FISCAL YEAR 2002 PERFORMANCE AND ACCOUNTABILITY REPORT

FINANCIAL STATEMENTS

DEPARTMENT OF STATE
CONSOLIDATED BALANCE SHEET

(Dollars in Thousands)

As of September 30,	**Notes**	**2002**	**2001**
ASSETS	3		
Intragovernmental Assets:			
Fund Balances With Treasury	4	$ 8,937,139	$ 7,652,119
Investments, Net	5	11,750,737	11,206,403
Accounts Receivable, Net	6	313,291	170,385
Interest Receivable		192,637	189,677
Total Intragovernmental Assets		21,193,804	19,218,584
Accounts Receivable, Net	6	45,349	42,111
Loans Receivable, Net	7	1,231	1,156
Cash and Other Monetary Assets	8	12,792	12,472
Inventory	9	7,784	6,927
Property and Equipment, Net	10	5,499,850	4,870,466
Other Assets	11	79,347	72,117
Total Assets		$ 26,840,157	$ 24,223,833

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	2002	2001
LIABILITIES	12		
Intragovernmental Liabilities:			
Accounts Payable		$ 4,120	$ 5,962
Other Liabilities		37,300	37,001
Total Intragovernmental Liabilities		41,420	42,963
Accounts Payable		780,679	817,856
Foreign Service Retirement Actuarial Liability	13	12,211,800	11,766,900
Liability to International Organizations	14	1,065,172	1,650,006
Capital Lease Liability	15	92,010	63,058
Funds Held in Trust	8	13,592	11,073
Federal Employees' Compensation Act Benefits		56,259	56,645
Other Liabilities		563,471	401,976
Total Liabilities		14,824,403	14,810,477
Commitments and Contingencies	16		
NET POSITION			
Unexpended Appropriations	17	7,154,023	5,961,844
Cumulative Results of Operations		4,861,731	3,451,512
Total Net Position		12,015,754	9,413,356
Total Liabilities and Net Position		$ 26,840,157	$ 24,223,833

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,	**2002**	**2001**
PROGRAM		
Diplomatic Relations and International Organizations		
Total Cost	$ 5,102,716	$ 4,714,729
Earned Revenue	(211,888)	(189,359)
Net Program Costs	4,890,828	4,525,370
American Citizens and U.S. Borders		
Total Cost	1,560,856	1,345,440
Earned Revenue	(1,049,592)	(1,095,100)
Net Program Costs	511,264	250,340
Humanitarian Response		
Total Cost	845,205	745,259
Earned Revenue	454	(1,119)
Net Program Costs	845,659	744,140
Law Enforcement		
Total Cost	712,762	839,416
Earned Revenue	(12,799)	(32,443)
Net Program Costs	699,963	806,973
EXECUTIVE DIRECTION AND OTHER COSTS NOT ASSIGNED		
Total Cost	2,616,296	2,341,999
Earned Revenue	(1,225,271)	(1,197,681)
Net Program Costs	1,391,025	1,144,318
Total Cost	**10,837,835**	**9,986,843**
Total Revenue	**(2,499,096)**	**(2,515,702)**
Total Net Cost	**$ 8,338,739**	**$ 7,471,141**

