audit;
- examining audit workpapers and evaluating key judgments;
- reviewing the audit report to ensure compliance with appropriate standards; and
- performing other procedures that OIG deemed appropriate in the circumstances.

OIG's review, as differentiated from an audit in accordance with *Government Auditing Standards*, was not intended to enable OIG to express, and OIG does not express, an opinion on the Department's financial statements or conclusions about the effectiveness of internal control and compliance with certain laws and regulations. However, OIG's review disclosed no instances where LGB did not comply, in all material respects, with *Government Auditing Standards*.

The Bureau of Resource Management (RM) agreed with the findings and conclusions, and its comments are included as Appendix A to the report. In addition to this report, OIG will transmit a separate management letter to RM discussing several other matters that were identified during the audit. OIG appreciates the cooperation extended to it by the Department's managers and staff during the audit.

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INDEPENDENT AUDITOR'S REPORT

To the Secretary, Department of State:

We have audited the Department of State's (Department) Consolidated Balance Sheet, Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and Combined Statement of Financing as of, and for the years ended, September 30, 2003 and 2002 (collectively the Principal Financial Statements); we have examined internal control over financial reporting in place as of September 30, 2003; and we have examined compliance with laws and regulations.

In our opinion, the Department's 2003 and 2002 Principal Financial Statements are presented fairly in all material respects.

We found:

- reportable conditions on weaknesses in the Department's internal controls,
- instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management system, and
- noncompliance with the Federal Financial Management improvement Act (FFMIA) of 1996.

Each of these conclusions is discussed in more detail below. This report also discusses the scope of our work.

PRINCIPAL FINANCIAL STATEMENTS

In our opinion, the Department's 2003 and 2002 Consolidated Balance Sheets, Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, Combined Statements of Budgetary Resources, and Combined Statements of Financing, including the notes thereto, present fairly, in all material respects, the Department's financial position as of September 30, 2003 and 2002, and the net cost of operations, the changes in net position, the use of budgetary resources, and the use of financing, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In 2003 and 2002, the Department implemented revised financial statement reporting requirements and Statements of Federal Financial Accounting Standards that became effective for those years. The details of these changes are presented in Note 2 to the Principal Financial Statements. The Department also changed its method for estimating domestic accounts payable in 2003. Details regarding this change are presented in Note 1 to the Principal Financial Statements.

INTERNAL CONTROL

We considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Principal Financial Statements. We limited our internal control testing to those controls necessary to achieve the objectives described in the Office of Management and Budget's (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the following objectives are met:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over assets;

- funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition;

- transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that OMB, Department

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management, or the Inspector General have identified as being significant for which compliance can be objectively measured and evaluated; and

- data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters of internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts, which would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted four matters, discussed in the following paragraphs, involving internal control that we consider to be reportable conditions.

- We have identified significant weaknesses related to information system security that we believe could be exploited to have a detrimental effect on the information used to prepare the financial statements. We believe that the information system networks for domestic operations are vulnerable to unauthorized access. Consequently, systems, including the Department's financial management system, which process data using these networks, may also be vulnerable. This weakness was first reported in *Computer Security: Pervasive, Serious Weaknesses Jeopardize State Department Operations* (GAO/AIMD-98-145) based on penetration tests performed by the General Accounting Office (GAO) and was then reported in our opinion on the 1997 financial statements.

  The Department was able to close the recommendations related to this GAO report in FY 2000. However, we did not believe that the closure of the GAO recommendations demonstrated that the previously cited material weakness had necessarily been corrected. Therefore, the Department performed tests of access controls in this area, which identified significant weaknesses. The Department has initiated a program to assess its information systems security on a comprehensive basis.

This condition had been reported as a material weakness in our audits of the Department's 1997 Principal Financial Statements and subsequent audits. The Department's work toward correcting this deficiency is now considered to be sufficiently advanced to reduce this deficiency to a reportable condition.

- The Department's financial and accounting system, as of September 30, 2003, was inadequate. This inadequacy prevented the Department from routinely issuing timely financial statements. There is a risk of materially misstating financial information under the current conditions. The principal areas of inadequacy were:

  - Certain elements of the financial statements, including, but not limited to, personal property, capital leases, and certain accounts payable, are developed from sources other than the general ledger. This is due, at least in part, to untimely processing and reporting of transactions by posts and bureaus. OMB Circular A-127, *Financial Management Systems,* requires that transaction processing be applied consistently throughout the Department's financial management system. The use of sources other than the general ledger to generate elements of the financial statements increases the potential for omission of significant transactions.

  - During 2003, the Department used several systems for the management of grants and other types of financial assistance. These lacked standard data classifications and common processes and were not integrated with the Department's centralized financial management system. Further, the Department could not produce reliable financial information that defined the universe of grants and other federal financial assistance.

- The Department's internal control process related to the management of undelivered orders was inadequate. The Department has made significant improvements in this area over the past two years. The Department has actively worked with bureaus to validate undelivered orders and has successfully cleared up a significant number of obligations that were outstanding from past years. However, the Department needs to perform additional work to correct this weakness. Our tests indicated that over $334 million of undelivered orders should have been deobligated as of September 30, 2003. Also, we noted that the Department's undelivered orders balance has grown significantly to $6.7 billion, as of September 30, 2003. The Budget and Accounting Procedures Act of 1950 requires that the Department's accounting system provide effective control over funds. Failure to deobligate funds in a timely manner may result in the loss of availability of those funds.

The above two reportable conditions were cited in our audits of the Department's 1997 Principal Financial Statements and subsequent audits.

- Although the Department complied with certain aspects of Statement of Federal Financial Accounting Standards #4, *Managerial Cost Accounting Standards* - for instance, it chose reasonable responsibility segments, recognized the cost of goods and services that it receives from other entities, and used an appropriate allocation methodology - it did not implement an effective process to routinely collect managerial cost accounting information, establish outputs for each responsibility segment, or allocate all support costs. Until this is done, we do not believe the information will be useful as a management decisionmaking tool. This was first reported in our audit of the Department's 2000 Principal Financial Statements.

These deficiencies in internal control may adversely affect any decision by management that is based, in whole or in part, on information that is inaccurate because of the deficiencies. Unaudited financial information reported by the Department, including budget information, also may contain misstatements resulting from these deficiencies.

We are not aware of any other known but uncorrected material findings or recommendations from prior audits that affect the current audit objectives.

In addition, we considered the Department's internal control over Required Supplementary Stewardship Information and Required Supplementary Information by obtaining an understanding of the Department's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of controls as required by OMB Bulletin 01-02, and not to provide assurance on those internal controls. Accordingly, we do not provide an opinion on those controls.

Finally, with respect to internal control related to performance measures reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant controls relating to the existence and completeness assertions and determined whether those controls had been placed in operation as required by OMB Bulletin 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We noted certain other internal control issues that we have reported to the Department's management in a separate letter dated December 24, 2003.

COMPLIANCE WITH LAWS AND REGULATIONS

The Department's management is responsible for complying with laws and regulations applicable to the Department. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin 01-02, including the requirements referred to in FFMIA. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department. The objective of our audit of the Principal Financial Statements, including our tests of compliance with selected provisions of applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions in statutes and regulations, that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements or that sensitivity warrants disclosure thereof.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed the following instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* issued by the Comptroller General of the United States and OMB Bulletin 01-02.

Overall, we found that the Department's financial management system did not comply with a number of laws and regulations, as follows:

- Budget and Accounting Procedures Act of 1950. This requires an accounting system to provide full disclosure of the results of financial operations; adequate financial information needed in the management of operations and the formulation and execution of the budget; and effective control over income, expenditures, funds, property, and other assets. However, we found that the financial systems: (1) did not manage undelivered orders effectively, and (2) did not issue interim financial reports that could be used for effective management of operations.

- Federal Managers' Financial Integrity Act of 1982. This requires the implementation of internal accounting and administrative controls that provide reasonable assurance that: (1) obligations and costs are in compliance with applicable laws; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to Department operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets. However, as discussed above, we found that the financial system did not manage undelivered orders effectively. Hence, these funds are not adequately protected from waste or loss.

- Chief Financial Officers Act of 1990. This requires the development and maintenance of an integrated accounting and financial management system that: (1) complies with applicable accounting principles, standards and requirements, and internal control standards; (2) complies with such policies and requirements as may be prescribed by the Director of OMB; (3) complies with any other requirements applicable to such systems; and (4) provides for (i) complete, reliable, consistent, and timely information that is prepared on a uniform basis and that is responsive to the financial information needs of agency management; (ii) the development and reporting of cost information; (iii) the integration of accounting and budgeting information; and (iv) the systematic measurement of performance. However, we found that the financial systems: (1) did not issue interim financial statements that could be used for effective management; and (2) did not provide complete information in that certain elements of the financial statements are developed from sources other than the general ledger.

- OMB Circular A-127. This requires the Department to establish and maintain an accounting system that provides for: (1) complete disclosure of the financial results of the activities of the Department; (2) adequate financial information for Department management and for formulation and execution of the budget; and (3) effective control over revenue, expenditure, funds, property, and other assets. However, we found, again, that the financial system did not maintain effective control over undelivered orders. Further, the Department's failure to implement an effective managerial cost accounting system precludes effective control over revenues and expenditures.

The above areas of noncompliance were cited in our audits of the Department's 1997 Principal Financial Statements and subsequent audits.

The results of our tests of compliance with other laws and regulations disclosed no material instances of noncompliance. Compliance with FFMIA is discussed below.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with federal financial management system requirements, applicable accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance, using the implementation guidance for FFMIA issued by OMB on January 4, 2001.

The results of our tests disclosed instances, described below, where the Department's financial management systems did not substantially comply with the requirement to follow the federal financial management system requirements. OMB implementation guidance states that, to be in substantial compliance with this requirement, the Department must meet specific requirements of OMB Circular A-127, including the computer security controls required by

OMB Circular A-130, *Management of Federal Information Resources*. We found instances of substantial noncompliance with these two requirements.

- Circular A-127 requires that the Department's systems support management's fiduciary role by providing complete, reliable, consistent, timely, and useful financial management information. Based on the weaknesses related to financial management systems discussed in the report on internal controls and the preceding paragraphs in the report on compliance with laws and regulations, we determined that the Department was not substantially in compliance with this standard.

- Circular A-130, Appendix III, requires that the Department ensure an adequate level of security for all agency automated information systems. Specifically, the Department should ensure that automated information systems operate effectively and have appropriate safeguards to ensure the integrity of those systems. Based on our concerns related to the financial management systems discussed in the report on internal control and the preceding paragraphs in the report on compliance with laws and regulations, we determined that the Department was not substantially in compliance with this standard.

The Department's Bureau of Resource Management (RM) has overall responsibility for the Department's financial management systems. The foregoing noncompliance has its roots in the lack of organization and integration of the Department's financial management systems. This issue has been highlighted since 1983 in the Department's annual report, required by the Federal Managers' Financial Integrity Act. In our audits of the Department's Principal Financial Statements since 1997, we observed that the Department's financial management systems were not in compliance with FFMIA and recommended, in connection with our audits of the Department's 1997 and 1998 Principal Financial Statements, that a remediation plan be prepared. RM submitted its plan to remediate noncompliance with FFMIA to OMB on March 16, 2000. The plan initially projected achieving substantial compliance with FFMIA during FY 2003. RM currently expects to achieve this goal in 2004. Although RM has completed several significant phases of its plan, the plan needs to specifically address systems security and management of grants and other types of federal assistance.

We noted certain other instances of noncompliance that we reported to the Department's management in a separate letter dated December 24, 2003.

RESPONSIBILITIES AND METHODOLOGY

Department management has the responsibility for:

- preparing the Principal Financial Statements and required supplementary stewardship information, required supplementary information, and other accompanying information in conformity with accounting principles generally accepted in the United States of America;
- establishing and maintaining effective internal control; and
- complying with applicable laws and regulations.

Our responsibility is to express an opinion on the Principal Financial Statements based on our audit. Auditing standards generally accepted in the United States of America require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Financial Statements are free of material misrepresentation and presented fairly in accordance with accounting principles generally accepted in the United States of America. We considered the Department's internal control for the purpose of expressing our opinion on the Principal Financial Statements referred to above and not to provide an opinion on internal control. We are also responsible for testing compliance with selected provisions of applicable laws and regulations that may materially affect the financial statements.

In order to fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the Principal Financial Statements;
- obtained an understanding of the internal controls over financial reporting by obtaining an understanding of the agency's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls;
- obtained an understanding of the internal controls relevant to performance measures included in Management's Discussion and Analysis, including obtaining an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether they had been placed in operations;

- obtained an understanding of the process by which the agency identifies and evaluates weaknesses required to be reported under FMFIA and related agency implementing procedures;

- tested compliance with selected provisions of laws and regulations that may have a direct and material effect on the financial statements;

- obtained written representations from management; and

- performed other procedures as we considered necessary in the circumstances.

Our audits were conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin 01-02. We believe that our audits provide a reasonable basis for our opinion.

The Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information are not a required part of the Principal Financial Statements, but are supplementary information required by OMB Bulletin 01-09, *Form and Content of Agency Financial Statements,* and the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

This report is intended for the information of the Inspector General of the U.S. Department of State, the Department's management, the Office of Management and Budget, and the Congress. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Comments by the Department's management on this report are presented as Appendix A.

Leonard G. Birnbaum and Company, LLP

Alexandria, Virginia
December 24, 2003

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United States Department of State

Assistant Secretary and Chief Financial Officer

Washington, D.C. 20520

December 24, 2003

MEMORANDUM

TO: OIG - Ms. Anne W. Patterson

FROM: RM - Christopher B. Burnham CBB

SUBJECT: Draft Audit Report on the Department of State's 2003 and 2002 Principal Financial Statements

This is in response to your request for comments on the draft report titled "Audit of the U.S. Department of State 2003 and 2002 Principal Financial Statements" (Report).

For the seventh consecutive year, the independent CPA firm selected by the Office of Inspector General (OIG) will issue an unqualified ("clean") opinion on the Department's consolidated financial statements. Achieving an unqualified opinion is an important accomplishment for both of our offices. Also noteworthy is that this year's opinion is five weeks earlier than the opinion on the FY 2002 consolidated financial statements. We would like to extend our appreciation to your staff and to your contractor, Leonard G. Birmbaum and Company, LLP, for the professional and cooperative manner in which they conducted the audit.

In relation to internal control, the Report cites four reportable conditions: (1) information systems security, (2) the inadequacy of the Department's financial management systems, (3) the management of unliquidated obligations, and (4) the implementation of Managerial Cost Accounting Standards. The Department's financial management systems are also reported as noncompliant with laws and regulations, including the Federal Financial Management Improvement Act of 1996 (FFMIA).

The Report cites the Department's security for information systems networks as a reportable condition, an improvement from last year's identification of this area as a material weakness. While improvement efforts in this area will continue, we are pleased that our progress is recognized in the Report. In 2003, the Department continued to strengthen our cyber security posture. These measures include establishing a baseline inventory of applications, developing and implementing a systems/site authorization project, meeting our goal of certifying and accrediting one-third of systems by August 2003, establishing a Departmentwide process to track corrective action in mitigating security weaknesses, revising Department cyber security roles and responsibilities, and maintaining a strong perimeter defense and incident response.

Our efforts to address this weakness also include periodic meetings with staff from your Office of Audits, Leonard G. Birnbaum and Company, LLP, senior managers in IRM and our office. The purpose is to identify and coordinate actions needed to improve controls and monitor progress. We have and will continue to provide a status of these efforts to the Office of Management and Budget (OMB) as part of our reporting on the President's Management Agenda.

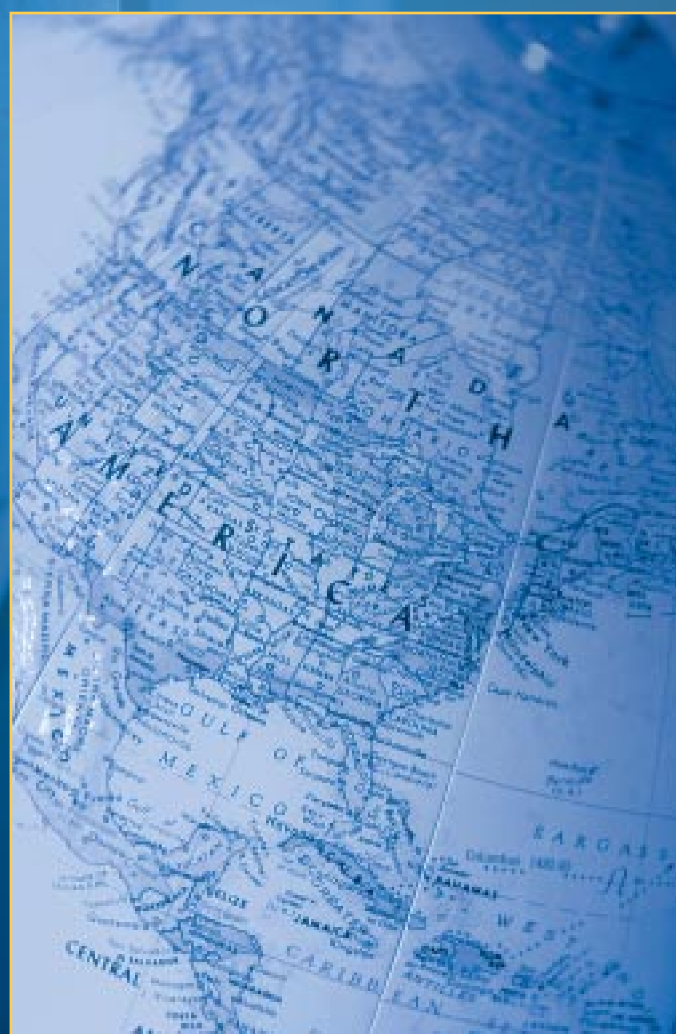
Substantial compliance with Federal financial systems requirements is a top priority of the Department, and many improvements have taken place to address the longstanding weaknesses in the Department's financial systems. Based on these improvements, including the implementation of the new Regional Financial Management Systems at all overseas posts, the MCSC voted to close the Department's one remaining material non-conformance for Financial and Accounting Systems. We believe our efforts in FY 2004 will provide for achieving substantial compliance with FFMIA.

Strengthening the management of unliquidated obligations is an important financial management initiative. As mentioned in the Report, the Department has made significant progress in this area. The Unliquidated Obligation System was implemented in FY 2000, and we use this system to facilitate the reconciliation, monitoring, reporting and oversight of unliquidated obligations worldwide. Data in the system is analyzed in various strata and reports to facilitate the review and management of open items. This information, together with new processes recently implemented in our financial systems, will provide for improved management and oversight of unliquidated obligations in FY 2004.

The Department is making progress in implementing Managerial Cost Accounting Standards (MCAS), but acknowledges that additional work is needed to fully comply with these standards. To address MCAS requirements, the Department developed a revised Statement of Net Cost methodology that allows for the reporting of cost information by strategic objectives and goals. This new method was used to produce the FY 2003 Statement of Net Cost.

We thank you for the opportunity to comment on the draft report and for working with us in a collaborative manner on the FY 2003 financial statements. We believe that our offices have made considerable progress over the past several years. The Department is committed to continuing its efforts to improve management of its programs and the quality of its financial reporting.