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, 2002	**Cumulative Results of Operations**	**Unexpended Appropriations**
Beginning Balances	$ 3,451,512	$ 5,961,844
Prior period adjustments (+/-)	0	0
Beginning Balances, as adjusted	3,451,512	5,961,844
Budgetary Financing Sources:		
Appropriations Received	-	10,227,805
Appropriations transfered-in/out (+/-)	-	1,024,187
Other adjusted (rescissions, etc.) (+/-)	-	(116,923)
Appropriations Used	9,942,890	(9,942,890)
Nonexchange revenue	16,267	-
Donations	33,581	-
Other Financing Sources:		
Transfers-in/out without reimbursement (+/-)	(327,859)	-
Imputed financing from costs absorbed by others	84,079	-
Total Financing Sources	9,748,958	1,192,179
Net Cost of Operations (+/-)	(8,338,739)	
Ending Balances	**$ 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,	**2002**
Budgetary Resources:	
Budget Authority	
Appropriations received	$ 11,434,158
Net transfers	1,040,178
Other	479,683
Unobligated balances:	
Beginning of period	2,369,063
Net transfers	(39,432)
Spending authority from offsetting collections:	
Earned	
Collected	2,081,677
Received from Federal sources	217,618
Change in unfilled customer orders	
Without advance from Federal sources	2,435
Subtotal	2,301,730
Recoveries	880,827
Temporarily not available pursuant to Public Law	(575,067)
Permanently not available	(96,549)
Total Budgetary Resources	**$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,	2002
Status of Budgetary Resources:	
Obligations incurred	
Direct	$ 13,670,130
Reimbursable	1,545,154
Subtotal	15,215,284
Unobligated balances available	
Apportioned	2,360,250
Exempt from apportionment	98,833
Other available	0
Unobligated balances not available	120,224
Total Status of Budgetary Resources	17,794,591
Relationship of Obligations to Outlays:	
Obligated balance, net, beginning of year	4,642,993
Obligated balance transferred, net	0
Less: obligated balance, net, end of year	
Accounts receivable	(636,037)
Unfilled customer orders from Federal sources	(1,618)
Undelivered orders	6,328,591
Accounts payable	299,386
Outlays	
Disbursements	12,767,075
Collections	(2,081,677)
Subtotal	10,685,398
Less: offsetting receipts	(806,806)
Net Outlays	**$ 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,	**2002**
Resources Used to Finance Activities:	
Budgetary Resources Obligated	
Obligations Incurred	$ 15,215,994
Less: Spending Authority from offsetting collections and recoveries	(3,180,772)
Obligations net of offsetting collections and recoveries	12,035,222
Less: Offsetting receipts	(806,806)
Net obligations	11,228,416
Other Resources	
Donations	$ 0
Transfers in/out without reimbursement	(327,859)
Imputed financing from costs absorbed by others	84,079
Other	31,840
Net other resources used to finance activities	(211,940)
Total Resources used to Finance Activities	**$ 10,942,476**
Resources Used to Finance Items not Part of Net Cost of Operations:	
Change in in budgetary resources obligated for goods, services, and benefits ordered but not yet received	1,765,930
Resources that fund expenses recognized in prior periods	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	287
Other	0
Resources that finance the acquisitions of assets	1,039,480
Other resources or adjustments to net obligated resources that do not affect net cost of operations	0
Total Resources used to Finance Items not Part of the Net Cost of Operations	4,696,072
Total Resources Used to Finance the Net Cost of Operations	$ 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,	**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 futue periods	
Increase in annual leave liability	$ 8,976
Increase in actuarial liability	1,057,328
Increase in IO liability	683,311
Other, net	9,454
Total components of Net Cost of Operations that will require or generate resources in future periods	1,759,069
Components not Requiring or Generating Resources:	
Depreciation and amortization	$ 246,034
Reevaluation of assets or liabilities	0
Other	13,232
Total components of Net Cost of Operations that will not require or generate resources	259,266
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	2,018,335
Net Cost of Operations	$ 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 CPAs' 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 is recorded over the asset's useful life as described below in Property and Equipment — Real Property and Property and Equipment — Personal Property.

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. These revenues are recognized in the American Citizens and U.S. Borders Program as the fees are collected. 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 Affairs 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, 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. The Department operates 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 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

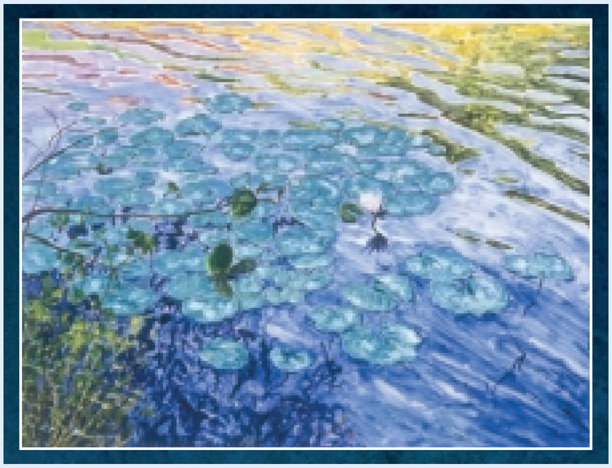
The FSRDF investments consist solely of special issues of U.S. Government securities, which are redeemable on demand at par. For financial statement purposes, the investments are therefore valued at par. Interest on investments is paid semi-annually on June 30 and December 31.