Financial Statements



PRINCIPAL FINANCIAL STATEMENTS

DEPARTMENT OF STATE
CONSOLIDATED BALANCE SHEET

(Dollars in Thousands)

As of September 30,	**Notes**	**2003**	**2002**
ASSETS	3		
Intragovernmental Assets:			
Fund Balances With Treasury	4	$ 9,953,197	$ 8,937,139
Investments, Net	5	12,301,173	11,750,737
Accounts Receivable, Net	6	372,303	313,291
Interest Receivable		189,366	192,637
Total Intragovernmental Assets		22,816,039	21,193,804
Accounts Receivable, Net	6	21,346	45,349
Loans Receivable, Net	7	1,215	1,231
Cash and Other Monetary Assets	8	16,086	12,792
Inventory	9	5,259	7,784
Property and Equipment, Net	10	5,996,493	5,499,850
Other Assets	11	38,208	79,347
Total Assets		$ 28,894,646	$ 26,840,157

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE
CONSOLIDATED BALANCE SHEET

(Dollars in Thousands)

As of September 30,	Notes	2003	2002
LIABILITIES	12		
Intragovernmental Liabilities:			
Accounts Payable		$ 39,889	$ 4,120
Other Liabilities		36,800	37,300
Total Intragovernmental Liabilities		76,689	41,420
Accounts Payable		1,018,625	780,679
Foreign Service Retirement Actuarial Liability	13	13,093,800	12,211,800
Liability to International Organizations	14	919,428	1,065,172
Capital Lease Liability	15	85,985	92,010
Funds Held in Trust	8	13,322	13,592
Federal Employees' Compensation Act Benefits		61,628	56,259
Other Liabilities	12	511,659	563,471
Total Liabilities		15,781,136	14,824,403
Commitments and Contingencies	16		
NET POSITION			
Unexpended Appropriations	17	8,536,307	7,154,023
Cumulative Results of Operations		4,577,203	4,861,731
Total Net Position		13,113,510	12,015,754
Total Liabilities and Net Position		$ 28,894,646	$ 26,840,157

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF NET COST (NOTE 18)

(Dollars in Thousands)

For the year ended September 30,	**2003**	**2002**
Achieve Peace and Security		
Regional Stability		
Total Cost	$ 982,449	$ 800,909
Earned Revenue	(46,567)	(31,054)
Net Program Costs	935,882	769,855
Counterterrorism		
Total Cost	461,209	346,172
Earned Revenue	(21,861)	(13,423)
Net Program Costs	439,348	332,749
Homeland Security		
Total Cost	450,960	860,906
Earned Revenue	(21,375)	(33,381)
Net Program Costs	429,585	827,525
Weapons of Mass Destruction		
Total Cost	366,038	315,697
Earned Revenue	(17,350)	(12,241)
Net Program Costs	348,688	303,456
International Crime and Drugs		
Total Cost	1,005,795	712,762
Earned Revenue	(32,127)	(12,799)
Net Program Costs	973,668	699,963
American Citizens		
Total Cost	1,492,507	1,334,435
Earned Revenue	(1,442,760)	(1,011,048)
Net Program Costs	49,747	323,387
Advance Sustainable Development and Global Interests		
Democracy and Human Rights		
Total Cost	492,444	366,647
Earned Revenue	(23,341)	(14,216)
Net Program Costs	469,103	352,431
Economic Prosperity and Security		
Total Cost	1,040,527	718,533
Earned Revenue	(49,319)	(27,860)
Net Program Costs	991,208	690,673
Social and Environment Issues		
Total Cost	255,740	213,322
Earned Revenue	(12,121)	(8,271)
Net Program Costs	243,619	205,051
Humanitarian Response		
Total Cost	775,718	845,205
Earned Revenue	(392)	454
Net Program Costs	775,326	845,659
Promote International Understanding		
Public Diplomacy and Public Affairs		
Total Cost	1,482,740	1,706,951
Earned Revenue	(129,811)	(109,986)
Net Program Costs	1,352,929	1,596,965
Executive Direction and Other Costs Not Assigned		
Total Cost	3,416,513	2,616,296
Earned Revenue	(1,365,999)	(1,225,271)
Net Program Costs	2,050,514	1,391,025
Total Cost	**12,222,640**	**10,837,835**
Total Revenue	**(3,163,023)**	**(2,499,096)**
Total Net Cost	**$ 9,059,617**	**$ 8,338,739**

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

(Dollars in Thousands)

For the Year Ended	September 30, 2003 Cumulative Results of Operations	September 30, 2003 Unexpended Appropriations	September 30, 2002 Cumulative Results of Operations	September 30, 2002 Unexpended Appropriations
Beginning Balances	$ 4,861,731	$ 7,154,023	$ 3,451,512	$ 5,961,844
Prior period adjustments (+/-)	—	—	—	—
Beginning Balances, as adjusted	4,861,731	7,154,023	3,451,512	5,961,844
Budgetary Financing Sources:				
Appropriations Received	—	10,320,841	—	10,227,805
Appropriations transfered-in/out (+/-)	—	558,225	—	1,024,187
Other adjusted (rescissions, etc.) (+/-)	—	(150,850)	—	(116,923)
Appropriations Used	9,345,932	(9,345,932)	9,942,890	(9,942,890)
Nonexchange revenue	862	—	16,267	—
Donations	3,927	—	33,581	—
Other Financing Sources:				
Transfers-in/out without reimbursement (+/-)	(663,172)	—	(327,859)	—
Imputed financing from costs absorbed by others	87,540	—	84,079	—
Total Financing Sources	8,775,089	1,382,284	9,748,958	1,192,179
Net Cost of Operations (+/-)	(9,059,617)	—	(8,338,739)	—
Ending Balances	**$ 4,577,203**	**$ 8,536,307**	**$ 4,861,731**	**$ 7,154,023**

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 19)

(Dollars in Thousands)

For the Year Ended September 30,	**2003**	**2002**
Budgetary Resources:		
Budget Authority		
Appropriations received	$ 11,952,495	$ 11,434,158
Net transfers	110,219	1,040,178
Other	—	479,683
Unobligated balances:		
Beginning of period	2,579,307	2,369,063
Net transfers	(17,645)	(39,432)
Spending authority from offsetting collections:		
Earned		
Collected	3,360,669	2,081,677
Receivable from Federal sources	(266,146)	217,618
Change in unfilled customer orders		
Without advance from Federal sources	1,619	2,435
Subtotal	3,096,142	2,301,730
Recoveries	529,542	880,827
Temporarily not available pursuant to Public Law	(555,093)	(575,067)
Permanently not available	(144,406)	(96,549)
Total Budgetary Resources	**$ 17,550,561**	**$17,794,591**

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 19)

(Dollars in Thousands)

For the Year Ended September 30,	**2003**	**2002**
Status of Budgetary Resources:		
Obligations incurred		
Direct	$ 15,170,135	$ 13,670,130
Reimbursable	(244,950)	1,545,154
Subtotal	14,925,185	15,215,284
Unobligated balances available		
Apportioned	2,356,174	2,360,250
Exempt from apportionment	7,489	98,833
Unobligated balances not available	261,713	120,224
Total Status of Budgetary Resources	17,550,561	17,794,591
Relationship of Obligations to Outlays:		
Obligated balance, net, beginning of year	5,990,322	4,642,993
Obligated balance transferred, net	—	—
Less: obligated balance, net, end of year		
Accounts receivable	(370,797)	(636,037)
Unfilled customer orders from Federal sources	(2,886)	(1,618)
Undelivered orders	6,679,670	6,328,591
Accounts payable	974,382	299,386
Outlays		
Disbursements	13,614,334	12,767,075
Collections	(3,360,669)	(2,081,677)
Subtotal	10,253,665	10,685,398
Less: offsetting receipts	(896,582)	(806,806)
Net Outlays	**$ 9,357,083**	**$ 9,878,592**

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE
COMBINED STATEMENT OF FINANCING (NOTE 20)

(Dollars in Thousands)

For the Year Ended September 30,	2003	2002
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 14,925,185	$ 15,215,994
Less: Spending Authority from offsetting collections and recoveries	(3,625,684)	(3,180,772)
Obligations net of offsetting collections and recoveries	11,299,501	12,035,222
Less: Offsetting receipts	(896,582)	(806,806)
Net obligations	10,402,919	11,228,416
Other Resources		
Donations	$ 3,927	$ —
Transfers in/out without reimbursement	(663,171)	(327,859)
Imputed financing from costs absorbed by others	87,540	84,079
Other	—	31,840
Net other resources used to finance activities	(571,704)	(211,940)
Total Resources used to Finance Activities	**$ 9,831,215**	**$ 11,016,476**
Resources Used to Finance Items not Part of Net Cost of Operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet received	349,811	1,765,930
Resources that fund expenses recognized in prior periods	156,320	1,890,375
Budgetary offsetting collections and receipts that do not affect net cost of operations		
Credit program collections which increase liability for loan guarantees or allowance for subsidy	1,198	287
Other	975,089	—
Resources that finance the acquisitions of assets	494,118	1,039,480
Other resources or adjustments to net obligated resources that do not affect net cost of operations	—	—
Total Resources used to Finance Items not Part of the Net Cost of Operations	1,976,536	4,696,072
Total Resources Used to Finance the Net Cost of Operations	$ 7,854,679	$ 6,320,404

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE
COMBINED STATEMENT OF FINANCING (NOTE 20)

(Dollars in Thousands)

For the Year Ended September 30,	2003	2002
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components requiring or generating resources in future periods		
Increase in annual leave liability	$ 17,945	$ 8,976
Increase in actuarial liability	887,369	1,057,328
Increase in IO liability	—	683,311
Other, net	68	9,454
Total components of Net Cost of Operations that will require or generate resources in future periods	905,382	1,759,069
Components not Requiring or Generating Resources:		
Depreciation and amortization	$ 275,281	$ 246,034
Reevaluation of assets or liabilities	—	—
Other	24,275	13,232
Total components of Net Cost of Operations that will not require or generate resources	299,556	259,266
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	1,204,938	2,018,335
Net Cost of Operations	$ 9,059,617	$ 8,338,739

The accompanying notes are an integral part of this financial statement.

DEPARTMENT OF STATE
NOTES TO PRINCIPAL FINANCIAL STATEMENTS

ORGANIZATION

Congress established the U.S. Department of State ("Department of State" or "Department"), the senior executive department of the United States Government in 1789, replacing the Department of Foreign Affairs, which was established in 1781. The Department advises the President in the formulation and execution of foreign policy. As head of the Department, the Secretary of State is the President's principal advisor on foreign affairs. The Department's primary objective is to promote the security and well-being of the United States.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity and Basis of Consolidation

The accompanying principal financial statements (statements) present the financial activity for the Department of State. The statements include the accounts of all funds under Department control that have been established and maintained to account for the resources entrusted to Department management, or for which the Department acts as a fiscal agent or custodian. The Department maintains General Funds, Special Funds, Revolving Funds, Trust Funds, and Deposit Funds.

- General and Special Funds are used to record financial transactions under Congressional appropriations or other authorization for spending general revenues.
- Revolving Funds are established by law to finance a continuing cycle of operations. Receipts derived from such operations are usually available in their entirety for the Fund to use without further action by Congress.
- Trust Funds are credited with receipts that are generated by the terms of a trust agreement or statute. At the point of collection, these receipts are either available immediately or unavailable depending upon statutory requirements. The largest trust fund is the Foreign Service Retirement and Disability Fund (FSRDF).
- Deposit Funds are established for: (1) amounts received for which the Department is acting as a fiscal agent or custodian; (2) unidentified remittances; (3) monies withheld from payments for goods and services received; and (4) monies held awaiting distribution on the basis of a legal determination.

Basis of Presentation

The accompanying statements have been prepared to report the financial position and results of operations for the Department of State. These statements are prepared as required by the Government Management and Reform Act (GMRA) of 1994 and presented in accordance with form and content requirements contained in Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements.* OMB Bulletin No. 01-09 defines the form and content for annual financial statements that are required to be submitted to the Director of OMB. The statements presented herein are in addition to the financial reports prepared by the Department in accordance with OMB and U.S. Department of the Treasury (Treasury) directives to monitor and control the status and use of budgetary resources.

The statements have been prepared from the Department's books and records, and are in accordance with the Department's accounting policies (the significant policies are summarized below in this Note). The Department's accounting policies follow accounting principles generally accepted in the United States of America (GAAP). GAAP for Federal entities is the hierarchy of accounting principles prescribed in the American Institute of Certified Public Accountants' Statement of Auditing Standards No. 91, *Federal GAAP Hierarchy*.

Basis of Accounting

Transactions are recorded on both an accrual and budgetary basis. Under the accrual basis, exchange revenues are recognized when earned, and expenses are recognized when a liability is incurred. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds.

Budgets and Budgetary Accounting

Congress annually enacts one-year appropriations that provide the Department with the authority to obligate funds within the respective fiscal year for necessary expenses to carry out mandated program activities. In addition, Congress enacts multi-year appropriations and appropriations that are available until expended. All appropriations are subject to OMB apportionment as well as Congressional restrictions. The Department also implements internal restrictions to ensure efficient and proper use of all appropriations. One-year and multi-year appropriations are canceled and cannot be used for disbursements if five years have passed since the appropriation was last available for obligation.

Revenues and Other Financing Sources

Department operations are financed through appropriations, reimbursement for the provision of goods or services to other Federal agencies, proceeds from the sale of property, certain consular-related and other fees, and donations. In addition, the Department collects passport, visa, and other consular fees that are not retained by the Department but are deposited directly to a Treasury account. The passport and visa fees are reported as earned revenues on the Statement of Net Cost and as a transfer-out of financing sources on the Statement of Changes in Net Position.

For financial statement purposes, appropriations are recorded as a financing source (i.e., Appropriations Used) and reported on the Statement of Changes in Net Position at the time they are recognized as expenditures. Appropriations expended for capitalized property and equipment are recognized when the asset is purchased. The applicable depreciation expense for real and personal property is recorded over the asset's useful life as described below in Property and Equipment.

Work performed for other Federal agencies under reimbursable agreements is initially financed through the account providing the service and is subsequently reimbursed. Reimbursements are recognized as revenue when earned, i.e., goods have been delivered or services rendered, and the associated costs have been incurred.

Administrative support services at overseas posts are provided to other Federal agencies through the International Cooperative Administrative Support Services (ICASS). ICASS bills for the services it provides to agencies at overseas posts. These billings are recorded as revenue to ICASS and must cover all overhead costs, operating expenses, and replacement costs for capital assets needed to carry on the operation.

Proceeds from the sale of real property, vehicles, and other personal property are recognized as revenue when the proceeds are credited to the account from which the asset was funded. For non-capitalized property, the full amount realized is recognized as revenue. For capitalized property, revenue or loss is determined by whether the proceeds received were more or less than the net book value of the asset sold. The Department retains proceeds of sale, which are available for purchase of the same or similar category of property.

The Department is authorized to collect and retain specific user fees for machine-readable visas, expedited passport processing, and fingerprint checks on immigrant visa applicants. The Department is also authorized to credit the respective appropriations with (1) fees for the use of Blair House; (2) lease payments and transfers from the International Center Chancery Fees held in Trust to the International Center Project; (3) registration fees for the Office of Defense Trade Controls;(4) reimbursement for international litigation expenses; and (5) reimbursement for training foreign government officials at the Foreign Service Institute.

Generally, donations received in the form of cash or financial instruments are recognized as revenue at their fair value in the period received. Contributions of services are recognized if the services received (a) create or enhance non-financial assets, or (b) require specialized skills that are provided by individuals possessing those skills, which would typically need to be purchased if not donated. Works of art, historical treasures, and similar assets that are added to collections are not recognized at the time of donation. If subsequently sold, proceeds from the sale of these items are recognized in the year of sale.

The Department receives most of the funding it needs to support the Repatriation Loan Program through an annual appropriation and permanent, indefinite borrowing authority. The appropriation has two components: (1) a subsidy portion for the present value of long-term cash flow, and (2) estimated expenses to administer the program. Appropriations are recognized as used at the time the loans are obligated and administrative expenses are incurred.

Fund Balances with Treasury

The Fund Balances with Treasury are available to pay accrued liabilities and finance authorized commitments relative to goods, services, and benefits. The Department does not maintain cash in commercial bank accounts for the funds reported in the Balance Sheet, except for the Emergencies in the Diplomatic and Consular Services, Office of Foreign Missions, Foreign Service National Defined Contributions Retirement Fund, and the International Center, which maintains a commercial account for lease fees held in trust — see Note 8, “Cash and Other Monetary Assets”. Treasury processes domestic receipts and disbursements. During 2003 and 2002, the Department operated three Financial Service Centers, which are located in Paris, Bangkok, and Charleston, South Carolina, and provide financial support for the Department and other Federal agencies’ operations overseas. The Paris operations were relocated to Charleston and Bangkok during 2003. The U.S. Disbursing Officer at each Center has the delegated authority to disburse funds on behalf of the Treasury.

Accounts Receivable

Intragovernmental Accounts Receivable are due principally from other Federal agencies for ICASS services, reimbursable agreements, and Working Capital Fund (WCF) services. Accounts Receivable from non-Federal entities are primarily the result of International Boundary and Water Commission (IBWC) receivables for Mexico’s share of IBWC activities, Repatriation Loans, and travel advances.

Accounts Receivable from non-Federal entities are subject to the full debt collection cycle and mechanisms, e.g., salary offset, referral to collection agents, and Treasury offset. In addition, Accounts Receivable from non-Federal entities are assessed interest, penalties and administrative fees if they become delinquent. Interest and penalties are assessed at the Current Value of Funds Rate established by Treasury. Except for amounts assessed on FSRDF accounts, any interest, penalties or fees collected are not retained but are treated as miscellaneous receipts and are deposited directly to a Treasury account. Amounts assessed on FSRDF accounts are credited to the FSRDF.

Allowances for uncollectible Accounts Receivable are based on criteria established for each type of receivable. Due to the relatively small number and dollar amount of non-Federal receivables, accounts are independently assessed to determine whether they are collectible and need an offsetting allowance. All Intragovernmental Accounts Receivable are considered collectible. However, an allowance may be established to recognize billing disputes. Similar to non-Federal receivables, Intragovernmental receivables are independently assessed to determine collectibility and the need for an offsetting allowance.

Interest Receivable

Interest earned on investments, but not received as of September 30, is recognized as interest receivable.

Loans Receivable

The Department provides Repatriation Loans for destitute American citizens overseas whereby the Department becomes the lender of last resort. These loans provide assistance to pay for return transportation, food and lodging, or medical expenses. The borrower executes a promissory note without collateral. Consequently, the loans are made anticipating a low rate of recovery. Interest, penalties, and administrative fees are assessed if the loan becomes delinquent.

Advances and Prepayments

Payments made in advance of the receipt of goods and services are recorded as advances or prepayments, and recognized as expenses when the related goods and services are received. Advances are made principally to Department employees for official travel, miscellaneous prepayments and advances to other entities for future services, and salary advances to Department employees transferring to overseas assignments. Advances and prepayments are reported as Other Assets on the Balance Sheet.

Valuation of Investments

The FSRDF investments consist solely of special issues of U.S. Government securities, which are redeemable on demand at par. For financial statement purposes, the investments are therefore valued at par. Interest on investments is paid semi-annually on June 30 and December 31.

The investments of the Gift Funds consist of U.S. guaranteed securities. These investments are reported at the acquisition cost, which equals the face value plus or minus the unamortized premium or discount. Premiums and discounts are amortized over the life of the Treasury bill using the straight-line method.

The Department administers the Israeli-Arab Scholarship and Eisenhower Exchange Fellowship Programs. The Israeli-Arab Scholarship Program provides grants and scholarships to Israeli-Arab students for degree programs at universities and colleges in the United States. The Eisenhower Exchange Fellowship Program honors the late president and increases educational opportunities for young leaders in preparation for and enhancement of their professional careers and advancement of peace through international understanding. The Israeli-Arab Scholarship Fund and Eisenhower Exchange Fellowship Program Trust Fund investments consist of market-based U.S. Treasury Securities. Interest on investments is paid semiannually at various rates. Investments are valued at their par value, net of unamortized premiums and discounts. Premiums and discounts are amortized over the life of the security on an effective interest basis. See Note 5, "Investments."

Works of Art and High Value Furnishings

The Department has collections of art and furnishings that are held for public exhibition, education, and official entertainment for visiting Chiefs of State, Heads of Government, Foreign Ministers, and other distinguished foreign and American guests. The Department has six separate collections: the Diplomatic Reception Rooms, the Art Bank, Art in Embassies, Curatorial Services Program, the Library Rare and Special Book Collection, and the Secretary of State's Register of Culturally Significant Property.