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

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.

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 a 5% salvage value. For all property except vehicles, depreciation is not recorded until the fiscal year after the item is put into service. Vehicles are depreciated over periods ranging from 3 to 6 years, and depreciation begins when the vehicle is put into service. 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 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 overseas and domestic accounts payable for FY 2002 and FY 2001, respectively. Overseas accounts payable are estimated based upon historical experience. Domestic accounts payable are based upon actual disbursements. The Department believes the new methodology more accurately reflects the financial position and results of operations.

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 7.00% (7.40% prior to January 14, 2001) of their salary; the Department contributes 8.51%. 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% (1.20% prior to January 14, 2001) 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 7.00% (7.40% prior to January 14, 2001) of their salary; the Department contributes 8.51%. FSPS employees contribute 1.30% (1.70% prior to January 14, 2001) of their salary; the Department contributes 20.34%. 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 $70.2 million and $70.6 million in 2002 and 2001, 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 2002 and 2001 was computed using a discount rate of 5.2% and 5.21%, respectively, for all years; in 2002 and 2001, the Department's liability changed by ($.4) million and $6.7 million, respectively. The total actuarial liability that the Department is responsible totaled $56.2 million as of September 30, 2002 and $56.6 million as of September 30, 2001.

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.

An actuary from the Treasury determines the Pension Actuarial Liability. 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.

For 2002 and 2001, the valuation included assumed average rates of return on investments of 6.75%, inflation of 3.75%, and salary increases of 4.25%. 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.

In March 2001, the Board of Actuaries announced a change in the dynamic economic assumptions used to calculate the actuarial liability. The economic assumptions reflect predictions about the long-term relationships among inflation, interest on investments, and salary adjustments. The new assumptions reflect recent financial experience and indicate a less optimistic view of the Board regarding long-term interest earnings in relation to the other two factors.

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 2002 and FY 2001.

	FY 2002	FY 2001
Normal Cost:		
FSRDS	30.65%	27.43%
FSPS	21.57%	21.04%

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 three Financial Service Centers.

2 ACCOUNTING CHANGES

Changes Implemented

In 2002 and 2001, 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 2001 reporting are as follows.

- **Integrated Reporting.** Combined performance and accountability reports that present both performance and financial reports are required for FY 2002 and subsequent years.
- **Accelerated Reporting.** For FY 2002, performance and accountability reports must be submitted to OMB and the Congress by February 1, 2003.
- **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. A comparative Balance Sheet and Statement of Net Cost are required for reporting periods beginning with FY 2001. However, comparative Statements of Changes in Net Position, Budgetary Resources, and Financing (and related footnotes) are not required until fiscal year 2003 and beyond. Also, information presented in the Financial Highlights Section (pages 38–44) of the Management Discussion and Analysis, Required Supplementary Stewardship Information (Pages 240–244) and Required Supplementary Information (Pages 245 –251) are presented on a comparative basis when the information is meaningful to the user of the financial report.

New SFFASs were adopted by the Department as follows.

NEW SFFASS		
SFFAS	**Effective Reporting Period**	**Description**
SFFAS No. 21 Reporting Corrections of Errors and Changes in Accounting Principles	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 fiinancial 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.
SFFAS No. 22 Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations	FY 2001	SFFAS No. 22 deletes the requirement in SFFAS No. 7 paragraph 80 that requires increases and decreases in receivables from the public related to exchange revenues be reported as a nonbudgetary resource, and makes other conforming changes.
SFFAS No. 18 Amendments to Accounting Standards for Direct Loans and Loan Guarantees	FY 2001	SFFAS No. 18 amends certain portions of SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees*, by adding the following requirements: (a) report subsidy reestimates in two components: interest rate reestimates and technical/default reestimates, (b) display in a note to the financial statements a reconciliation between the beginning and ending balances of loan guarantee liability and the subsidy cost allowance for direct loans, and (c) provide disclosure and discussion for changes in program subsidy rates, subsidy expense, and subsidy reestimates.
SFFAS No. 10 Accounting for Internal Use Software	FY 2001	SFFAS No. 10 provides accounting standards for internal use software. It classifies internal use software as "general property, plant, and equipment" as defined in SFFAS No. 6, *Accounting for Property, Plant and Equipment,* and requires software costs meeting certain criteria to be capitalized whether purchased as commercial off-the-shelf (COTS), or developed by a contractor or internally developed. SFFAS No. 10 provides guidance regarding the types of cost elements to capitalize, the timing of capitalization, and other issues. Under SFFAS No. 10, agencies are to determine their own dollar value capitalization thresholds. The Department established a threshold of $500 thousand.