Judith Miller
Water Lillies/Greenbrook Sanctuary #1

The collections consist of items that were donated, purchased using donated or appropriated funds, or are on loan from individuals, organizations, or museums. The Department provides protection and preservation services for these collections.

The items that the Department owns are considered heritage assets (see " Required Supplementary Stewardship Information — Heritage Assets"). In accordance with SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* no value is assigned to these assets in the Consolidated Balance Sheet. Purchases of items for collections are recorded as an expense in the year of purchase. Proceeds from disposals are recognized as revenue in the year of sale and are designated for future collection acquisitions.

Inventories

The Department's Consolidated Balance Sheet reflects inventories held by WCF's Publishing Services, and the Supply Services Center and Stock Account. The WCF inventory consists primarily of paper and ink used for printing and reproduction services (Publishing Services), furniture held for sale to bureaus in the Department (Supply Services Center and Stock Account), and publications held for sale.

The WCF's Publishing Services inventory is valued at the latest acquisition cost. The Supply Services Center and Stock Account inventory is valued monthly using a weighted moving average. The inventory value of the publications held for sale is based on the cost of production. Recorded values are adjusted for the results of periodic physical inventories.

Property and Equipment—Real Property

Real property assets primarily consist of facilities used for U.S. diplomatic missions abroad and capital improvements to these facilities, including unimproved land; residential and functional-use buildings such as embassy/consulate office buildings; office annexes and support facilities; and construction-in-progress. Title to these properties is held under various conditions including fee simple, restricted use, crown lease, and deed of use agreement. Some of these properties are considered historical treasures and are considered multi-use heritage assets. These items are reported on the Balance Sheet and included on the Required Supplementary Stewardship Information—Heritage Assets.

Since 1997, additions to the real property asset accounts have been based on historical costs. Construction-in-Progress represents the costs incurred for new facilities, major rehabilitations, or other improvements in the design or construction stage. After these projects are completed, costs are transferred to Buildings and Structures or Leasehold Improvements as appropriate. The Department

The Tangier Old Legation, the first property that the United States Government acquired for a diplomatic mission, was presented as a gift to the American people by Sultan Moulay Suliman in 1821.

capitalizes construction of new buildings and all building acquisitions regardless of cost. The Department also capitalizes improvements greater than $250,000.

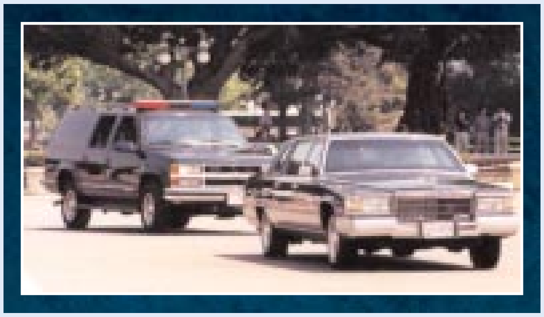
Prior to 1997, historical cost information for most of the Department's overseas properties was either unavailable or incomplete. The Department therefore estimated the value of overseas real property assets as of September 30, 1996.

The Department also owns several domestic real properties, including the National Foreign Affairs Training Center (Arlington, Va.); the International Center (Washington, D.C.); the Charleston Financial Services Center (S.C.); the Beltsville Information Management Center (Md.); the Florida Regional Center (Ft. Lauderdale); and consular centers in Charleston (S.C.); Portsmouth (N.H.) and Williamsburg (Ky.). These properties have been recorded at either actual or estimated historical cost.

The International Boundary and Water Commission (IBWC) has buildings and structures related to its boundary preservation, flood control, and sanitation programs. IBWC's buildings and structures are capitalized at cost.

Depreciation of buildings and other structures is computed on a straight-line basis, and depreciated principally over a 30-year period.

Property and Equipment—Personal Property



In general, personal property and equipment with an acquisition cost of $25,000 or more, and a useful life of two or more years is capitalized at cost. However, there are exceptions to this capitalization policy. All vehicles are capitalized, and ADP software costing over $500,000 with a useful life of two or more years is capitalized.

Depreciation of property and equipment is calculated on a straight-line basis over the asset's estimated life with salvage values generally ranging from 5 to 10%. Depreciation begins when the item is put into service. Vehicles are depreciated over periods ranging from 3 to 6 years. Other personal property and equipment is depreciated over periods generally ranging from 5 to 8 years. Telecommunication equipment is depreciated over 20 years. ADP software is generally amortized over the lesser of its estimated useful life or seven years.

Capital Leases

Leases are accounted for as capital leases if they meet one of the following criteria: (1) the lease transfers ownership of the property by the end of the lease term; (2) the lease contains an option to purchase the property at a bargain price; (3) the lease term is equal to or greater than 75% of the estimated useful life of the property; or (4) the present value of the minimum lease payment equals or exceeds 90% of the fair value of the leased property. The initial recording of the lease's value (with a corresponding liability) is the lesser of the net present value of the lease payments or the fair value of the leased property. Capital leases are amortized over the term of the lease.

Grants

The Department awards educational, cultural exchange, and refugee assistance grants to various individuals, universities, and not-for-profit organizations. Budgetary obligations are recorded when grants are awarded. Grant funds are disbursed in two ways: grantees draw funds commensurate with their immediate cash needs via the Department of Health and Human Services (HHS) Payments Management System (PMS); or grantees submit invoices. In both cases, the expense is recorded upon disbursement.

Accounts Payable and Other Liabilities

Accounts payable and other liabilities represent the amounts accrued for employees' salaries; employee and annuitant benefits; contracts for goods and services received but unpaid at the end of the fiscal year; and unearned revenue from the sale of real property. The Department changed its method for computing the value of domestic accounts payable for FY 2003. In addition to payables recorded through the Department's normal business activities, domestic accounts payable also includes an estimate of subsequent disbursements attributable to FY 2003 payables based upon an average of actual disbursements over the last 5-year period. In 2002, domestic accounts payable were based on actual post-2002 disbursements.

Annual, Sick and Other Leave

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. At the end of each fiscal year, the balance in the accrued annual leave liability account is adjusted to reflect current pay rates. The amount of the adjustment is recorded as an expense. Current or prior year appropriations are not available to fund annual leave earned but not taken. Funding occurs in the year the leave is taken and payment is made. Sick leave and other types of non-vested leave are expensed as taken.

Employee Benefit Plans

Retirement Plans: Civil Service employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Members of the Foreign Service participate in either the Foreign Service Retirement and Disability System (FSRDS) or the Foreign Service Pension System (FSPS).

Employees covered under CSRS contribute 7% of their salary; the Department contributes 7%. Employees covered under CSRS also contribute 1.45% of their salary to Medicare insurance; the Department makes a matching contribution. On January 1, 1987, FERS went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, were allowed to join FERS or remain in CSRS. Employees participating in FERS contribute 0.80% of their salary, with the Department making contributions of 10.70%. FERS employees also contribute 6.20% to Social Security and 1.45% to Medicare insurance. The Department makes matching contributions to both. A primary feature of FERS is that it offers a Thrift Savings Plan (TSP) into which the Department automatically contributes 1% of pay and matches employee contributions up to an additional 4%.

Foreign Service employees hired prior to January 1, 1984, participate in FSRDS with certain exceptions. FSPS was established pursuant to Section 415 of Public Law 99-335, which became effective June 6, 1986. Foreign Service employees hired after December 31, 1983, participate in FSPS with certain exceptions. FSRDS employees contribute 7.25% of their salary; the Department contributes 7.25%. FSPS employees contribute 1.35% of their salary; the Department contributes 20.22%. Both FSRDS and FSPS employees contribute 1.45% of their salary to Medicare; the Department matches their contributions. Similar to FERS, FSPS also offers the TSP described above.

Foreign Service Nationals (FSNs) and Third Country Nationals (TCNs) at overseas posts who were hired prior to January 1, 1984, are covered under CSRS. FSNs and TCNs hired after that date are covered under a variety of local government plans in compliance with the host country's laws and regulations. In cases where the host country does not mandate plans or the plans are inadequate, employees are covered by a privately managed pension plan that conforms to the prevailing practices of comparable employers.

Health Insurance: Most American employees participate in the Federal Employees Health Benefits Program (FEHBP), a voluntary program that provides protection for enrollees and eligible family members in case of illness and/or accident. Under FEHBP, the Department contributes the employer's share of the premium as determined by the U.S. Office of Personnel Management (OPM).

Life Insurance: Unless specifically waived, employees are covered by the Federal Employees Group Life Insurance Program (FEGLIP). FEGLIP automatically covers eligible employees for basic life insurance in amounts equivalent to an employee's annual pay, rounded up to the next thousand dollars plus $2,000. The Department pays one-third and employees pay two-thirds of the premium. Enrollees and their family members are eligible for additional insurance coverage but the enrollee is responsible for the cost of the additional coverage.

Other Post Employment Benefits: The Department does not report CSRS, FERS, FEHBP or FEGLIP assets, accumulated plan benefits, or unfunded liabilities applicable to its employees; OPM reports this information. As required by SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, the Department reports the full cost of employee benefits for the programs that OPM administers. The Department recognizes an expense and imputed financing source for the annualized unfunded portion of CSRS, post-retirement health benefits, and life insurance for employees covered by these programs. The Department recognized $84.5 million and $70.2 million in 2003 and 2002, respectively, for unfunded pension and post-retirement benefits. The additional costs are not actually owed or paid to OPM, and thus are not reported on the Balance Sheet as a liability, but instead are reported as an imputed financing source from costs absorbed from others on the Statement of Changes in Net Position.

Future Workers' Compensation Benefits

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to cover Federal employees injured on the job or who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to job-related injury or occupational disease. The U.S. Department of Labor (DOL) administers the FECA program. DOL initially pays valid claims and bills the employing Federal agency. DOL calculates the actuarial liability for future workers' compensation benefits and reports to each agency its share of the liability.

The present value of the liability for 2003 and 2002 was computed using a discount rate of 4.9% and 5.2%, respectively, for all years; in 2003 and 2002, the Department's liability changed by $5.4 million and ($.4) million, respectively. The total actuarial liability for which the Department is responsible totaled $61.6 million as of September 30, 2003 and $56.2 million as of September 30, 2002.

Valuation of FSN Separation Liability

Separation payments are made to eligible FSN employees who voluntarily resign, retire, or lose their jobs due to a reduction in force, and are in countries that require a voluntary separation payment. The amount required to finance the current and future costs of FSN separation pay is determined annually.

Actuarial Present Value of Projected Plan Benefits for the Foreign Service Retirement and Disability Program

The Department's financial statements present the Pension Actuarial Liability of the Foreign Service Retirement and Disability Program (the "Plan") as the actuarial present value of projected plan benefits, as required by the SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. The Pension Actuarial Liability represents the future periodic payments provided for current employee and retired Plan participants, less the future employee and employing Federal agency contributions, stated in current dollars.

Future periodic payments include benefits expected to be paid to (1) retired or terminated employees or their beneficiaries; (2) beneficiaries of employees who have died; and (3) present employees or their beneficiaries, including refunds of employee contributions as specified by Plan provisions. Total projected service is used to determine eligibility for retirement benefits. The value of voluntary, involuntary, and deferred retirement benefits is based on projected service and assumed salary increases. The value of benefits for disabled employees or survivors of employees is determined by multiplying the benefit the employee or survivor would receive on the date of disability or death, by a ratio of service at the valuation date to projected service at the time of disability or death.

Under existing law, an actuary from the Treasury determines the Pension Actuarial Liability. This year, in order to meet its statutory requirement, Treasury contracted with independent actuaries to prepare the valuation. The Pension Actuarial Liability is calculated by applying actuarial assumptions to adjust the projected plan benefits to reflect the discounted time value of money and the probability of payment (by means of decrements such as death, disability, withdrawal or retirement) between the valuation date and the expected date of payment.

The economic assumptions used for valuing the Plan were revised this year so that they would be the same as the economic assumptions adopted during FY 2003 by the Civil Service Board of Actuaries for valuing CSRS and FERS. The prior assumption of 3.75% for annual increase in inflation and 6.75% for the interest assumption were both decreased by 0.50%. The annual salary increase assumption of 4.25% was decreased by 0.25 to 4.00%.

The Plan uses the aggregate entry age normal actuarial cost method, whereby the present value of projected benefits for each employee is allocated on a level basis (such as a constant percentage of salary) over the employee's service between entry age and assumed exit age. The portion of the present value allocated to each year is referred to as the normal cost.

The calculation of normal cost considers both economic and demographic assumptions. Based on the new economic assumptions, the plan actuary revised the normal cost percentages. The table below presents the normal costs for FY 2003 and FY 2002.

	FY 2003	FY 2002
Normal Cost:		
FSRDS	32.52%	30.65%
FSPS	23.23%	21.57%

Actuarial assumptions are based on the presumption that the Plan will continue. If the Plan terminates, different actuarial assumptions and other factors might be applicable for determining the actuarial present value of accumulated plan benefits.

Net Position

The Department's net position contains the following components:

1. **Unexpended Appropriations** — the sum of undelivered orders and unobligated balances. Undelivered orders represent the amount of obligations incurred for goods or services ordered, but not yet received. An unobligated balance is the amount available after deducting cumulative obligations from total budgetary resources. As obligations for goods or services are incurred, the available balance is reduced.

2. **Cumulative Results of Operations** — include (1) the accumulated difference between revenues and financing sources less expenses since inception; (2) the Department's investment in capitalized assets financed by appropriation; (3) donations; and (4) unfunded liabilities, whose liquidation may require future Congressional appropriations or other budgetary resources.

Foreign Currency

Accounting records for the Department are maintained in U.S. dollars, while a significant amount of the Department's overseas expenditures are in foreign currencies. For accounting purposes, overseas obligations and disbursements are recorded in U.S. dollars based on the rate of exchange as of the date of the transaction. Foreign currency payments are made by the U.S. Disbursing Officers located at the Department's Financial Service Centers.

2 REPORTING IMPROVEMENTS

Changes Implemented

In 2003 and 2002, the Department implemented revised financial statement reporting requirements and new Statement of Federal Financial Accounting Standards (SFFAS). None of the changes had a material effect on the Department's financial position or results of operations.

On September 25, 2001, OMB issued Bulletin 01-09 (Bulletin), *Form and Content of Agency Financial Statements.* This Bulletin provides guidance for preparing agency financial statements and supersedes OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. It contains significant changes. The requirements contained in the Bulletin are phased in beginning with FY 2001, are effective in their entirety for the preparation of financial statements for fiscal years beginning after September 30, 2001 (i.e., FY 2002 and beyond), and significantly affect how the Department reports on its programs.

The major changes required by the Bulletin for FYs 2002 and beyond reporting are as follows.

- **Integrated Reporting.** Combined performance and accountability reports that present both performance and financial reports are required for FY 2002 and beyond.
- **Accelerated Reporting.** For FY 2003 and FY 2002, performance and accountability reports must be submitted to OMB and the Congress by February 1.
- **Budget Integration.** The Statement of Budgetary Resources is revised to improve the linkage between this statement and the Budget of the United States Government.
- **Financial Statement Formats.** Significant changes in labeling and formatting of line items on the Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing are effective to facilitate an understanding of the flow of information between statements. Labeling and formatting of line items on the Balance Sheet are streamlined to improve usefulness to readers of the financial statements.
- **Comparative Reporting.** The preparation of comparative financial statements is required for FYs 2003 and beyond. FY 2003 is the first year for which comparative Statements of Changes in Net Position, Budgetary Resources, and Financing (and related footnotes) are presented. Also, information presented in the Financial Highlights Section of the Management Discussion and Analysis, Required Supplementary Stewardship Information and Required Supplementary Information are presented on a comparative basis when the information is meaningful to the user of the financial report.
- **Interim Financial Reporting.** Beginning in FY 2003, unaudited financial statements are required to be prepared and submitted to OMB on a quarterly basis (i.e., December 31, March 31, and June 30) no later than 45 days after the end of the reporting period. The Department met this requirement for FY 2003 by submitting timely interim statements for each required quarter.

The Statement of Net Cost for FY 2003 and 2002 is presented differently from last year's report. Specifically, the Department presents net cost by strategic goal which is conistent with OMB Bulletin 01-09, and explained more fully in Note 18 to the financial statements.

The Department implements SFFASs when they become effective. No new SFFASs were implemented during FY 2003. For FY 2002, the Department adopted SFFAS No 21, *Reporting Corrections of Errors and Changes in Accounting Principles,* which became effective for FY 2002. SFFAS No. 21 amends SFFAS No. 7. SFFAS No. 7 did not allow reporting entities, when presenting prior period financial statements for comparative purposes, to restate prior period financial statements to show the effect of accounting errors. SFFAS No. 21 requires that when material errors are discovered in prior period financial statements, all statements presented must be restated to correct the error.

Changes to be Implemented

As indicated above, the requirements contained in OMB Bulletin 01-09 are effective in their entirety for the preparation of financial statements for fiscal years 2002 and beyond. Future significant changes that the Department will implement are as follows.

- **Accelerated Reporting.** For FY 2004, OMB is accelerating further the due dates for performance and accountability reports. Performance and accountability reports for FY 2004 must be submitted to OMB and the Congress by November 15, 2004. The Department is making progress towards meeting this requirement for FY 2004, as evidenced by the issuance of this FY 2003 performance and accountability report well in advance of last year's release date.
- **Interim Financial Reporting.** Beginning with the second quarter for FY 2004, the due date for quarterly statements will accelerate to no later than 21 days after the end of each quarter.

3 ASSETS

The Department's assets are classified as entity assets and non-entity assets. Entity assets are those assets that the Department has authority to use for its operations. Non-entity assets are those held by the Department but are not available for use in its operations. The vast majority of the Department's assets are entity assets. The non-entity assets consist primarily of lease fees collected by the Department for the International Chancery Center; and amounts in the Bosnia Federation Defense Fund. Total non-entity assets at September 30, 2003 and 2002 were $11.1 million and $11.4 million, respectively. These items are included in amounts reported as Cash and Other Monetary Assets (See Note 8, "Cash and Other Monetary Assets" for further information).

4 FUND BALANCES WITH TREASURY

Fund Balances with Treasury at September 30, 2003 and 2002, are summarized below (Dollars in Thousands).

Fund Balances	2003	2002
Appropriated Funds	$ 9,519,680	$ 8,574,965
Revolving Funds	216,351	156,665
Trust Funds	110,990	105,478
Other Funds	106,176	100,031
Total	$ 9,953,197	$ 8,937,139

Status of Fund Balance	2003	2002
Unobligated Balances		
Available	$ 2,363,663	$ 2,459,083
Unavailable	261,713	120,224
Obligated Balances not yet Disbursed	$ 7,327,821	6,357,832
Total	$ 9,953,197	$ 8,937,139

5 INVESTMENTS

The Department has activities that have the authority to invest excess cash resources. A description of those activities, the investments made and a listing of the outstanding investments follow. Although funds in the Chancery Development Trust Account and the Bosnia Federation Defense Fund are invested, because they are considered non-entity assets the investments for these funds are not shown in this section, but are described in Note 8, "Cash and Other Monetary Assets."

Foreign Service Retirement and Disability Fund (FSRDF)

Treasury initially invests FSRDF receipts in special, non-marketable U.S. Government securities. These special-issue Certificates of Indebtedness mature on the following June 30. On June 30, the Treasury rolls over the Certificates of Indebtedness into special, non-marketable bonds, with maturities spread over 15 years and a yield equaling the average of all marketable Treasury securities. All securities are purchased and redeemed at par, regardless of market conditions. Interest is paid semi-annually on December 31 and June 30. Maturity dates on these securities range from 2004 through 2017, and interest rates range from 3.50% to 8.75%.

Israeli-Arab Scholarship and Eisenhower Exchange Fellowship Program Trust Funds

The Israeli-Arab Scholarship and Eisenhower Exchange Fellowship Program Trust Funds are invested in market-based securities, issued at either a premium or a discount, and are redeemable for par at maturity. The discounts and premiums on these investments are amortized over the life of the security using the effective interest method. Maturity dates on these securities range from 2004 to 2013; interest rates range from 3.25% to 7.875%.