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.
- **Interim Financial Reporting.** In FY 2003, unaudited financial statements shall 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.

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, 2002 and 2001 were $11.4 million and $11.1 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, 2002 and 2001, are summarized below (Dollars in Thousands).

	2002	2001
Appropriated Funds	$ 8,574,965	$ 7,387,602
Revolving Funds	156,665	125,769
Trust Funds	105,478	103,752
Other Funds	100,031	34,996
Total	$ 8,937,139	$ 7,652,119

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 2003 through 2016, and interest rates range from 4.375% to 9.25%.

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 2003 to 2011; interest rates range from 5.0% 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. Maturity dates on these securities range from 2002 to 2003; interest rates range from 1.48% to 1.55%.

Summary of Investments

Investments at September 30, 2002 and 2001, are summarized below (Dollars in Thousands). All investments are classified as Intragovernmental Securities.

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

At September 30, 2001:	Par	Amortization Method	Unamortized (Discount)	Investments (Net)	Market Value
Non-Marketable, Par Value:					
FSRDF Certificates of Indebtedness	$ 46,054	N/A	$ —	$ 46,054	$ 46,054
FSRDF Special Bonds	11,145,560	N/A	—	11,145,560	11,145,560
Subtotal	$ 11,191,614		$ —	$ 11,191,614	$ 11,191,614
Non-Marketable, Market Based:					
Israeli-Arab Scholarship, Notes	4,277	Interest	238	4,515	4,834
Eisenhower Exchange Fellowship, Notes	7,512	Interest	(428)	7,084	8,013
Gift Funds, Bills	3,233	Straight-line	(43)	3,190	3,158
Subtotal	$ 15,022		$ (233)	$ 14,789	$ 16,005
Total Investments	$ 11,206,636		$ (233)	$ 11,206,403	$ 11,207,619

6 ACCOUNTS RECEIVABLE

The Department's Accounts Receivable at September 30, 2002 and 2001, are summarized below (Dollars in Thousands):

	2002				2001		
	Entity Accounts Receivable	Non-entity Accounts Receivable	Allowance for Uncollectible Accounts Receivable	Net Receivables	Accounts Receivable	Allowance for Estimated Uncollectible	Net Receivables
Intragovernmental	$ 313,337	$ -	$ (46)	$ 313,291	$ 174,956	$ (4,571)	$ 170,385
Non-Federal	51,273	-	(5,924)	45,349	43,039	(928)	42,111
Total	$ 364,610	$ -	$ (5,970)	$ 358,640	$ 217,995	$ (5,499)	$ 212,496

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:

	2002	2001
Loans Receivable Gross	$516	$430
Interest and Penalty Receivable	86	85
Allowance for Uncollectible Loans	(572)	(490)
Net Loans Receivable	$ 30	$ 25

Repatriation Loans Obligated after 1991 (Dollars in Thousands)

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**

At September 30, 2001:

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	$ 106	$ 39	$ 101	$ 44
1993	110	21	91	40
1994	79	17	67	29
1995	178	43	155	66
1996	549	206	529	226
1997	449	105	388	166
1998	591	69	462	198
1999	393	40	303	130
2000	393	31	297	127
2001	328	20	243	105
Total	**$ 3,176**	**$ 591**	**$ 2,636**	**$ 1,131**

Total Amount of Direct Loans Disbursed (Post-1991)

In 2002, the Department disbursed approximately $710,000 in repatriation loans. In 2001, it disbursed approximately $642,000.

Subsidy Expense for Post-1991 Repatriation Loans

The subsidy expense for the 2002 and 2001 loan program contains the following components (Dollars in Thousands):

	2002	**2001**
Interest Differential	—	—
Default	$ 568	$ 514
Fees	—	—
Other	—	—
Total	$ 568	$ 514

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, 2001	$ 2,636
Add: subsidy expense for loans disbursed during 2002	568
Adjustments	—
Ending balance for the subsidy cost allowance before re-estimates	3,204
Effect of subsidy re-estimate by component:	
Interest rate re-estimate	—
Technical/default re-estimate	(403)
Ending balance of the subsidy cost allowance	$ 2,801

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 $607,000 in 2002 and 2001.

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 $402,000 in 2002, and established that amount as a payable to Treasury. The total amount payable to Treasury is approximately $4.8 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 the Federal Financial Accounting Standards.

Accounts payable also includes a payable to Treasury of $0.7 million resulting from the collection of Pre-Credit Reform loans.

Borrowings from Treasury (Dollars in Thousands)

	2002	2001
Beginning Balance, October 1	$ (191)	$ (341)
Borrowings, Net of Repayments	(65)	150
Ending Balance, September 30	$ (256)	$ (191)

8 CASH AND OTHER MONETARY ASSETS

The Cash and Other Monetary Assets at September 30, 2002 and 2001, are summarized below (Dollars in Thousands). There are no restrictions on entity cash. Non-Entity cash is restricted as discussed below.

	2002			2001		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Bosnia Federation Defense Fund	$ —	$ 309	$ 309	$ —	$ 672	$ 672
Chancery Development						
Trust Account:						
Cash	—	2	2	—	2	2
Treasury Bills, at par	—	11,169	11,169	—	10,745	10,745
Unamortized Discount	—	(88)	(88)	—	(346)	(346)
Cash-Imprest and Other Funds	1,400	—	1,400	1,399	—	1,399
Total	$ 1,400	$ 11,392	$ 12,792	$ 1,399	$ 11,073	$ 12,472

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, 2002 and 2001, is summarized below (Dollars in Thousands).

	2002	2001
Inventory Held for Current Sale:		
Publishing Services – Raw Materials	$ 1,797	$ 961
Publishing Services – Publications for Sale	3,279	3,278
Inventory for Resale	2,708	2,688
Total	$ 7,784	$ 6,927

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, 2002 and 2001, are shown in the following table (Dollars in Thousands):

	2002			2001		
Major Classes	**Cost**	**Accumulated Depreciation**	**Net Value**	**Cost**	**Accumulated Depreciation**	**Net Value**
Real Property:						
Overseas —						
Land and Land Improvements	$ 1,904,743	$ (95)	$ 1,904,648	$ 1,864,051	$ (45)	$1,864,006
Buildings and Structures	3,768,927	(2,210,702)	1,558,225	3,702,237	(2,045,870)	1,656,367
Construction-in-Progress	886,914	—	886,914	512,379	—	512,379
Assets Under Capital Lease	120,940	(43,819)	77,121	94,342	(46,876)	47,466
Leasehold Improvements	52,634	(14,418)	38,216	50,474	(10,890)	39,584
Domestic —						
Structures, Facilities and Leaseholds	521,350	(172,862)	348,488	510,134	(155,679)	354,455
Construction-in-Progress	58,484	—	58,484	56,484	—	56,484
Land and Land Improvements	80,654	(3,836)	76,818	80,654	(3,523)	77,131
Subtotal — Real Property	$ 7,394,646	$(2,445,732)	$ 4,948,914	$ 6,870,755	$(2,262,883)	$ 4,607,872
Personal Property:						
Vehicles	$ 174,369	$ (112,291)	$ 62,078	$ 172,337	$ (97,384)	$ 74,953
Communication Equipment	45,072	(11,121)	33,951	43,632	(9,879)	33,753
ADP Equipment	21,528	(15,577)	5,951	20,307	(12,640)	7,667
Reproduction Equipment	13,325	(10,036)	3,289	12,970	(9,268)	3,702
Security	67,289	(25,032)	42,257	—	—	—
Software	77,208	(9,328)	67,880	—	—	—
Software-in-Development	33,476	—	33,476	37,073	—	37,073
Other Equipment	327,130	(25,076)	302,054	140,208	(34,762)	105,446
Subtotal — Personal Property	$ 759,397	$ (208,461)	$ 550,936	$ 426,527	$ (163,933)	$ 262,594
Total	$ 8,154,043	$(2,654,193)	$ 5,499,850	$ 7,297,282	$(2,426,816)	$ 4,870,466