Gift Funds

The Gift Funds invest in U.S. Government non-marketable, market-based securities, which are issued at either a premium or a discount, and are redeemable for par at maturity. The discounts and premiums on these investments are amortized over the life of the Treasury bill using the straight-line method. These securities matured in 2003; interest rates ranged from 1.48% to 1.55%.

Summary of Investments

Investments at September 30, 2003 and 2002, are summarized below (Dollars in Thousands). All investments are classified as Intragovernmental Securities.

At September 30, 2003:	Par	Amortization Method	Unamortized (Discount)	Investments (Net)	Market Value
Non-Marketable, Par Value:					
FSRDF Certificates of Indebtedness	$ 2,576,177	N/A	$ —	$ 2,576,177	$ 2,576,177
FSRDF Special Bonds	9,713,125	N/A	—	9,713,125	9,713,125
Subtotal	$ 12,289,302		$ —	$ 12,289,302	$ 12,289,302
Non-Marketable, Market Based:					
Israeli-Arab Scholarship, Notes	4,277	Interest	111	4,388	4,689
Eisenhower Exchange Fellowship, Notes	7,534	Interest	(51)	7,483	8,172
Gift Funds, Bills	—	Straight-line	—	—	—
Subtotal	$ 11,811		$ 60	$ 11,871	$ 12,861
Total Investments	$ 12,301,113		$ 60	$ 12,301,173	$ 12,302,163

At September 30, 2002:	Par	Amortization Method	Unamortized (Discount)	Investments (Net)	Market Value
Non-Marketable, Par Value:					
FSRDF Certificates of Indebtedness	$ 1,306,221	N/A	$ —	$ 1,306,221	$ 1,306,221
FSRDF Special Bonds	10,428,019	N/A	—	10,428,019	10,428,019
Subtotal	$ 11,734,240		$ —	$ 11,734,240	$ 11,734,240
Non-Marketable, Market Based:					
Israeli-Arab Scholarship, Notes	4,277	Interest	176	4,453	4,857
Eisenhower Exchange Fellowship, Notes	7,395	Interest	(42)	7,353	8,086
Gift Funds, Bills	4,721	Straight-line	(30)	4,691	4,651
Subtotal	$ 16,393		$ 104	$ 16,497	$ 17,594
Total Investments	$ 11,750,633		$ 104	$ 11,750,737	$ 11,751,834

6 ACCOUNTS RECEIVABLE

The Department's Accounts Receivable at September 30, 2003 and 2002, are summarized below (Dollars in Thousands):

	2003				2002		
	Entity Accounts Receivable	Non-entity Accounts Receivable	Allowance for Uncollectible Accounts Receivable	Net Receivables	Accounts Receivable	Allowance for Estimated Uncollectible	Net Receivables
Intragovernmental	$ 372,348	$ —	$ (45)	$ 372,303	$ 313,337	$ (46)	$ 313,291
Non-Federal	25,816	—	(4,470)	21,346	51,273	(5,924)	45,349
Total	$ 398,164	$ —	$ (4,515)	$ 393,649	$ 364,610	$ (5,970)	$ 358,640

7 LOANS RECEIVABLE

Repatriation Direct Loan Program

Repatriation loan obligations made prior to 1992 and the resulting direct loans are reported net of an allowance for uncollectible loans or estimated losses. The loss allowance estimates amounts that the Department does not expect to recover on loans made prior to 1992. These allowances are based upon historical experience.

The *Federal Credit Reform Act* governs Repatriation loan obligations made after 1991, and the resulting direct loans. The Act requires that the present value of the subsidy costs (i.e., interest rate differentials, interest subsidies, estimated delinquencies and defaults, fee offsets, and other cash flows) associated with the loans be recognized as a cost in the year the loan is disbursed. An analysis of loans receivable, the nature and amounts of the subsidy, and the administrative costs associated with the loans are summarized below.

Repatriation Loans Obligated Prior to 1992 (Dollars in Thousands)

At September 30:

	2003	2002
Loans Receivable Gross	$400	$516
Interest and Penalty Receivable	87	86
Allowance for Uncollectible Loans	(463)	(572)
Net Loans Receivable	$ 24	$ 30

Repatriation Loans Obligated after 1991 (Dollars in Thousands)

At September 30, 2003:

Fiscal Year	Loans Receivable Gross	Interest, Penalty And Administrative Charges Receivable	Allowance for Subsidy Cost	Net Present Value Of Assets Related To Direct Loans
1992	$ 105	$ 42	$ 105	$ 42
1993	104	17	86	35
1994	71	20	68	23
1995	162	46	143	65
1996	415	187	407	195
1997	416	142	395	163
1998	515	75	464	126
1999	324	29	261	92
2000	254	22	193	83
2001	349	65	277	137
2002	437	53	363	127
2003	443	15	355	103
Total	**$ 3,595**	**$ 713**	**$ 3,117**	**$ 1,191**

At September 30, 2002:

Fiscal Year	Loans Receivable Gross	Interest, Penalty And Administrative Charges Receivable	Allowance for Subsidy Cost	Net Present Value Of Assets Related To Direct Loans
1992	$ 105	$ 34	$ 97	$ 42
1993	104	19	86	37
1994	79	18	68	29
1995	163	42	143	62
1996	530	214	521	223
1997	445	109	388	166
1998	564	75	447	192
1999	322	33	248	107
2000	312	27	237	102
2001	390	52	310	132
2002	338	27	256	109
Total	**$ 3,352**	**$ 650**	**$ 2,801**	**$ 1,201**

Total Amount of Direct Loans Disbursed (Post-1991)

In 2003, the Department disbursed approximately $843,000 in repatriation loans. In 2002, it disbursed approximately $710,000.

Subsidy Expense for Post-1991 Repatriation Loans

The subsidy expense for the 2003 and 2002 loan program contains the following components (Dollars in Thousands):

	2003	2002
Interest Differential	—	—
Default	$ 674	$ 568
Fees	—	—
Other	—	—
Total	$ 674	$ 568

Subsidy Rates for Direct loans

The Department uses a subsidy rate of 80%. Because the Department has complied with the provisions of the Debt Collection Improvement Act, it has received collections much higher than anticipated.

Schedule for Reconciling Subsidy Cost Allowance Balances (Dollars in Thousands)

Beginning balance of the subsidy cost allowance – October 1, 2002	$ 2,801
Add: subsidy expense for loans disbursed during 2003	674
Adjustments	(22)
Ending balance for the subsidy cost allowance before re-estimates	3,453
Effect of subsidy re-estimate by component:	
Interest rate re-estimate	—
Technical/default re-estimate	(336)
Ending balance of the subsidy cost allowance	$ 3,117

The above schedule reflects the effect of re-estimates; however, the Department has not performed re-estimates as part of its budget process. The above re-estimates are for financial reporting purposes only, and are more fully described below under the Accounts Payable to Treasury section.

Administrative Expenses

Total administrative expense was approximately $603,000 and $607,000 in 2003 and 2002, respectively.

Accounts Payable to Treasury

The Department estimates a subsidy rate based upon collections of 20%. Over the past several years, however, the actual collection rate has been closer to 40%. As a result, the subsidy allowance established at 80% understated the net credit program receivable. A re-estimate of the subsidy rate will correct this by reducing the amount of subsidy allowance. The Department, however, has not yet completed the re-estimation of the subsidy. For financial reporting purposes, the Department reduced the subsidy allowance by approximately $336,000 in 2003, and established that amount as a payable to Treasury. The total amount payable to Treasury is approximately $5.2 million, which represents the cumulative effect of subsidy re-estimates since 1992. Although the Department has not re-estimated, the subsidy allowance reduction is consistent with the reporting requirements of GAAP.

Accounts payable also includes a payable to Treasury of $789,000 resulting from the collection of Pre-Credit Reform loans.

Borrowings from Treasury (Dollars in Thousands)

	2003	2002
Beginning Balance, October 1	$ 256	$ 191
Borrowings, Net of Repayments	92	65
Ending Balance, September 30	$ 348	$ 256

8 CASH AND OTHER MONETARY ASSETS

The Cash and Other Monetary Assets at September 30, 2003 and 2002, are summarized below (Dollars in Thousands). There are no restrictions on entity cash. Non-Entity cash is restricted as discussed below.

	2003			2002		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Bosnia Federation Defense Fund	$ —	$ 39	$ 39	$ —	$ 309	$ 309
Chancery Development						
Trust Account:						
Cash	—	2	2	—	2	2
Treasury Bills, at par	—	11,169	11,169	—	11,169	11,169
Unamortized Discount	—	(88)	(88)	—	(88)	(88)
Cash-Imprest and Other Funds	4,964	—	4,964	1,400	—	1,400
Total	$ 4,964	$ 11,122	$ 16,086	$ 1,400	$ 11,392	$ 12,792

The Bosnia Federation Defense Fund is a depository account, which contains funds that have been donated by various foreign governments to assist the Federation of Bosnia and Herzegovina in establishing a military balance that will promote lasting peace in the region. A corresponding liability for these amounts is reflected as Funds Held in Trust.

Lease fees collected from foreign governments by the Department for the International Chancery Center are deposited into an escrow account called the Chancery Development Trust Account. The funds are unavailable to the Department at time of deposit, and do not constitute expendable resources until funds are necessary for additional work on the Center project. The Chancery Development Trust account invests in one-year marketable Treasury bills issued at discount and redeemable for par at maturity. A corresponding liability for these amounts is reflected as Funds Held in Trust.

9 INVENTORY

Inventory held at September 30, 2003 and 2002, is summarized below (Dollars in Thousands).

	2003	2002
Inventory Held for Current Sale:		
Publishing Services – Raw Materials	$ 1,214	$ 1,797
Publishing Services – Publications for Sale	2,215	3,279
Inventory for Resale	1,830	2,708
Total	$ 5,259	$ 7,784

The inventories of Raw Materials are valued using the latest acquisition cost. Publications for Sale are valued at cost of production. Inventories for resale are valued at cost for items held in the European Logistics Support Office's Expedited Logistics Program, and the weighted moving average method is used for items in the Material Management Branch.

10 PROPERTY AND EQUIPMENT, NET

Property and equipment balances at September 30, 2003 and 2002, are shown in the following table (Dollars in Thousands):

	2003			2002		
Major Classes	**Cost**	**Accumulated Depreciation**	**Net Value**	**Cost**	**Accumulated Depreciation**	**Net Value**
Real Property:						
Overseas —						
Land and Land Improvements	$ 1,938,191	$ (159)	$ 1,938,032	$ 1,904,743	$ (95)	$ 1,904,648
Buildings and Structures	3,827,738	(2,362,612)	1,465,126	3,768,927	(2,210,702)	1,558,225
Construction-in-Progress	1,383,703	—	1,383,703	886,914	—	886,914
Assets Under Capital Lease	117,542	(46,985)	70,557	120,940	(43,819)	77,121
Leasehold Improvements	58,467	(18,645)	39,822	52,634	(14,418)	38,216
Domestic —						
Structures, Facilities and Leaseholds	564,467	(190,222)	374,245	521,350	(172,862)	348,488
Construction-in-Progress	20,370	—	20,370	58,484	—	58,484
Land and Land Improvements	80,654	(4,148)	76,506	80,654	(3,836)	76,818
Subtotal — Real Property	$ 7,991,132	$(2,622,771)	$ 5,368,361	$ 7,394,646	$(2,445,732)	$ 4,948,914
Personal Property:						
Vehicles	$ 185,468	$ (123,718)	$ 61,750	$ 174,369	$ (112,291)	$ 62,078
Communication Equipment	50,382	(13,575)	36,807	45,072	(11,121)	33,951
ADP Equipment	23,615	(18,532)	5,083	21,528	(15,577)	5,951
Reproduction Equipment	13,204	(10,255)	2,949	13,325	(10,036)	3,289
Security	79,218	(32,484)	46,734	67,289	(25,032)	42,257
Software	108,794	(27,210)	81,584	77,208	(9,328)	67,880
Software-in-Development	67,732	—	67,732	33,476	—	33,476
Other Equipment	376,961	(51,468)	325,493	327,130	(25,076)	302,054
Subtotal — Personal Property	$ 905,374	$ (277,242)	$ 628,132	$ 759,397	$ (208,461)	$ 550,936
Total	$ 8,896,506	$(2,900,013)	$ 5,996,493	$ 8,154,043	$(2,654,193)	$ 5,499,850

11 OTHER ASSETS

The Department's other assets at September 30, 2003 and 2002, are summarized below (Dollars in Thousands).

	2003	2002
Salary Advances to Employees	$ 6,944	$ 7,296
Travel Advances to Employees	12,627	12,705
Prepayments	—	12,000
Other Advances	18,637	47,346
Total Other Assets	$ 38,208	$ 79,347

12 LIABILITIES

The Department's liabilities are classified as covered by budgetary resources or not covered by budgetary resources. Liabilities not covered by budgetary resources result from the receipt of goods and services, or occurrence of eligible events in the current or prior periods, for which revenue or other funds to pay the liabilities have not been made available through appropriations or current earnings of the Department. The major liabilities in this category include assessments from international organizations, unfunded actuarial liability for FSRDF, future workers' compensation benefits, capital leases, and accrued annual leave. Liabilities not covered by budgetary resources at September 30, 2003 and 2002, are summarized below (Dollars in Thousands).

	2003	2002
Intragovernmental Liabilities –		
Accounts Payable	$ —	$ —
Other Liabilities	17,961	17,966
Total Intragovernmental Liabilities	$ 17,961	$ 17,966
Foreign Service Retirement Actuarial Liability	653,804	324,776
Liability to International Organizations	919,428	1,065,172
Capital Lease Liability	85,985	92,010
Funds Held in Trust	13,322	13,592
Federal Employees' Compensation Act Benefits	61,628	56,259
Accrued Annual Leave	198,864	180,926
Other Liabilities	5,228	8,621
Total Liabilities not Covered by Budgetary Resources	$1,956,220	$1,759,322

Other Liabilities at September 30, 2003 and 2002 were $511.7 million and $563.5 million, respectively, and consist primarily of accrued employee benefits.

13 FOREIGN SERVICE RETIREMENT ACTUARIAL LIABILITY

The Foreign Service Retirement and Disability Fund finances the operations of the FSRDS and the FSPS. The FSRDS and the FSPS are defined-benefit single-employer plans. FSRDS was originally established in 1924; FSPS in 1986.

The FSRDS is a single-benefit retirement plan. Retirees receive a monthly annuity from FSRDS for the rest of their lives. FSPS provides benefits from three sources: a basic benefit (annuity) from FSPS, Social Security, and the Thrift Savings Plan.

The following table presents the calculation of the combined FSRDS and FSPS Pension Actuarial Liability and the assumptions used in computing it for the years ended September 30, 2003 and 2002 (Dollars in Millions).

For the Year Ended September 30,	**2003**	**2002**
Pension Actuarial Liability, Beginning of Year	$12,211.8	$11,766.9
Add Pension Expense:		
Normal Cost	227.0	198.0
Interest on Pension Liability	810.9	780.3
Prior Service Costs	—	—
Actuarial Losses/(Gains)	468.2	79.0
Total Pension Expense	1,506.1	1,057.3
Less Payments to Beneficiaries (annuities and refunds)	(624.1)	(612.4)
Pension Actuarial Liability, End of Year	13,093.8	12,211.8
Less: Net Assets Available for Benefits	(12,440.0)	(11,887.0)
Actuarial Unfunded Pension Liability for Projected Plan Benefits	$ 653.8	$ 324.8
Actuarial Assumptions:		
Rate of Return on Investments	6.25%	6.75%
Rate of Inflation	3.25%	3.75%
Salary Increase	4.00%	4.25%

Net Assets Available for Benefits at September 30, 2003 and 2002, consist of the following (Dollars in Thousands):

	2003	**2002**
Fund Balances with Treasury	$ 43	$ —
Receivables	202,949	203,793
Investments in USG Securities	12,289,302	11,734,240
Total Assets	12,492,294	11,938,033
Less: FSRDF Liabilities	(52,298)	(51,009)
Net Assets Available for Benefits	$ 12,439,996	$ 11,887,024

14 LIABILITIES TO INTERNATIONAL ORGANIZATIONS

The Department reports an unfunded liability for the accumulated arrears assessed by the United Nations (UN), its affiliated agencies, and other international organizations in the amount of $50.1 million and $303.5 million for 2003 and 2002, respectively, for regular budget assessments and international peacekeeping. These financial commitments mature into obligations (as that term is used in domestic law) only when funds are authorized and appropriated by Congress. As of September 30, 2003, a total of $926 million had been appropriated by Congress for payment of the U.S. arrearage. These amounts, however, were made available subject to certifications by the Secretary of State that certain legislative requirements were met. A payment of $100 million was made in FY 2000; a payment of $475 million and a credit of $107 million were made in FY 2002; and payments totaling $242 million were made in FY 2003. Thus, $2.1 million of appropriations for arrearage payments remain.

The financial statements also report an unfunded liability of $869.2 and $761.6 million at September 30, 2003 and 2002, respectively, for the current year 2003 and 2002 unfunded or restricted annual assessments from the United Nations, its affiliated agencies and several other international organizations, as well as for peacekeeping. It has been the Department's policy to pay annual assessments for the UN and certain international organizations out of the following fiscal year's appropriation, usually in the last quarter of the calendar year (i.e., the 2003 calendar year assessment is paid from the Department's 2004 appropriation). The Liability to International Organizations at September 30, 2003 and 2002, is summarized below (Dollars in Thousands).

	2003	2002
Accumulated Arrears	$ 50,191	$ 303,525
Unfunded Annual Assessments	869,237	761,647
Liability to International Organizations	$ 919,428	$1,065,172

15 LEASES

The Department is committed to over 9,000 leases, which cover office and functional properties, and residential units at diplomatic missions overseas. The majority of these leases are short-term, operating leases. In most cases, management expects that the leases will be renewed or replaced by other leases.

Personnel from other U.S. Government agencies occupy some of the leased facilities (both residential and non-residential). These agencies reimburse the Department for the use of the properties. Reimbursements are received for approximately $40.0 million of the lease costs.

Capital Leases

The Department has various long-term leases (more than 10 years) for overseas real property that meet the criteria as a capital lease in accordance with SFFAS No. 6, *Accounting for Property, Plant, and Equipment.* Assets that meet the definition of a capital lease and their related lease liability, are initially recorded at the present value of the future minimum lease payments or fair market value, whichever is less. In general, capital assets are depreciated over the estimated remaining life of the asset, and the related liability is amortized over the term of the lease, which can result in a different value in the asset versus the liability.

Following is a summary of Net Assets Under Capital Leases and future minimum lease payments as of September 30 (Dollars in Thousands).

	2003	2002
Net Assets Under Capital Leases:		
Land and Buildings	$117,542	$120,940
Accumulated Depreciation	(46,985)	(43,819)
Net Assets under Capital Leases	$ 70,557	$ 77,121

Future Minimum Lease Payments:

	2003		2002	
	Fiscal Year	**Lease Payments**	**Fiscal Year**	**Lease Payments**
	2004	$ 6,982	2003	$ 8,467
	2005	6,982	2004	6,899
	2006	6,344	2005	6,899
	2007	6,344	2006	6,609
	2008	6,314	2007	6,609
	2009 and thereafter	491,594	2008 and thereafter	467,166
Total Minimum Lease Payments		$ 524,560		$ 502,649
Less: Amount Representing Interest		(438,575)		(410,639)
Obligations under Capital Leases		$ 85,985		$ 92,010

Operating Leases

The Department leases real property in overseas locations under operating leases. These leases expire in various years. Minimum future rental payments under operating leases having remaining terms in excess of one year as of September 30, 2003 for each of the next 5 years and in aggregate are as follows (Dollars in Thousands).

Year Ended September 30	Operating Lease Amounts
2004	$ 329,107
2005	231,716
2006	147,749
2007	83,006
2008	56,635
2009 and thereafter	83,360
Total Minimum Future Lease Payments	$ 931,573

16 COMMITMENTS AND CONTINGENCIES

Commitments

In addition to the future lease commitments discussed in Note 15, "Leases," the Department is committed under obligations for goods and services which have been ordered but not yet received (undelivered orders — see Note 17, "Unexpended Appropriations" and Note 19, "Statement of Budgetary Resources") at fiscal yearend.