11 OTHER ASSETS

The Department's other assets at September 30, 2002 and 2001, are summarized below (Dollars in Thousands).

	2002	2001
Salary Advances to Employees	$ 7,296	$ 5,221
Travel Advances to Employees	12,705	14,048
Prepayments	12,000	12,009
Other Advances	47,346	40,839
Total Other Assets	$ 79,347	$ 72,117

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, 2002 and 2001, are summarized below (Dollars in Thousands).

	2002	2001
Intragovernmental Liabilities –		
Accounts Payable	$ —	$ —
Other Liabilities	17,966	17,929
Total Intragovernmental Liabilities	$ 17,966	$ 17,929
Foreign Service Retirement Actuarial Liability	324,776	424,884
Liability to International Organizations	1,065,172	1,650,006
Capital Lease Liability	92,010	63,058
Funds Held in Trust	13,592	11,073
Federal Employees' Compensation Act Benefits	56,259	56,645
Accrued Annual Leave	180,926	171,950
Other Liabilities	8,621	8,621
Total Liabilities not Covered by Budgetary Resources	$1,759,322	$2,404,166

Other Liabilities consists 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, 2002 and 2001 (Dollars in Millions).

For the Year Ended September 30,	2002	2001
Pension Actuarial Liability, Beginning of Year	$11,766.9	$11,475.9
Add Pension Expense:		
Normal Cost	198.0	185.9
Interest on Pension Liability	780.3	789.1
Prior Service Costs	—	—
Actuarial Losses/(Gains)	79.0	(92.3)
Total Pension Expense	1,057.3	882.7
Less Payments to Beneficiaries (annuities and refunds)	(612.4)	(591.7)
Pension Actuarial Liability, End of Year	12,211.8	11,766.9
Less: Net Assets Available for Benefits	(11,887.0)	(11,342.0)
Actuarial Unfunded Pension Liability for Projected Plan Benefits	$ 324.8	$ 424.9
Actuarial Assumptions:		
Rate of Return on Investments	6.75%	6.75%
Rate of Inflation	3.75%	3.75%
Salary Increase	4.25%	4.25%

Net Assets Available for Benefits at September 30, 2002 and 2001, consist of the following (Dollars in Thousands):

	2002	2001
Fund Balances with Treasury	$ 0	$ 6
Receivables	203,793	199,501
Investments in USG Securities	11,734,240	11,191,614
Total Assets	11,938,033	11,391,121
Less: FSRDF Liabilities	(51,009)	(49,105)
Net Assets Available for Benefits	$ 11,887,024	$ 11,342,016

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 $303.5 million and $895.1 million for 2002 and 2001, 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, 2002, 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 $211.9 million were made in early FY 2003. Thus, $32.1 million of appropriations for arrearage payments remain.

The financial statements also report an unfunded liability of $761.6 and $755.0 million at September 31, 2002 and 2001, respectively, for the current year 2002 and 2001 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 2002 calendar year assessment is paid from the Department's 2003 appropriation). The Liability to International Organizations at September 30, 2002 and 2001, is summarized below (Dollars in Thousands).

	2002	2001
Accumulated Arrears	$ 303,525	$ 895,054
Unfunded Annual Assessments	761,647	754,952
Liability to International Organizations	$1,065,172	$1,650,006

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 $36.2 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).