Contingencies

Rewards for Justice Program. The Department operates rewards programs for information critical to combating international terrorism, narcotics trafficking, and war crimes. The Terrorism Information Rewards Program offers rewards up to $5 million (or higher, if personally authorized by the Secretary under certain conditions) for information leading to: the arrest or conviction in any country of persons committing (or conspiring or attempting to commit, or aiding or abetting the commission of) acts of international terrorism against United States persons or property; the prevention, frustration or favorable resolution of such acts; or the identification or location of key leaders of a terrorist organization. The Narcotics Information Rewards Program offers rewards up to $5 million for information leading to: the arrest or conviction in any country of persons committing (or conspiring or attempting to commit, or aiding and abetting the commission of) major foreign violations of U.S. narcotics laws or the killing or kidnapping of U.S. narcotics law enforcement officers or their family members; or the prevention, frustration or favorable resolution of such criminal acts. The War Crimes Information Rewards Program currently offers rewards up to $5 million for information leading to the arrest, transfer, or conviction of persons indicted by the International Criminal Tribunal for the Former Yugoslavia or the International Criminal Tribunal for Rwanda for serious violations of international humanitarian law, or their arrest or conviction in any country for such violations. Authority exists to create a similar war crimes program for information related to indictees of the Special Court of Sierra Leone.

The Department is a party in various administrative proceedings, legal actions, environmental suits, and claims brought by and against it. Some of the actions are not related directly to Department programs but the Department is involved because of its status as the U.S. Government's foreign policy agency. In the opinion of management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or results of operations of the Department.

Claims Filed in Response to Embassy Bombings: Nearly 4,000 Kenyan nationals filed administrative tort claims against the Department alleging that Department negligence was responsible for the damages they suffered when terrorists bombed the American Embassy in Nairobi, Kenya on August 7, 1998. These claims are for sums ranging from $150 to $10,000,000 and total approximately $1.5 billion. Two lawsuits, in the amounts of $1 billion and $500 million, arising from these tort claims were dismissed this year by the Federal District Court in Washington, D.C. Both of the cases have been appealed to the D.C. Circuit Court of Appeals. After that court affirmed the District Court's dismissal of the $1 billion action in July 2003, the plaintiffs in the other, almost identical, suit abandoned their appeal. The plaintiffs in the first case have petitioned the Supreme Court for certiorari. In addition, the families of eleven of the twelve Americans killed in the bombing also filed administrative tort claims with the Department alleging that Department negligence led to the death of their family members in Nairobi. These claims, including those by the estates of the deceased, are for a total of $117 million. The Department is vigorously defending against all of the tort claims and lawsuits. Any settlements or judgments in excess of $2,500 would be funded and paid from the Judgment Fund maintained by the Treasury.

Dillingham Construction International, Inc. v. the Department of State: Dillingham Construction International, Inc. seeks approximately $22 to $27 million in claims (including interest) arising from construction of the U.S. Embassy chancery building in Singapore. The litigation was before the Court of Federal Claims, where the Department was represented by the Commercial Litigation Branch, Civil Division, Department of Justice. Cross-motions for partial summary judgment were decided largely in the Department's favor. The case was settled for an immaterial amount that will be initially paid from the Judgement Fund and later charged to the Department.

North American Free Trade Agreement (NAFTA) Arbitrations: NAFTA allows Canadian and Mexican investors to bring arbitration proceedings against the United States for breaches of certain NAFTA provisions. These cases raise allegations of expropriation as well as other claims of treatment inconsistent with international law or specific treaty commitments that provide investment protections. The United States has successfully defended itself against two claims submitted to arbitration under Chapter 11 of the NAFTA. The United States is currently defending itself against five claims submitted to arbitration and six claims not yet submitted under Chapter 11 of NAFTA. These claims total approximately $2.9 billion. The United States has also received notice of another claim not submitted in the amount of either $5.8 billion or $13.6 billion, depending on how one interprets the notice. The U.S. Government intends to vigorously contest these claims. In no case is the Department a named respondent in these arbitrations. The Department's involvement is due to its unique experience with international arbitration, particularly with respect to these types of claims. Any adverse award in any of these cases would be paid out of the Judgment Fund.

Certain legal matters to which the Department is a party are administered and, in some instances, litigated and paid by other U.S. Government agencies. Generally, amounts to be paid under any decision, settlement, or award pertaining to these legal matters are funded from the Judgment Fund. None of the amounts paid under the Judgment Fund on behalf of the Department in 2003 and 2002 had a material effect on the financial position or results of operations of the Department.

17 UNEXPENDED APPROPRIATIONS

Unexpended Appropriations include the amount of unobligated appropriations and undelivered orders outstanding for Congressional appropriations provided to the Department. As these accounts incur obligations, the available balance of the appropriation is reduced.

Unobligated balances are the amount of appropriations or other authority that remains after deducting cumulative obligations. The unobligated balance is classified as unavailable for all expired accounts and for amounts appropriated subject to certain conditions. Undelivered orders represent the amount of obligations incurred for goods or services ordered but not yet received. Unexpended Appropriations at September 30, 2003 and 2002, are summarized below (Dollars in Thousands).

	2003	2002
Unexpended Appropriations:		
(1) Unobligated		
(a) Available	$ 1,880,494	$ 1,692,029
(b) Unavailable	261,713	404,026
(2) Undelivered Orders	6,394,100	5,057,968
Total	$ 8,536,307	$ 7,154,023

18 STATEMENT OF NET COST

The Consolidated Statement of Net Cost reports the Department's gross and net cost for its strategic objectives and strategic goals. The net cost of operations is the gross (i.e., total) cost incurred by the Department, less any exchange (i.e., earned) revenue.

The Consolidating Schedule of Net Cost categorizes costs and revenues by strategic goal and responsibility segment. A responsibility segment is the component that carries out a mission or major line of activity, and whose managers report directly to top management. For the Department, a Bureau (e.g., Bureau of African Affairs) is considered a responsibility segment. For presentation purposes, Bureaus have been summarized and reported at the Under Secretary level (e.g., Under Secretary for Political Affairs). For 2000 and beyond, a new responsibility segment has been added for the Under Secretary for Public Diplomacy and Public Affairs as a result of the merger of the former USIA. Information on the Bureaus (or equivalent) that report to each Under Secretary can be found on the Organization Chart for the Department provided in the MD&A Section of this report.

The presentation of program results by strategic objectives and strategic goals is based on the Department's current Strategic Plan established pursuant to the Government Performance and Results Act of 1993. In prior years, the Department presented its program information at the National Interest level to the extent that it was practicable. In accordance with current guidance, prior year data have been recast consistent with the 2003 presentation for comparative purposes.

As outlined in the Strategic Plan, the United States conducts relations with foreign governments and others to pursue U.S. national interests, and create a more secure, democratic and prosperous world for the benefit of the American people and the international community. These strategic objectives and strategic goals are:

STRATEGIC OBJECTIVE	STRATEGIC GOAL	GOAL DESCRIPTION
Achieve Peace and Security	**Regional Stability**	Avert and resolve local and regional conflicts to preserve peace and minimize harm to the national interests of the United States.
	Counterterrorism	Prevent attacks against the United States, our allies, and our friends, and strengthen alliances and international arrangements to defeat global terrorism.
	Homeland Security	Protect the homeland by enhancing the security of our borders and infrastructure.
	Weapons of Mass Destruction	Reduce the threat of weapons of mass destruction to the United States, our allies, and our friends.
	International Crime and Drugs	Minimize the impact of international crime and illegal drugs on the United States and its citizens.
	American Citizens	Assist American citizens to travel, conduct business, and live abroad securely.
Advance Sustainable Development and Global Interests	**Democracy and Human Rights**	Advance the growth of democracy and good governance, including civil society, the rule of law, respect for human rights, and religious freedom.
	Economic Prosperity and Security	Strengthen world economic growth, development, and stability, while expanding opportunities for U.S. businesses and ensuring economic security for the nation.
	Social and Environmental Issues	Improve health, education, environment, and other conditions for the global population.
	Humanitarian Response	Minimize the human costs of displacement, conflicts, and natural disasters.
Promote International Understanding	**Public Diplomacy and Public Affairs**	Increase understanding for American values, policies, and initiatives to create a receptive international environment.
Strengthen Diplomatic and Program Capabilities	**Management and Organizational Excellence**	Ensure a high quality workforce supported by modern and secure infrastructure and operational capabilities.

The Management and Organizational Excellence strategic goal relates to the Department's responsibilities for managing infrastructure, information, and human resources. The ability of the Department to advance national and foreign policy interests depends on the quality of these items — the two largest and most visible of which are Diplomatic Security and Overseas Buildings Operations.

DEPARTMENT OF STATE
CONSOLIDATING SCHEDULE OF NET COST

For the year ended September 30, 2003

(Dollars in Thousands)

STRATEGIC GOAL	Under Secretary for: Arms Control, Int'l Security	Under Secretary for: Economic, Business and Agriculture	Under Secretary for: Global Affairs	Under Secretary for: Political Affairs	Under Secretary for: Public Diplomacy and Public Affairs	Under Secretary for: Management - Consular Affairs	Eliminations	Total
Regional Stability								
Total Cost	$ 116,392	$ 10,449	$ 14,645	$ 883,807	$ —	$ 8	$ (42,852)	$ 982,449
Earned Revenue	(13,142)	(1,153)	(1,647)	(73,476)	—	(1)	42,852	(46,567)
Net Program Costs	103,250	9,296	12,998	810,331	—	7	—	935,882
Counterterrorism								
Total Cost	54,640	4,905	6,875	414,902	—	4	(20,117)	461,209
Earned Revenue	(6,170)	(541)	(773)	(34,493)	—	(1)	20,117	(21,861)
Net Program Costs	48,470	4,364	6,102	380,409	—	3	—	439,348
Homeland Security								
Total Cost	53,426	4,796	6,722	405,682	—	4	(19,670)	450,960
Earned Revenue	(6,033)	(529)	(756)	(33,727)	—	—	19,670	(21,375)
Net Program Costs	47,393	4,267	5,966	371,955	—	4	—	429,585
Weapons of Mass Destruction								
Total Cost	43,365	3,893	5,456	329,287	—	3	(15,966)	366,038
Earned Revenue	(4,897)	(430)	(614)	(27,375)	—	—	15,966	(17,350)
Net Program Costs	38,468	3,463	4,842	301,912	—	3	—	348,688
International Crime and Drugs								
Total Cost	—	—	964,178	43,945	1,804	—	(4,132)	1,005,795
Earned Revenue	—	—	(29,087)	(7,143)	(29)	—	4,132	(32,127)
Net Program Costs	—	—	935,091	36,802	1,775	—	—	973,668
American Citizens								
Total Cost	—	—	155	1,010,053	—	814,754	(332,455)	1,492,507
Earned Revenue	—	—	(31)	(268,704)	—	(1,506,480)	332,455	(1,442,760)
Net Program Costs	—	—	124	741,349	—	(691,726)	—	49,747
Democracy and Human Rights								
Total Cost	58,340	5,238	7,340	443,001	—	4	(21,479)	492,444
Earned Revenue	(6,587)	(578)	(825)	(36,829)	—	(1)	21,479	(23,341)
Net Program Costs	51,753	4,660	6,515	406,172	—	3	—	469,103
Economic Prosperity and Security								
Total Cost	123,272	11,067	15,510	936,054	—	9	(45,385)	1,040,527
Earned Revenue	(13,919)	(1,221)	(1,744)	(77,819)	—	(1)	45,385	(49,319)
Net Program Costs	109,353	9,846	13,766	858,235	—	8	—	991,208
Social and Environment Issues								
Total Cost	30,298	2,720	3,813	230,062	—	2	(11,155)	255,740
Earned Revenue	(3,421)	(300)	(429)	(19,126)	—	—	11,155	(12,121)
Net Program Costs	26,877	2,420	3,384	210,936	—	2	—	243,619
Humanitarian Response								
Total Cost	—	—	775,671	38	138	—	(129)	775,718
Earned Revenue	—	—	(520)	—	(1)	—	129	(392)
Net Program Costs	—	—	775,151	38	137	—	—	775,326
Public Diplomacy and Public Affairs								
Total Cost	98,467	8,840	12,389	747,702	651,588	7	(36,253)	1,482,740
Earned Revenue	(11,118)	(975)	(1,393)	(62,161)	(90,416)	(1)	36,253	(129,811)
Net Program Costs	87,349	7,865	10,996	685,541	561,172	6	—	1,352,929
Executive Direction and Other Costs Not Assigned								
Total Cost	4,721	4,494	61,857	3,984,091	536,000	4,390	(1,179,040)	3,416,513
Earned Revenue	(2,534)	(2,412)	(33,197)	(2,179,385)	(288,466)	(2,356)	1,142,351	(1,365,999)
Net Program Costs	2,187	2,082	28,660	1,804,706	247,534	2,034	(36,689)	2,050,514
Total Cost	582,921	56,402	1,874,611	9,428,624	1,189,530	819,185	(1,728,633)	12,222,640
Total Revenue	(67,821)	(8,139)	(71,016)	(2,820,238)	(378,912)	(1,508,841)	1,691,944	(3,163,023)
Total Net Cost	$ 515,100	$ 48,263	$ 1,803,595	$ 6,608,386	$ 810,618	$ (689,656)	$ (36,689)	$ 9,059,617

Executive Direction and Other Costs Not Assigned relate to high-level executive direction (e.g., Office of the Secretary, Office of the Legal Adviser), international commissions, general management, and certain administrative support costs that cannot be directly traced or reasonably allocated to a particular program. For the year ended September 30, 2003 and 2002, these consist of costs and earned revenue for the following table (Dollars in Thousands).

	2003			2002		
Program	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**
Costs:						
Executive Direction	$ 2,039,675	$ 159,629	$ 1,880,046	$ 1,681,836	$ 117,887	$ 1,563,949
FSRDF	1,506,093	347,165	1,158,928	1,057,328	314,864	742,464
ICASS	965,358	670,831	294,527	906,142	692,376	213,766
International Commissions	84,427	1,415	83,012	93,510	(2,607)	96,117
Total Costs	$ 4,595,553	$ 1,179,040	$ 3,416,513	$ 3,738,816	$ 1,122,520	$ 2,616,296
Earned Revenue:						
Executive Direction	$ 335,553	$ 159,629	$ 175,924	$ 235,115	$ 117,887	$ 117,228
FSRDF	1,177,066	310,476	866,590	1,157,436	293,367	864,069
ICASS	982,504	670,831	311,673	920,918	692,376	228,542
International Commissions	13,227	1,415	11,812	2,825	(2,607)	5,432
Total Earned Revenue	$ 2,508,350	$ 1,142,351	$ 1,365,999	$ 2,316,294	$ 1,101,023	$ 1,215,271
Total Net Cost for Executive Direction and Other Costs Not Assigned	$ 2,087,203	$ 36,689	$ 2,050,514	$ 1,422,522	$ 21,497	$ 1,401,025

Program Costs

These costs include the full cost of resources consumed by a program, both direct and indirect, to carry out its activities. Direct costs can be specifically identified with a program. Indirect costs include resources that are commonly used to support two or more programs, and are not specifically identified with any program. Indirect costs are assigned to programs through allocations. Full costs also include the costs of goods or services received from other Federal entities (referred to as inter-entity costs), whether or not the Department reimburses that entity.

Indirect Costs: Indirect costs consist primarily of Management and Organizational Excellence charges for central support functions performed in 2003 and 2002 under the Under Secretary for Management by the following organizations (Dollars in Thousands):

Bureau (or equivalent)	**2003**	**2002**
Bureau of Diplomatic Security	$ 1,154,129	$ 782,344
Office of Overseas Buildings Operations	689,219	643,675
Bureau of Administration	520,549	513,562
Bureau of Information Resource Management	326,900	298,470
Bureau of Personnel	303,272	265,282
Bureau of Resource Management	324,899	(95,662)
Foreign Service Institute	113,885	106,424
Medical Services and Other	229,229	157,442
Total Central Support Costs	$ 3,662,082	$ 2,671,537

These support costs were distributed to programs on the basis of a program's total base salaries for its full-time employees, as a percentage of total base salaries for all full-time employees, except for the Office of Overseas Buildings Operations. Since the Office of Overseas Buildings Operations supports overseas operations, its costs were allocated based on the percentage of budgeted cost by program for the regional bureaus. The distribution of support costs to programs in 2003 and 2002 was as follows (Dollars in Thousands):

Program Receiving Allocation	2003	2002
Regional Stability	$ 320,648	$ 191,907
Counterterrorism	150,528	82,947
Homeland Security	147,183	206,283
Weapons of Mass Destruction	119,467	75,645
International Crime and Drugs	45,815	38,011
American Citizens	928,342	721,816
Democracy and Human Rights	160,722	87,853
Economic Prosperity and Security	339,604	172,169
Social and Environmental Issues	83,467	51,114
Humanitarian Response	18	12
Public Diplomacy and Public Affairs	271,269	273,028
Executive Direction and Other Costs Not Assigned	1,095,019	770,752
Total	$ 3,662,082	$ 2,671,537

Since the cost incurred by the Under Secretary for Management and the Secretariat are primarily support costs, these costs were distributed to the other Under Secretaries to show the full costs under the responsibility segments that have direct control over the Department's programs. One exception within the Under Secretary for Management is the Bureau of Consular Affairs, which is responsible for the American Citizens program. As a result, these costs were not allocated and continue to be reported as the Under Secretary for Management.

The Under Secretary for Management/Secretariat costs (except for the Bureau of Consular Affairs) were allocated to the other Department responsibility segments based on the percentage of total costs by organization for each program. The allocation of these costs to the other Under Secretaries and to the Bureau of Consular Affairs was as follows (Dollars in Thousands):

Under Secretary	2003	2002
Political Affairs	$ 4,450,321	$ 2,817,597
Public Diplomacy	674,502	502,608
Management (Consular Affairs)	454,104	344,715
Arms Control, International Security Affairs	279,740	191,111
Global Affairs	151,211	63,456
Economic, Business and Agriculture Affairs	27,853	18,090
Total	$ 6,037,731	$ 3,937,577

Inter-Entity Costs and Imputed Financing: The Department is an agency of the U.S. Government, which performs many services for other U.S. Government agencies, especially overseas. Conversely, other U.S. Government agencies make financial decisions and report certain financial matters on behalf of the U.S. Government as a whole, including matters to which the Department may be an interested party.

To measure the full cost of activities, SFFAS No. 4, *Managerial Cost Accounting,* requires that total costs of programs include costs that are paid by other U.S. Government entities, if material. As provided by SFFAS No. 4, OMB issued a Memorandum in April 1998, entitled "Technical Guidance on the Implementation of Managerial Cost Accounting Standards for the Government." In that Memorandum, OMB established that reporting entities should recognize inter-entity costs for (1) employees' pension benefits; (2) health insurance, life insurance, and other benefits for retired employees; (3) other post-retirement benefits for retired, terminated and inactive employees, including severance payments, training and counseling, continued health care, and unemployment and workers' compensation under the *Federal Employees' Compensation Act;* and (4) payments made in litigation proceedings. This requirement to recognize specific inter-entity costs was extended in September 2001 and September 2000 to FY 2002 and 2001 financial statements by Bulletin 01-09 and OMB Memorandum M-00-14, "Technical Amendments to OMB Bulletin 97-01, *Form and Content of Agency Financial Statements,*" respectively.

The Department recognizes an imputed financing source on the Statement of Changes in Net Position for the value of inter-entity costs paid by other U.S. Government entities. This consists of all inter-entity amounts as reported below except for the Federal Workers' Compensation Benefits (FWCB). For FWCB, the Department recognizes its share of the change in the actuarial liability for FWCB as determined by the Department of Labor (DoL). The Department reimburses DoL for FWCB paid to current and former Department employees.

The following inter-entity costs and imputed financing sources were recognized in the Statement of Net Cost and Statement of Changes in Net Position, respectively, for the year ended September 30, 2003 and 2002 (Dollars in Thousands):

Inter-Entity Cost	2003	2002
Other Post-Employment Benefits:		
Civil Service Retirement Program	$ 25,010	$ 17,912
Federal Employees Health Benefits Program	59,256	52,179
Federal Employees Group Life Insurance Program	230	114
Litigation funded by Treasury Judgment Fund	3,044	13,874
Subtotal – Imputed Financing Source	$ 87,540	$ 84,079
Future Workers' Compensation Benefits	13,490	7,620
Total Inter-Entity Costs	$101,030	$ 91,699

Intra-departmental Eliminations. Intra-departmental eliminations of cost and revenue were recorded against the program that provided the service. Therefore the full program cost was reported by leaving the reporting of cost with the program that received the service.

Earned Revenues

Earned revenues occur when the Department provides goods or services to the public or another Federal entity. Earned revenues are reported regardless of whether the Department is permitted to retain all or part of the revenue. Specifically, the Department collects but does not retain passport, visa, and certain other consular fees. Earned revenues for the year ended September 30, 2003 and 2002, consist of the following (Dollars in Thousands):

	2003			2002		
Program	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**
Consular Fees:						
Passport, Visa and Other Consular Fees	$ 642,076	$ —	$ 642,076	$ 523,863	$ —	$ 523,863
Machine Readable Visa	550,597	—	550,597	368,875	—	368,875
Expedited Passport	98,207	—	98,207	65,286	—	65,286
Fingerprint Processing, Diversity Lottery, and Affadavit of Support	23,514	—	23,514	12,289	—	12,289
Subtotal – Consular Fees	$ 1,314,394	$ —	$ 1,314,394	$ 970,313	$ —	$ 970,313
FSRDF	$ 1,177,066	$ 310,476	$ 866,590	$ 1,157,436	$ 293,367	$ 864,069
ICASS	982,504	670,831	311,673	920,918	692,376	228,542
Reimbursable Agreements With Federal Agencies	1,088,382	543,632	544,750	692,225	338,911	353,314
Working Capital Fund	270,606	167,005	103,601	252,037	172,157	79,880
Other	22,015	—	22,015	2,978	—	2,978
Total	$ 4,854,967	$ 1,691,944	$ 3,163,023	$ 3,995,907	$ 1,496,811	$ 2,499,096

Pricing Policies

Generally, a Federal agency may not earn revenue from outside sources unless it obtains specific statutory authority. Accordingly, the pricing policy for any earned revenue depends on the revenue's nature, and the statutory authority under which the Department is allowed to earn and retain (or not retain) the revenue. Earned revenue that the Department is not authorized to retain is deposited into the Treasury's General Fund.

The FSRDF finances the operations of the Foreign Service Retirement and Disability System (FSRDS) and the Foreign Service Pension System (FSPS). The FSRDF receives revenue from employee/employer contributions, a U.S. Government contribution, and interest on investments. By law, FSRDS participants contribute 7.25% of their base salary, and each employing agency contributes 7.25%; FSPS participants contribute 1.35% of their base salary and each employing agency contributes 20.22%. Employing agencies report employee/employer contributions biweekly. Total employee/employer contributions for 2003 and 2002 were $185.4 million and $171.3 million, respectively.

The FSRDF also receives a U.S. Government contribution to finance (1) FSRDS benefits not funded by employee/employer contributions; (2) interest on FSRDS unfunded liability; and (3) FSRDS disbursements attributable to military service. The U.S. Government contributions for 2003 and 2002 were $219.0 million and $216.0 million, respectively. FSRDF cash resources are invested in special non-marketable securities issued by the Treasury. Total interest earned on these investments in 2003 and 2002 was $772.6 million and $770.1 million, respectively.

Consular Fees are established primarily on a cost recovery basis and are determined by periodic cost studies. Reimbursable Agreements with Federal agencies are established and billed on a cost-recovery basis. ICASS billings are computed on a cost-recovery basis; billings are calculated to cover all operating, overhead, and replacement of capital assets, based on budget submissions, budget updates, and other factors. In addition to services covered under ICASS, the Department provides administrative support to other agencies overseas for which the Department does not charge. Areas of support primarily include buildings and facilities, diplomatic security (other than the local guard program), overseas employment, communications, diplomatic pouch, receptionist and selected information management activities. The Department receives direct appropriations to provide this support; individual costs for these activities have not been determined.

Gross Cost and Earned Revenue by Budget Functional Classification (BFC)

The Department's costs and revenue are included in the *Financial Report of the United States Government – Fiscal 2003* (formerly the Consolidated Financial Statements of the United States Government), which is published by the Department of the Treasury. The *Financial Report of the United States Government – Fiscal 2003* presents gross costs and earned revenue by BFC. Following is the Department's gross cost and earned revenue by BFC for the years ended September 30, 2003 and 2002 (Dollars in Thousands and reported net of intra-departmental eliminations):

	2003			2002		
Budget Functional Classification	**Gross Cost**	**Earned Revenue**	**Net Cost**	**Gross Cost**	**Earned Revenue**	**Net Cost**
International Affairs	$10,635,744	$ 2,284,316	$ 8,351,428	$ 9,691,896	$ 1,621,693	$ 8,070,203
Income Security	1,515,832	870,185	645,647	1,065,979	864,069	201,910
Natural Resources	71,064	8,522	62,542	79,960	13,334	66,626
Total	$12,222,640	$ 3,163,023	$ 9,059,617	$10,837,835	$ 2,499,096	$ 8,338,739

19 STATEMENT OF BUDGETARY RESOURCES

The Statement of Budgetary Resources reports information on how budgetary resources were made available and their status as of and for the years ended September 30, 2003 and 2002. Intra-departmental transactions have not been eliminated in the amounts presented.

The Budgetary Resources section presents the total budgetary resources available to the Department. For 2003 and 2002, the Department received approximately $17.6 billion and $17.8 billion in budgetary resources, respectively, primarily consisting of the following:

Source of Budgetary Resources	**2003**	**2002**
Budget Authority:		
Direct or related appropriations	$ 10.9 billion	$11.8 billion
Authority financed from Trust Funds	1.2 billion	1.1 billion
Spending authority from providing goods and services	3.1 billion	2.3 billion
Unobligated Balances – Beginning of Year	2.6 billion	2.3 billion
Adjustments	(0.2) billion	0.3 billion
Total Budgetary Resources	$17.6 billion	$17.8 billion

The Department received permanent indefinite appropriations of $35.6 million and $35.5 million for 2003 and 2002, respectively. The permanent indefinite appropriation provides payments to the Foreign Service Retirement and Disability Fund to finance the interest on the unfunded pension liability for the year and disbursements attributable to military service.

Information on U.S. Government agencies' budgets is reported in the *Budget of the United States Government, Fiscal Year 2004* – Appendix (*Appendix*). The *Appendix* includes for each agency (including the Department), among other things, budget schedules for the agency's accounts. Information on budgetary resources and their status will be displayed in the *Program and Financing (P&F)* Schedule under each account. Amounts presented in the *P&F Schedules* are in millions of dollars. Each agency is responsible for submitting the data presented in the *P&F Schedules* via the MAX system. The information submitted for "2003 Actual" via MAX has been reconciled with the information presented in the Statement of Budgetary Resources. Amounts shown on the Statement of Budgetary Resources will differ from "2003 Actual" reported in the *P&F Schedules* for the Department's accounts as follows:

- The Budget Authority reported on the Statement of Budgetary Resources includes $865 million the Department received for 2003 to administer programs related to International Security Assistance. Amounts for these programs will not be presented under the Department in the *Appendix*. Instead, these amounts will be reported in the *Appendix* under the section titled International Assistance Programs.

- The Unobligated Balances – Beginning of Year reported on the Statement of Budgetary Resources includes a $230 million adjustment (increase) pertaining to undelivered orders that will not be reported in the *Appendix.*

- The Unobligated Balances – Beginning of Year reported on the Statement of Budgetary Resources includes $198 million of unavailable unobligated balances (primarily for expired annual accounts) that will not be reported in the *Appendix*. These unavailable unobligated balances in expired accounts (2002 and prior) remain available for adjustment, liquidation of obligations and other purposes authorized by law, until such amounts are closed as required by law (Public Law 101-510) and any remaining amounts will be returned to the General Fund of the U.S. Treasury. However, they are not available to incur new obligations since their period of availability to do such has expired. Consequently, the P&F Schedule reports only available unobligated balances (versus unavailable) as budgetary resources available for obligation.

- The Unobligated Balance – End of Year reported on the Statement of Budgetary Resources includes $55 million of unavailable unobligated balances (primarily for expired annual accounts) that will not be reported in the *Appendix*. These unavailable unobligated balances in expired accounts (2002 and prior) remain available for adjustment, liquidation of obligations and other purposes authorized by law until the accounts are closed as required by law (Public Law 101-510) and any remaining amounts are returned to the General Fund of the U.S. Treasury. However, they are not available to incur new obligations since their period of availability to do such has expired. Consequently, the P&F Schedule reports only available unobligated balances (versus unavailable) as budgetary resources available for obligation.

- The Unobligated Balance, Available and Unavailable – End of Year reported on the Statement of Budgetary Resources includes a $334.4 million adjustment (increase) pertaining to undelivered orders that will not be reported in the *Appendix*.

- The Obligated Balance, Net – Beginning of Year reported on the Statement of Budgetary Resources includes a $230 million decrease pertaining to undelivered orders that will not be reported in the *Appendix*.

- The Obligated Balance, Net – End of Year reported on the Statement of Budgetary Resources includes a $334.4 million adjustment (decrease) pertaining to undelivered orders that will not be reflected in the *Appendix*.

The *Appendix* is organized by major subordinate organizations or program areas within the agency, and then by the nature of account(s) (e.g., general, special, revolving, trust) within organization or program area. The Department's section consists of the following areas: Administration of Foreign Affairs, International Organizations and Conferences, International Commissions, and Other. The Combining Schedule of Budgetary Resources appearing as Required Supplementary Information presents amounts in the Combined Statement of Budgetary Resources by these areas.

The format of the Statement of Budgetary Resources changed for FY 2002. The new format requires separate disclosure of credit reform programs. Due to the immateriality of the Department's credit reform program, the credit reform information is being presented in this note versus the principal statement (Dollars in Thousands).

Credit Reform	2003	2002
Budget Authority		
Appropriations	1,469	1,219
Borrowing Authority	94	153
Unobligated Balance, beginning of Year	3,061	2,056
Spending Authority from Offsetting Collections		
Earned		
Collected	592	287
Receivable from Federal Sources	337	362
Other	(5)	–
Total Budgetary Resources	5,548	4,077
Obligations Incurred:		
Direct Obligations	2,532	1,929
Unobligated Balance, Available:		
Exempt from Apportionment	2,702	1,524
Unobligated Balance Not Available:		
Other	314	624
Total Status of Budgetary Resources	5,548	4,077
Obligated Balance, Net as of Beginning of Year	1,409	169
Obligated Balance, Net as of End of Year		
Undelivered Orders	1,638	957
Accounts Payable	132	1
Outlays:		
Disbursements	1,831	779
Collections	(592)	(288)

The amount of budgetary resources obligated for undelivered orders for all activities was approximately $6.7 billion and $5.6 billion as of September 30, 2003 and 2002, respectively. This includes amounts for revolving and trust funds of $286 million for September 30, 2003 and $472 million for September 30, 2002.

20 STATEMENT OF FINANCING

Accrual-based measures used in the Statement of Net Cost differ from the obligation-based measures used in the Statement of Budgetary Resources. The Statement of Financing for the years ended September 30, 2003 and 2002, presents information to reconcile these different measures. In doing so, the Statement of Financing provides assurance that the financial information is consistent with similar amounts found in budget reports. The Statement of Financing reconciles obligations of budget authority to the accrual-based net cost of operations. The Net Cost of Operations as presented on the Statement of Financing is determined by netting the obligations as adjusted and non-budgetary resources and making adjustments for the total resources that do not fund net cost of operations, the total costs that do not require resources, and financing sources yet to be provided. The Net Cost of Operations that results from the reconciliation on the Statement of Financing equals the Net Cost of Operations reported on the Statement of Net Cost. Intra-departmental transactions have not been eliminated in the amounts presented.

21 CUSTODIAL ACTIVITY

The Department administers certain activities associated with the collection of non-exchange revenues, which are deposited and recorded directly to the General Fund of the Treasury. The Department does not retain the amounts collected. Accordingly, these amounts are not considered or reported as financial or budgetary resources for the Department. At the end of each fiscal year, the accounts are closed and the balances are brought to zero by Treasury. Specifically, the Department collects interest, penalties and handling fees on accounts receivable; fines for Munitions Control violations; international contributions for ice patrol activities; and other miscellaneous receipts. In 2003 and 2002, the Department collected $8.2 million and $6.2 million, respectively, in custodial revenues that were transferred to the Treasury.

22 DEDICATED COLLECTIONS

The Department administers nine Trust Funds that receive dedicated collections. In the U.S. Government budget, Trust Funds are accounted for separately and used only for specified purposes. A brief description of these Funds and their purpose follows.

Foreign Service Retirement and Disability Fund (19X8186)

The Foreign Service Retirement and Disability Fund (FSRDF) was established in 1924 to provide pensions to retired and disabled members of the Foreign Service. The FSRDF's revenues consist of contributions from active participants and their U.S. Government agency employers; appropriations; and interest on investments. Monthly annuity payments are made to eligible retired employees or their survivors. Separated employees without title to an annuity may take a refund of their contributions. P.L. 96-465 limits the amount of administrative expense that can be charged to the fund to $5,000. The total cost for administering FSRDF was $3.0 million and $2.9 million in 2003 and 2002, respectively. Cash is invested in U.S. Treasury securities until it is needed for disbursement.

Foreign Service National Separation Liability Trust Fund (FSNSLTF) (19X8340)

FSNSLTF funds separation liabilities to foreign service national (FSNs) and personal service contractor (PSCs) employees who voluntarily resign, retire, or lose their jobs due to a reduction in force. The liability is applicable only in those countries that, due to local law, require a lump-sum voluntary separation payment based on years of service. The FSNSLTF was authorized in 1991 and initially capitalized with a transfer from the Department. Contributions are made to the FSNSLTF by the Department's appropriations, from which the FSNs and PSCs are paid. Once the liability to the separating FSN or PSC is computed in accordance with the local compensation plan, the actual disbursement is made from the FSNSLTF.

Conditional and Unconditional Gift Funds (19X8821 and 19X8822)

The Department maintains two Trust Funds for receiving and disbursing donations. It is authorized to accept gifts from private organizations and individuals in the form of cash, gifts-in-kind, and securities. Gifts are classified as Restricted or Unrestricted Gifts. Restricted Gifts must be used in the manner specified by the donor. Unrestricted Gifts can be used for any expense normally covered by an appropriation, such as representational purposes or embassy refurbishment.

Israeli-Arab Scholarship Program (19X8271)

The Israeli-Arab Scholarship Program provides grants and scholarships to Israeli-Arab students for degree programs at universities and colleges in the United States. This program was authorized by Section 214 of the Foreign Relations Authorization Act, Fiscal Years 1992 and 1993 (P.L. 102-138). A permanent endowment of $4.9 million was established in 1992.

Eisenhower Exchange Fellowship Program Trust Fund (95X8276)

The Eisenhower Exchange Fellowship Act of 1990 (P.L. 101-454) authorized a permanent endowment for the Eisenhower Exchange Fellowship Program to honor the late president by increasing educational opportunities for young leaders who wish to prepare for and enhance their professional careers and advance peace through international understanding. The 1992 Department of State and Related Agencies Appropriations Act provided $5.0 million to establish a permanent endowment for the Program, and appropriated the interest and earnings. The 1995 Department of State and Related Agencies Appropriations Act made an additional payment of $2.5 million to the endowment.

Miscellaneous Trust Funds, Information and Exchange Programs (19X8166, 19X8167, and 19X8272)

Funds advanced by other governments, business concerns, and private organizations to the Department are used to send experts abroad to perform requested services; give foreign nationals scientific, technical, or other training; purchase films and other products owned or controlled by the Department; and for international exhibitions.

Financial data of the Trust Funds as of and for the years ending September 30, 2003 and 2002, is summarized on the following pages (Dollars in Thousands). Intra-departmental transactions have not been eliminated in the amounts presented.

	FSRDF	FSNSLTF	Gift Funds	Israeli-Arab Scholarship	Eisenhower Exchange Fellowship	Misc. Trust Funds
For the year ending September 30, 2003:						
Assets:						
Fund Balances with Treasury	$ 43	$ 94,878	$ 12,908	$ 484	$ 6	$ 2,670
Investments	12,289,302	—	—	4,388	7,483	—
Other Assets	202,949	—	11	106	—	4
Total Assets	12,492,294	94,878	12,919	4,978	7,489	2,674
Liabilities:						
Payable to Beneficiaries	42,645	—	—	—	—	—
Actuarial Liability	9,653	—	—	—	—	—
Other Liabilities	13,093,800	4,941	4,178	—	—	103
Total Liabilities	13,146,098	4,941	4,178	—	—	103
Net Position (Deficit)	(653,804)	89,937	8,741	4,978	7,489	2,571
Total Liabilities and Net Position	$ 12,492,294	$ 94,878	$ 12,919	$ 4,978	$ 7,489	$ 2,674
Revenues and Financing:						
Exchange Revenue:						
Intragovernmental	$ 1,151,649	$ 9,454	$ —	$ 259	$ —	$ —
Governmental	25,416	—	—	—	—	—
Non Exchange Revenue:						
Intragovernmental	—	—	54	—	450	2
Governmental	—	—	3,927	—	—	—
Other Financing Sources	—	—	—	—	—	—
Total Revenues and Financing	1,177,065	9,454	3,981	259	450	2
Expenses:						
Program Expenses	—	9,712	3,661	371	419	229
Actuarial Expenses	1,506,093	—	—	—	—	—
Total Expenses	$ 1,506,093	$ 9,712	$ 3,661	$ 371	$ 419	$ 229

	FSRDF	FSNSLTF	Gift Funds	Israeli-Arab Scholarship	Eisenhower Exchange Fellowship	Misc. Trust Funds
For the year ending September 30, 2002:						
Assets:						
Fund Balances with Treasury	$ —	$ 95,130	$ 7,581	$ 530	$ 105	$ 2,133
Investments	11,734,240	—	3,980	4,454	7,353	711
Other Assets	203,793	—	8	105	—	4
Total Assets	11,938,033	95,130	11,569	5,089	7,458	2,848
Liabilities:						
Payable to Beneficiaries	41,283	—	—	—	—	—
Actuarial Liability	12,211,800	—	—	—	—	—
Other Liabilities	9,726	4,934	3,146	—	—	50
Total Liabilities	12,262,809	4,934	3,146	—	—	50
Net Position (Deficit)	(324,776)	90,196	8,423	5,089	7,458	2,798
Total Liabilities and Net Position	$ 11,938,033	$ 95,130	$ 11,569	$ 5,089	$ 7,458	$ 2,848
Revenues and Financing:						
Exchange Revenue:						
Intragovernmental	$ 1,133,237	$ 9,606	$ —	$ —	$ —	$ —
Governmental	24,199	—	—	—	—	—
Non Exchange Revenue:						
Intragovernmental	—	—	88	263	730	15
Governmental	—	—	33,582	—	—	—
Other Financing Sources	—	—	—	—	—	—
Total Revenues and Financing	1,157,436	9,606	33,670	263	730	15
Expenses:						
Program Expenses	—	8,651	33,495	402	356	515
Actuarial Expenses	1,057,328	—	—	—	—	—
Total Expenses	$ 1,057,328	$ 8,651	$ 33,495	$ 402	$ 356	$ 515

DEPARTMENT OF STATE REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION HERITAGE ASSETS

FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2003 AND 2002

The Department has collections of art objects, furnishings, books, and buildings that are considered heritage or multi-use heritage assets. These collections are housed in the Diplomatic Reception Rooms, senior staff offices in the Secretary's suite, offices, reception areas, conference rooms, the cafeteria and related areas, and embassies throughout the world. The items have been acquired as donations, are on loan from the owners, or were purchased using gift and appropriated funds. The assets are classified into six categories: the Diplomatic Reception Rooms, Art Bank, Art in Embassies, Curatorial Services Program, Library Rare & Special Book Collection, and Secretary of State's Register of Culturally Significant Property. Items in the Register of Culturally Significant Property category are classified as multi-use heritage assets due to their use in general government operations.

Diplomatic Reception Rooms

Under the management of the Curator's Office, the Diplomatic Reception Room collection is comprised of museum-caliber American furnishings from the 1750 to 1825 period. These items are used to decorate the Diplomatic Reception Rooms located on the 8th floor of the Department of State, as well as 19 offices on the 7th floor used by the Secretary of State and the Secretary's senior staff. These items have been acquired through donations or purchases funded through gifts from private citizens, foundations, and corporations. Tax dollars have not been used to acquire or maintain the collection.

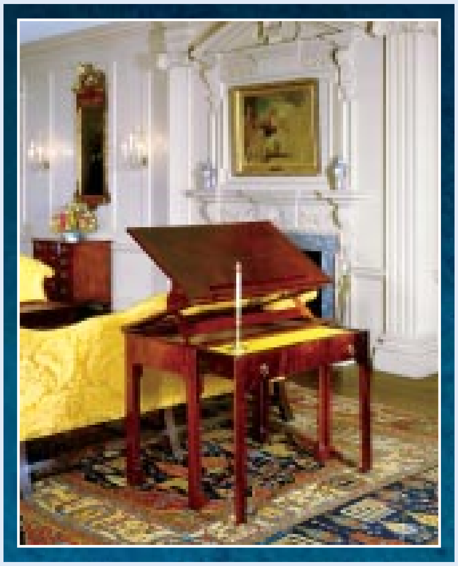


Photo: Richard Cheek

Philadelphia mahogany table-desk on which Thomas Jefferson drafted the Declaration of Independence.

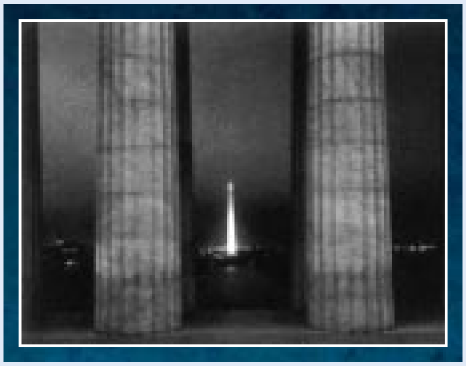
Thomas Jefferson State Reception Room.

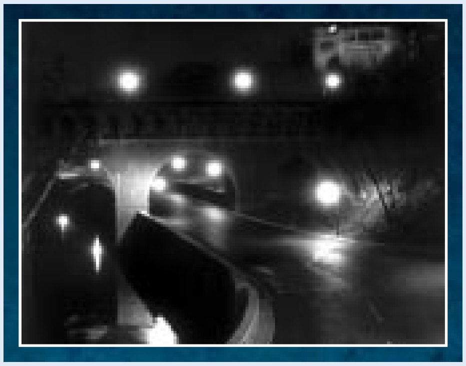
Photo: Richard Cheek

The Benjamin Franklin State Dining Room.

Art Bank

The Art Bank was established in 1984 to acquire artworks that could be displayed throughout the Department's offices and annexes. The works of art are displayed in staff offices, reception areas, conference rooms, the cafeteria, and related public areas. The collection consists of original works on paper (watercolors and pastels) as well as limited edition prints, such as lithographs, woodcuts, intaglios, and silk-screens. These items are acquired through purchases funded by contributions from each participating bureau.



Volkwup Wertzel
(clockwise from top left)
U.S. Capitol
The Washington Monument
Q Street Bridge
Pennsylvania Avenue

Rare & Special Book Collection

In recent years, the Library has identified books that require special care or preservation. Many of these publications have been placed in the Rare Books and Special Collections Room, which is located adjacent to the Reading Room. Among the treasures is a copy of the Nuremberg Chronicles, which was printed in 1493; volumes signed by Thomas Jefferson; and books written by Foreign Service authors.

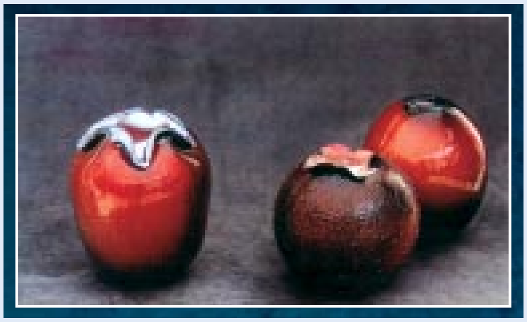
Curatorial Services Program

The Curatorial Services Program, which is managed by the Overseas Buildings Operations' Interior Planning, Design and Furnishings Division, is responsible for antiques, works of art, and high-value furnishings that the Department owns abroad. These objects are important due to their historical significance, antiquity, rare quality, or high dollar value. These items may have been donated or obtained as part of the furnishings acquired with a building.

Art in Embassies

The Art in Embassies Program was established in 1964 to promote national pride and the distinct cultural identity of America's arts and its artists. The program, which is managed by the Bureau of Overseas Buildings Operations, provides original U.S. works of art for the representational rooms of United States ambassadorial residences worldwide. The works of art were purchased or are on loan from individuals, organizations, or museums.

1



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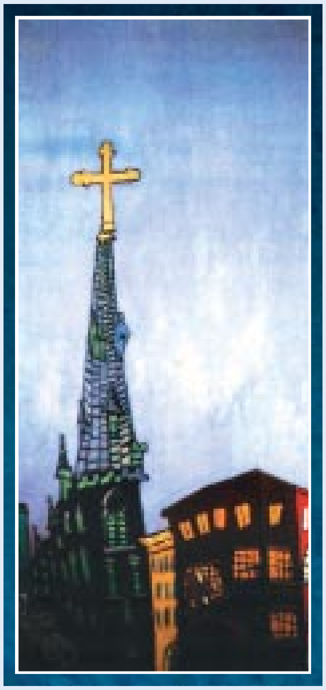


3

1. Mary Sheppard Burton Fantasia 1975 (132x96 cm) hooked and hand-dyed wool on linen mounted board. Courtesy of the artist, Germantown, Maryland

2. Jerry Hovanec, Persimmon with Pulled Stem-Cap 1998, Persimmon with Copper Stem-Cap 1997, and Untitled|Persimmon Vessel 1997, (17 x 13 x 13 cm) blown glass. Courtesy of the artist, Lusby, Maryland

3. Barbara Cooper Hanson, Federal Hill, 1992 (180 x 81 cm) oil on canvas. Courtesy of the artist, Baltimore, Maryland

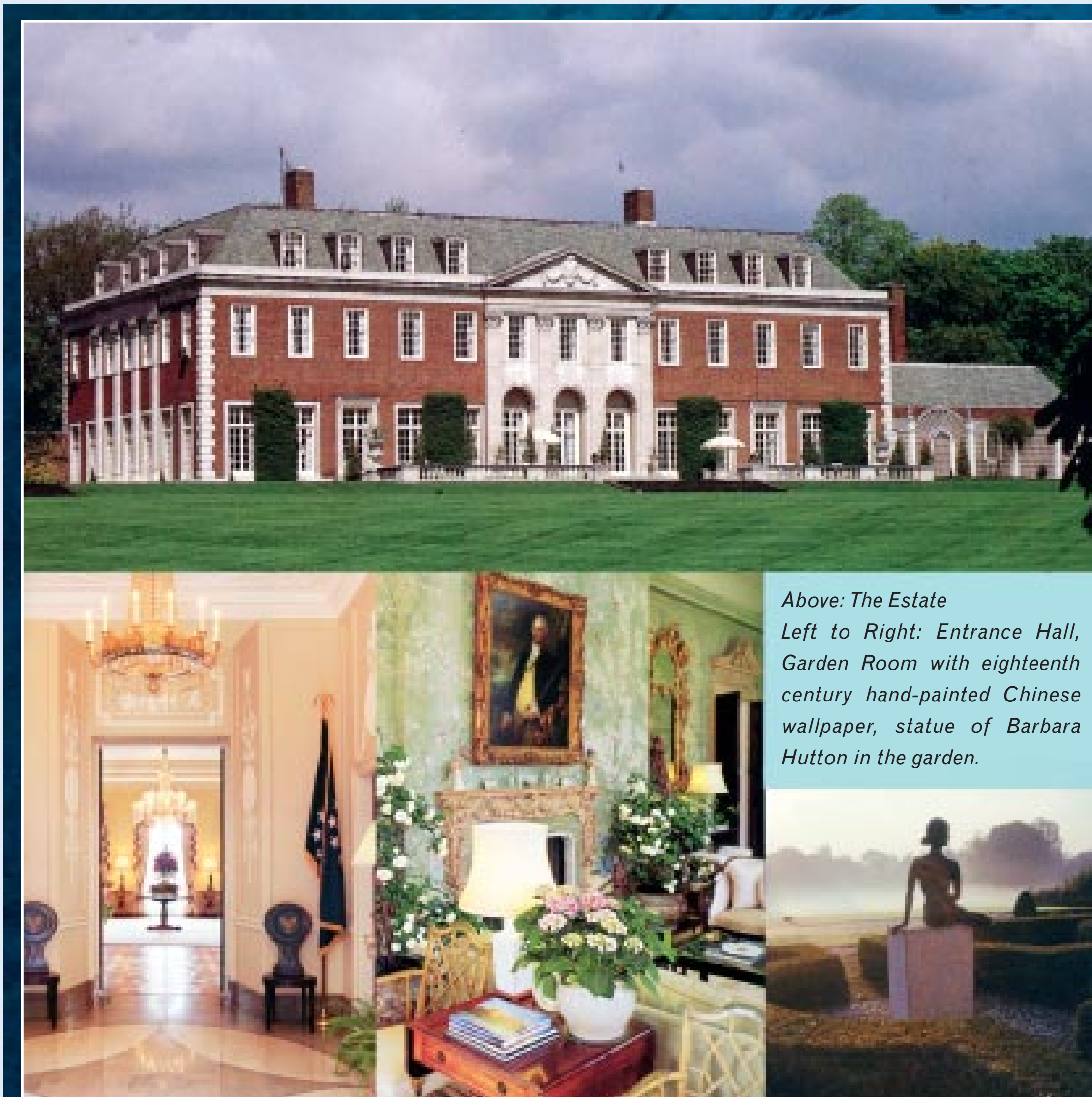
"There are many ways to conduct diplomacy. The Art in Embassies Program is a special way. Works of American art, on display around the world, share our beloved country, our values, our history, our culture, our deep belief in freedom of expression, and in the creative power of the individual. Each work of art becomes a diplomatic instrument, each artist an ambassador. It is an outstanding program."

Colin L. Powell

U.S. Secretary of State

Secretary of State's Register of Culturally Significant Property

The Secretary of State's Register of Culturally Significant Property was established in January 2001 to recognize the Department's owned properties overseas, which have historical, architectural, or cultural significance. Properties in this category include chanceries, consulates, and residences. All these properties are used predominantly in general government operations and are thus classified as multi-use heritage assets. Financial information for multi-use heritage assets is presented in the principal statements.



Above: The Estate
Left to Right: Entrance Hall, Garden Room with eighteenth century hand-painted Chinese wallpaper, statue of Barbara Hutton in the garden.

Situated adjacent to Regent's Park in London, England, Winfield House is the residence of the U.S. Ambassador to the Court of St. James. Heiress Barbara Hutton built this country manor in 1936, and named it after her grandfather F.W. (Winfield) Woolworth, who had founded the famous Woolworth stores where any item could be purchased for five or ten cents. After World War II, Hutton offered the building to the United States Government to use as the ambassador's residence for the price of one American dollar.

	Diplomatic Reception Rooms Collection	Art Bank	Art in Embassies Program	Curatorial Services Program	Library Rare & Special Book Collection	Secretary of State's Register of Culturally Significant Property
Description	Collectibles – Art and furnishings from the period 1750 to 1825	Collectibles – American works of art	Collectibles – American works of art	Collectibles – Art and furnishings of cultural or historic value	Collectibles – Rare books and other publications of historic value	Noncollection – Buildings of historic, cultural, or architectural significance
Acquisition and Withdrawal	Acquired through donation or purchase using donated funds. Excess items are sold.	Acquired through purchase. Excess items are sold.	Acquired through purchase or donation. Excess items are sold.	Acquired through purchase or donation. Excess items are sold.	Acquired through purchase or donation. Excess items are sold.	Acquired through purchase. Excess items are sold.
Condition	Good to excellent	Good to excellent	Good to excellent	Good to excellent	Good to excellent	Poor to Excellent
Number of Items – 09/30/2001	3,402	2,011	895	4,045	179	8
Acquisitions	3	90	82	443	—	—
Adjustments	—	4[1]	—	—	856 [1]	-—
Disposals	—	(43)	(24)	(74)	—	-—
Number of Items – 09/30/2002	3,405	2,062	953	4,414	1,035	8
Acquisitions	10	59	25	45	—	—
Adjustments	—	—	—	—	—	—
Disposals	(3)	—	(16)	(1)	(2)	—
Number of Items – 09/30/2003	3,412	2,121	962	4,458	1,033	8
Deferred Maintenance	N/A	N/A	N/A	N/A	N/A	$14,324,707

[1] Adjustments due to physical inventories.

DEPARTMENT OF STATE REQUIRED SUPPLEMENTARY INFORMATION

DEPARTMENT OF STATE

COMBINING SCHEDULE OF BUDGETARY RESOURCES

For the Year Ended September 30, 2003

(Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Budgetary Authority:						
Appropriations received	$ 7,380,737	$ 1,535,331	$ 57,303	$ 945,694	$ 2,033,430	$11,952,495
Net transfers	27,246	—	600	(80,763)	163,136	110,219
Unobligated Balance:						
Beginning of period	1,878,488	60,407	10,098	129,880	500,434	2,579,307
Net Transfers	—	—	—	(4,557)	(13,088)	(17,645)
Spending Authority from Offsetting Collections:						
Earned						
Collected	3,325,920	—	7,119	9,782	17,848	3,360,669
Receivable from Federal sources	(281,777)	—	(1,591)	16,420	802	(266,146)
Change in unfilled customer orders						
Without advance from Federal sources	—	—	1,619	—	—	1,619
Subtotal	3,044,143	—	7,147	26,202	18,650	3,096,142
Recoveries from Prior Year Obligations:						
Actual	379,116	78,480	115	16,741	55,090	529,542
Temporarily Not Available Pursuant to Public Law:	(555,093)	—	—	—	—	(555,093)
Permanently Not Available:	(99,973)	(18,323)	(414)	(9,082)	(16,614)	(144,406)
Total Budgetary Resources	12,054,664	1,655,895	74,849	1,024,115	2,741,038	17,550,561

DEPARTMENT OF STATE

COMBINING SCHEDULE OF BUDGETARY RESOURCES *Continued*

For the Year Ended September 30, 2003

(Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Obligations Incurred:						
Direct	10,351,451	1,791,895	61,309	972,852	1,992,628	15,170,135
Reimbursable	(251,824)	—	7,184	(310)	—	(244,950)
Subtotal	10,099,627	1,791,895	68,493	972,542	1,992,628	14,925,185
Unobligated Balance:						
Apportioned	1,571,071	105,102	6,935	33,500	639,566	2,356,174
Exempt from apportionment	—	—	—	—	7,489	7,489
Other available	—	—	—	—	—	—
Unobligated Balance Not Available:	383,966	(241,102)	(579)	18,073	101,355	261,713
Total Status of Budgetary Resources	12,054,664	1,655,895	74,849	1,024,115	2,741,038	17,550,561
Obligated Balance, Net,Beginning of Year:	3,522,623	688,221	15,339	325,657	1,438,482	5,990,322
Obligated Balance, Net, End of Year:						
Accounts Receivable	(348,616)	67	(825)	(21,226)	(197)	(370,797)
Unfilled customer orders	—	—	(2,886)	—	—	(2,886)
Undelivered orders	4,043,073	545,103	21,266	458,788	1,611,440	6,679,670
Accounts payable	767,204	18,995	6,702	48,995	132,486	974,382
Outlays:						
Disbursements	9,266,533	1,837,472	67,915	778,026	1,664,388	13,614,334
Collections	(3,325,920)	—	(7,119)	(9,782)	(17,848)	(3,360,669)
Subtotal	5,940,613	1,837,472	60,796	768,244	1,646,540	10,253,665
Less: Offsetting receipts	(896,096)				(486)	(896,582)
Net Outlays	$ 5,044,517	$ 1,837,472	$ 60,796	$ 768,244	$ 1,646,054	$ 9,357,083

Intragovernmental Amounts

Intragovernmental amounts represent transactions between federal entities included in the *Financial Report of the United States Government – Fiscal Year 2003* (formerly the Consolidated Financial Statements of the United States Government) published by the U.S. Department of the Treasury. All amounts presented are net of intra-departmental eliminations.

The amount of intragovernmental assets and liabilities classified by trading partner at September 30, 2003 and 2002, are summarized below (Dollars in Thousands).

As of September 30, 2003:	**ASSETS**				**LIABILITIES**	
Trading Partner	**Fund Balance With Treasury**	**Investments**	**Interest Receivable**	**Accounts Receivable, Net**	**Accounts Payable**	**Other Liabilities**
Department of Agriculture				$ 1,689		
Department of Commerce				8,937	$ 653	
Department of Defense				215,762	24,109	
Department of Justice				30,171		
Department of Labor				2		$ 18,047
Department of the Treasury	$ 9,953,197	$12,301,173	$ 189,366	9,667	6,954	368
Agency for International Development				17,498		
Environmental Protection Agency				572		21
Office of Personnel Management				17	36	9,232
Other Agencies				87,988	8,137	9,132
Total	$ 9,953,197	$12,301,173	$ 189,366	$ 372,303	$ 39,889	$ 36,800

As of September 30, 2002:	**ASSETS**				**LIABILITIES**	
Trading Partner	**Fund Balance With Treasury**	**Investments**	**Interest Receivable**	**Accounts Receivable, Net**	**Accounts Payable**	**Other Liabilities**
Department of Agriculture				$ 2,380	$ 19	
Department of Commerce				2,264	48	
Department of Defense				58,388	2,809	
Department of Justice				10,698	1	
Department of Labor				119	26	18,052
Department of the Treasury	$ 8,937,139	$11,750,737	$ 192,637	5,815	114	5,863
Agency for International Development				16,070	784	
Environmental Protection Agency				157		
Office of Personnel Management				17		7,486
Other Agencies				217,383	319	5,899
Total	$ 8,937,139	$11,750,737	$ 192,637	$ 313,291	$ 4,120	$ 37,300

The amounts of intragovernmental earned revenues classified by trading partner and related gross costs, which generated this revenue, categorized by budget functional classification for the years ended September 30, 2003 and 2002, are summarized below (Dollars in Thousands). The gross cost to generate intragovernmental revenue represents costs, for both federal and non-federal vendors, the Department incurred to provide goods and services to other Federal entities. This differs from the intra-governmental expenses presented on the following page. Intragovernmental expenses represent costs the Department incurred for goods and services received from other federal entities.

Intragovernmental Earned Revenues

For the Year Ended September 30,	2003	2002
Trading Partner	**Earned Revenue**	**Earned Revenue**
Executive Office of the President	$ 2,345	$ 16,779
Department of Agriculture	18,798	17,083
Department of Commerce	31,333	28,379
Department of Defense	599,982	375,957
Department of Energy	11,124	4,812
Department of Health and Human Services	11,637	10,518
Department of Justice	72,321	58,620
Department of Transportation	3,038	4,093
Department of the Treasury	785,405	802,522
Agency for International Development	105,074	115,769
Environmental Protection Agency	1,675	4,513
Social Security Administration	9,178	7,863
Other Agencies	132,162	416,447
Total	$ 1,784,072	$ 1,863,355

For the Year Ended September 30,	2003			2002		
Budget Functional Classification	**Gross Cost to Generate Revenue**	**Earned Revenue**	**Net Cost**	**Gross Cost to Generate Revenue**	**Earned Revenue**	**Net Cost**
International Affairs	$ 935,469	$ 938,666	$ (3,197)	$1,010,891	$1,016,069	$ (5,178)
Income Security	863,679	841,170	22,509	831,966	837,822	(5,856)
Natural Resources	4,236	4,236	—	9,464	9,464	—
Total	$1,803,384	$1,784,072	$ 19,312	$1,852,321	$1,863,355	$ (11,034)

The amounts of intragovernmental non-exchange revenues classified by trading partner for the years ended September 30, 2003 and 2002 are summarized below (Dollars in Thousands).

For the Year Ended September 30,	2003	2002
Trading Partner	**Non-Exchange Revenue**	**Non-Exchange Revenue**
Department of the Treasury	$ 765	$ 1,096

The amounts of intragovernmental expenses classified by trading partner and by budget functional classification for the years ended September 30, 2003 and 2002, are summarized below (Dollars in Thousands).

For the Year Ended September 30,	**2003**	**2002**
Trading Partner	**Expenses**	**Expenses**
Department of Agriculture	$ 769	$ 888
Department of Commerce	5,126	2,128
Department of Defense	93,557	71,847
Department of Energy	18,658	24,753
Department of Justice	35,346	55,106
Department of Labor	8,276	8,993
Department of the Treasury	20,770	29,882
General Services Administration	464,292	431,054
Government Printing Office	1,851	16,576
Office of Personnel Management	220,736	191,379
U.S. Postal Service	9,484	8,446
Other Agencies	100,590	54,127
Total	$ 979,455	$ 895,179

For the Year Ended September 30,	**2003**	**2002**
Budget Functional Classification	**Expenses**	**Expenses**
International Affairs	$ 971,634	$ 884,872
Natural Resources	7,821	10,229
Income Security	—	78
Total	$ 979,455	$ 895,179

Deferred Maintenance
For the Fiscal Year Ended September 30, 2003

The Department occupies more than 3,000 government-owned or long-term leased real properties at more than 260 overseas locations. It uses a condition assessment survey method to evaluate the asset's condition, and determine the repair and maintenance requirements for its overseas buildings.

SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* requires that deferred maintenance (measured using the condition survey method) and the description of the requirements or standards for acceptable operating condition be disclosed. Fundamentally, the Department considers all of its overseas facilities to be in an "acceptable condition" in that they serve their required mission. Adopting standard criteria for a classification of acceptable condition is difficult due to the complex environment in which the Department operates.

From a budgetary perspective, funding for maintenance and repair has been insufficient in the past. As a result, the Department has identified current maintenance and repair backlog of $717.2 million for buildings and facilities-related equipment that have not been funded. This figure is less than the $723.2 million reported for 2002. The current estimate is a more realistic measure of maintenance and repair work that must be done to buildings and equipment to bring them up to where the Department believes they should be.

Of the deferred maintenance figure, $128.5 million is for over 150 buildings that are under consideration for the Secretary of State's Register of Culturally Significant Property.

Working Capital Fund

The Working Capital Fund (WCF) is a revolving fund, which was authorized in the Foreign Assistance Act of 1963 (P.L. 88-205) as an amendment to the Department of State Basic Authorities Act. It was created to finance a continuing cycle of business-type operations for the Department.

The WCF serves bureaus and offices within the Department of State, U.S. Government agencies operating abroad, foreign governments, and international organizations located in the U.S. WCF consists of two lines of business. The products/services provided by each business line are as follows:

- WCF — Provides centralized management for equipment, services and maintenance of unclassified voice/data telecommunications; arranges ocean and airfreight shipment of personal property and official supplies from the U.S. to overseas posts; provides permanent storage of household belongings for employees assigned to overseas posts; provides printing and editorial services; procures all publications, periodicals, books and newspapers for the Department; assists overseas posts with procuring local supplies and materials; provides motor vehicle transportation; and provides moving and delivery services; regulates foreign government activities undertaken in the U.S.; registers and licenses motor vehicles belonging to a foreign mission or its staff; administers travel restrictions and controls on members of foreign missions; reviews and approves/denies all foreign mission real property acquisitions, leases, and sales; and protects and preserves foreign mission properties that belong to countries that no longer maintain diplomatic relations with the U.S.
- International Cooperative Administrative Support Service (ICASS) — Manages the interagency administrative support services for overseas posts, which includes services such as computer and financial management services, guard service, mail and messenger service, and motor pool and health services.

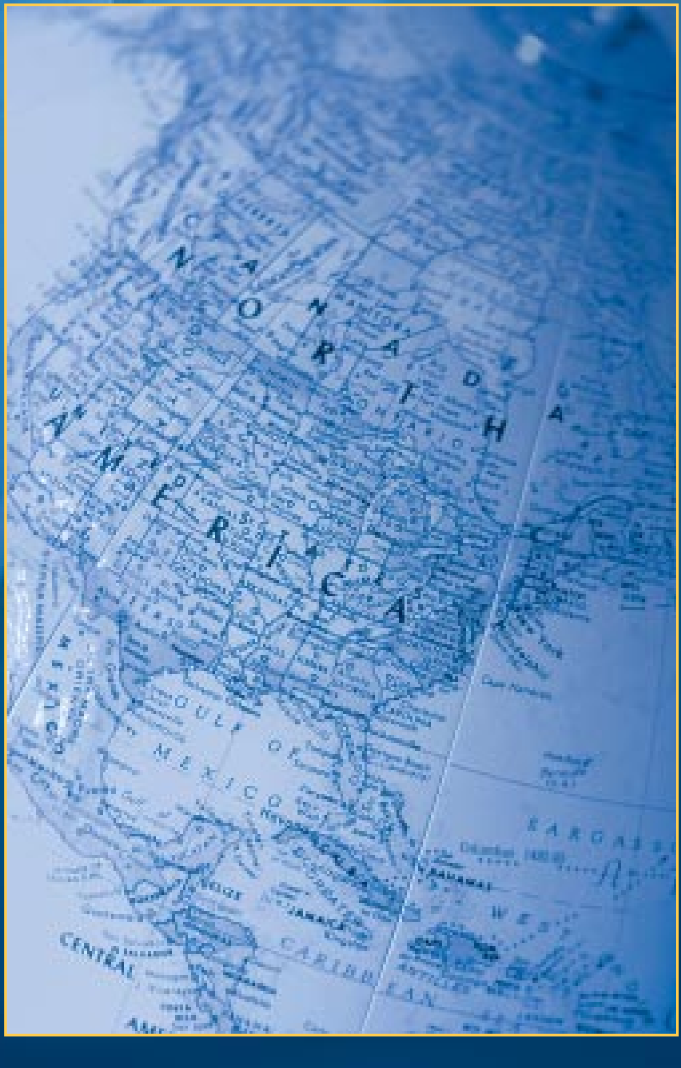
The WCF balance sheet at September 30, 2003 and 2002, is presented below (Dollars in Thousands).

	2003			2002		
	WCF	ICASS	Total	WCF	ICASS	Total
Assets:						
Fund Balances with Treasury	$ 8,458	$ 207,895	$ 216,353	$ 39,096	$ 117,570	$ 156,666
Accounts Receivable, Net	78,694	159,260	237,954	46,539	242,924	289,463
Plant, Property and Equipment, Net	27,363	30,747	58,110	24,169	30,059	54,228
Other Assets	5,272	5,492	10,764	7,800	3,689	11,489
Total Assets	119,787	403,394	523,181	117,604	394,242	511,846
Liabilities:						
Accounts Payable	21,188	121,555	142,743	12,255	77,406	89,661
Other Liabilities	664	3,754	4,418	5,113	55,088	60,201
Total Liabilities	21,852	125,309	147,161	17,368	132,494	149,862
Cumulative Results of Operations	$ 97,935	$ 278,085	$ 376,020	$ 100,236	$ 261,748	$ 361,984

The cost of providing services and the exchange revenue earned for the years ended September 30, 2003 and 2002 are presented below (Dollars in Thousands). These amounts do not include intra-departmental eliminations.

	WCF	ICASS	Total
2003			
Costs	$ 274,421	$ 975,609	$ 1,250,030
Exchange Revenue	272,120	991,946	1,264,066
Net Cost (Revenue)	$ 2,301	$ (16,337)	$ (14,036)
2002			
Costs	$ 175,614	$ 906,142	$ 1,081,756
Exchange Revenue	(253,347)	(926,642)	(1,179,989)
Net Cost (Revenue)	$ (77,733)	$ (20,500)	$ (98,233)

Supplemental Information and Other Reporting Requirements



FEDERAL CIVIL PENALTIES INFLATION ADJUSTMENT ACT

The Federal Civil Penalties Inflation Adjustment Act of 1990 established annual reporting requirements for civil monetary penalties assessed and collected by Federal agencies. Civil penalties are defined as any non-criminal penalty, fine or other sanction for which a given dollar amount or maximum amount is specified by Federal law, and that is assessed or enforced by an agency as a result of an administrative proceeding or civil action in the Federal courts. The Department has assessed fines on individuals and companies for exporting defense materials without required approvals and for misrepresenting facts on export applications.

COMPANY NAME	VIOLATION	DATE ASSESSED	AMOUNT ASSESSED	PAYMENTS
BOEING COMPANY	Reportedly exporting defense articles (technical data) and defense services to Russia, Ukraine, Norway, and Germany without the required approvals from the Department	9/29/1998	$7,500,000	$3,500,000 initially, then $800,000 for five subsequent years
A&C INTERNATIONAL TRADE, INC.	Knowingly and willfully exporting a defense article (pressurized pepper gas system) to the Peoples Republic of China without applying or obtaining the required approval from the Department	3/14/2000	$100,000	$33,333.34 initially, then $33,333.33 for next two years
LOCKHEED MARTIN CORPORATION	Exporting defense articles and defense services in violation of the terms or conditions of other approvals that were provided by the Department, making proposals for the transfer of defense services, and by omitting material facts from export license applications	6/13/2000	$8,000,000	$1,500,000 for four years and $2,000,000 due in year five
BOEING COMPANY	Violating the items and conditions of the Department's munitions licenses, exporting defense articles and services without a munitions license and omitting material facts from its applications for munitions licenses	3/30/2001	$3,800,000	$1,000,000 for three years and $800,000 in year four
SPACE SYSTEMS/LORAL, INC.	Violating the express terms and conditions of the Department's munitions licenses and exporting defense services without a munitions license or other authorization to the People's Republic of China	1/9/2002	$14,000,000	$2,200,000 initially, then $1,685,714 for seven subsequent years
RATHEON COMPANY	Export and attempted export of defense articles, defense services and technical data (troposcatter communication systems) to the government of Pakistan	2/27/2003	$3,000,000	$3,000,000
HUGHES ELECTRONICS CORP. & BOEING SATELLITE SYSTEMS	Violating the terms and conditions of the Department's munitions licenses and exporting defense services without munitions licenses or other authorizations (and conduct relating to two failed launches of rockets carrying spacecrafts) to the People's Republic of China	3/4/2003	$12,000,000	$1,500,000 for eight years
AGILENT TECHNOLOGIES, INC.	Exporting defense articles (scanners/receivers) to Israel and Singapore without obtaining an export license or written approval	8/20/2003	$225,000	$225,000
MULTIGEN-PARADIGM, INC.	Exporting defense articles and services (software) without munitions licenses or other authorizations to the People's Republic of China, India, Israel, Singapore, Australia, South Korea, Taiwan, France, Japan, Canada, Czech Republic, Italy, Spain, United Kingdom, Sweden and Peru	9/25/2003	$250,000	—
TOTAL		—	$48,875,000	—

COMPANY NAME	Balance Outstanding September 30, 2002	Fiscal Year 2003 Assessments	Fiscal Year 2003 Collections	Balance Outstanding September 30, 2003
BOEING COMPANY	$800,000	—	$800,000	—
A&C INTERNATIONAL TRADE, INC.	$66,666.66	—	$66,666.66 (delinquent payments made)	—
LOCKHEED MARTIN CORPORATION	$3,500,000	—	$1,500,000	$2,000,000
BOEING COMPANY	$1,800,000	—	$1,000,000	$800,000
SPACE SYSTEMS/LORAL, INC.	$11,800,000	—	$1,685,714	$10,114,286
RATHEON COMPANY	—	$3,000,000	$3,000,000	—
HUGHES ELECTRONICS CORP. & BOEING SATELLITE SYSTEMS	—	$12,000,000	$1,500,000	$10,500,000
AGILENT TECHNOLOGIES, INC.	—	$225,000	$225,000	—
MULTIGEN-PARADIGM, INC.	—	$250,000	—	$250,000
	$17,966,666.66	$15,475,000	$9,777,380.66	$23,664,286

INSPECTOR GENERAL'S ACT AMENDMENTS – MANAGEMENT FOLLOW-UP TO OIG RECOMMENDATIONS

The information on the Department's follow-up on audit recommendations covers 2003. It includes information on the status of recommendations more than one year old without final management decisions, and the dollar value of those reports in which funds could be put to better use or costs could be disallowed.

During 2003, the Department of State tracked 22 audit reports that were more than one year old and included a total of 73 recommendations in which final action was not taken, which would have brought closure to the reports. These audits contain over $10,581,619 in disallowed costs. The Department is working to bring closure to the 22 audits and recognizes that the follow-up actions and compliance to the recommendations are essential to improving the effectiveness and efficiency of program operations.

Management Statistical Summary
22 Audits Over One Year Old Requiring Final Action

Program Area	Number of Audit Reports	Recommendations
Counterintelligence	1	8
Financial Management	8	30
Information Management	3	13
Security Oversight	7	19
Support Programs	1	1
Property Management and Procurement	1	1
Contracts and Grants	1	1
TOTALS	22	73

Status of Audits with Recommendations that Funds Be Put to Better Use

On October 1, 2002, there was one audit with recommendations to put funds to better use, with a dollar value of $70,000, in which management had not taken final action. During the year, final action was taken. Therefore, on September 30, 2003, there were no audits with recommendation to put funds to better use.

Status of Audits of Disallowed Costs

On October 1, 2002, there was one audit with management decision on which final action had not been taken with a dollar value of disallowed costs totaling $195,000. During the year, one audit with a value of $195,000 was resolved. During the year, three audits were completed that included disallowed costs of $10,581,619. The resulting balance on September 30, 2003 was $10,581,619.

Funds Put to Better Use and Disallowed Costs in Audit Reports

	Number of Audit Reports Identifying Amount of Funds Put to Better Use	Amount of Funds Put to Better Use	Number of Audit Reports Identifying Disallowed Costs	Disallowed Costs
Beginning Balance	1	$ 70,000	1	$ 195,000
New Audits	-	-	3	10,581,619
Implemented Actions	(1)	(70,000)	(1)	(195,000)
Ending Balance	-	$ -	3	$ 10,581,619

DEBT MANAGEMENT

Outstanding debt from non-Federal sources (net of allowances) increased from $45.3 million in 2002 to 51.5 million in 2003. Refer to Notes to the Principal Financial Statements, Note 6, for an analysis of Accounts Receivable balances. Non-Federal receivables consist of debts owed to the International Boundary and Water Commission, and amounts owed for Repatriation Loans, medical costs, travel advances, proceeds from the sale of real property, and other miscellaneous receivables.

Of the delinquent receivables over 365 days old, the majority ($3.7 million) is for the Repatriation Loan Program. These are loans given to destitute American citizens stranded overseas to allow them to return to the United States. The loans are given only if the individual cannot obtain funds from relatives, friends, employers, or another source. The Department acts as the lender of last resort. The loan becomes delinquent 60 days after repatriation to the United States. Due to their poor economic situation, most of these individuals are unable to repay the loans on time.

The Department uses installment agreements, salary offset, and restrictions on passports as tools to collect its receivables. It also receives collections through its cross-servicing agreement with the Department of the Treasury. In 1998, the Department entered into a cross-servicing agreement with the Department of the Treasury for collection of delinquent receivables. In accordance with the agreement and the Debt Collection Improvement Act of 1996 (Public Law 104-134), the Department referred $960,270 to Treasury for cross-servicing in 2003. *The 2002 first quarter anthrax related U.S. mail disruptions affected the Department's ability to receive payments and to provide debtors proper due process notification. Thus, the Department was unable to refer debts to Treasury for most of 2002.* Of the current and past debts referred to Treasury, $290,406 was collected in 2003.

Receivables Referred to the Department of the Treasury for Cross-Servicing

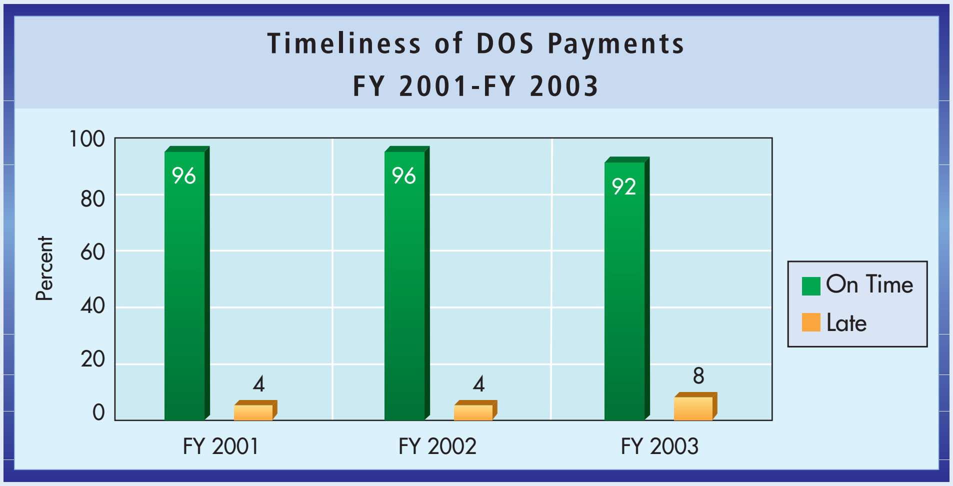
	FY 2003	FY 2002	FY 2001
Number of Accounts	927	177	677
Amounts Referred (In Thousands)	$960	$194	$795

PAYMENTS MANAGEMENT

PROMPT PAYMENT ACT

TIMELINESS OF PAYMENTS

The Prompt Payment Act (PPA) requires Federal agencies to pay their bills on time or an interest penalty must be paid to vendors. During FY 2003, 92% of invoices were paid on time. Presented below is a chart that reflects the timeliness of the Department's payments from FY 2001 through FY 2003.



During FY 2003, 3% of invoices required interest penalties compared to 2% for FY 2002.

SELECTED PAYMENT DATA

	2003	2002	2001
Interest Paid ($000)	396	443	774
Interest Under $1 Not Due ($000)	—	4	8
Interest Due But Not Paid ($000)	—	—	—
Number of Procurement Card Transactions			
Domestic	57,312	53,379	47,032
Overseas	112,766	46,297	38,298

ELECTRONIC PAYMENTS

The Department successfully increased the number and percentage of payments it makes electronically. In 2003, 79% of all payments were made by electronic funds transfer (EFT). Domestically, 96% of payments were made electronically. The Department processed 65% of its 2003 overseas payments by EFT, a 5% increase from 2002.

EFT AND CHECK PAYMENT VOLUMES

	2003		2002		2001	
Payment Type	**Number**	**Percent**	**Number**	**Percent**	**Number**	**Percent**
EFT:						
Domestic	1,248,335		1,210,054		1,137,510	
Overseas	988,329		841,050		780,418	
EFT Subtotal	2,236,664	79	2,051,104	77	1,917,928	74
Checks:						
Domestic	47,043		56,668		74,811	
Overseas	531,046		560,026		606,128	
Checks Subtotal	578,089	21	616,694	23	680,939	26
Total Payments	**2,814,753**	**100**	**2,667,798**	**100**	**2,598,867**	**100**