	2002	**2001**
Net Assets Under Capital Leases:		
Land and Buildings	$120,940	$ 94,342
Accumulated Depreciation	(43,819)	(46,876)
Net Assets under Capital Leases	$ 77,121	$ 47,466

Future Minimum Lease Payments:

	2002		**2001**	
	Fiscal Year	**Lease Payments**	**Fiscal Year**	**Lease Payments**
	2003	$ 8,467	2002	$ 5,944
	2004	$ 6,899	2003	5,250
	2005	6,899	2004	4,466
	2006	6,609	2005	4,466
	2007	6,609	22006	4,192
	2008 and thereafter	467,166	2007 and thereafter	125,529
Total Minimum Lease Payments		$ 502,649		$ 149,847
Less: Amount Representing Interest		(410,639)		(86,789)
Obligations under Capital Leases		$ 92,010		$ 63,058

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, 2002 for each of the next 5 years and in aggregate are as follows (Dollars in Thousands).

Year Ended September 30	Operating Lease Amounts
2003	$ 273,831
2004	191,941
2005	117,524
2006	66,198
2007	38,807
2008 and thereafter	84,759
Total Minimum Future Lease Payments	$ 773,060

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 conducts Counter-Terrorism, Counternarcotics, and War Criminals rewards programs. The Counter-Terrorism Rewards Program offers rewards up to $5 million for information preventing acts of international terrorism against United States persons or property, or leading to the arrest or conviction of terrorist criminals responsible for such acts. The Counternarcotics Rewards Program offers rewards up to $2 million. The War Criminals Rewards Program offers rewards up to $5 million for information leading to the arrest and/or conviction of war criminals from the former Yugoslavia.

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. One of the cases has been appealed to the D.C. Circuit Court of Appeals, and the other will probably be appealed to that court in the near future. 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 is before the Court of Federal Claims, where the Department is represented by the Commercial Litigation Branch, Civil Division, Department of Justice. Document discovery and depositions have been largely completed. Decisions were issued in November on a number of cross-motions for partial summary judgment. These decisions were largely favorable to the Government. The Department will continue to vigorously defend against these claims.

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 four claims submitted to arbitration and four claims not yet submitted under Chapter 11 of NAFTA. These claims total approximately $2.7 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 2002 and 2001 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, 2002 and 2001, are summarized below (Dollars in Thousands).

	2002	2001
Unexpended Appropriations:		
(1) Unobligated		
(a) Available	$ 1,692,029	$ 1,795,905
(b) Unavailable	404,026	962,017
(2) Undelivered Orders	5,057,968	3,203,922
Total	$ 7,154,023	$ 5,961,844

18 STATEMENT OF NET COST

The Statement of Net Cost reports the Department's gross and net cost for its major programs. 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 major program 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 major programs is based on the Department's Strategic Plan established pursuant to the Government Performance and Results Act of 1993. 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, prosperous, democratic world. These national interests are:

- **National Security** — Secure peace; deter aggression; prevent, diffuse, and manage crises; halt the proliferation of weapons of mass destruction; and advance arms control and disarmament.
- **Economic Prosperity** — Expand exports; open markets; assist American business; foster economic growth; and promote sustainable development.
- **Democracy** — Increase foreign government adherence to democratic practices and respect for human rights.
- **Global Issues: Environment, Population and Health** — Improve the global environment; stabilize world population growth; and protect human health.
- **Humanitarian Response** — Provide humanitarian assistance to victims of crisis and disaster.
- **American Citizens and U.S. Borders** — Protect American citizens abroad and safeguard the borders of the United States.
- **Law Enforcement** — Combat international terrorism, crime, and narcotics trafficking.

National interests are reported as programs to the extent that it is practicable. Exceptions include National Security, Economic Prosperity, Democracy, and Global Issues. These national interests are primarily carried out through the Department's Diplomatic Relations and International Organizations programs, which have been combined and are reported as such on the Statement of Net Cost. Diplomatic Readiness 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.

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, 2002 and 2001, these consist of costs and earned revenue for the table (Dollars in Thousands) on page 229.

DEPARTMENT OF STATE
CONSOLIDATING SCHEDULE OF NET COST

For the year ended September 30, 2002
(Dollars in Thousands)

PROGRAM	Under Secretary for: Arms Control, Int'l Security	Economic, Business and Agriculture	Global Affairs	Political Affairs	Public Diplomacy and Public Affairs	Manage-ment—Consular Affairs	Elimina-tions	Total
Diplomatic Relations and International Organizations								
Total Cost	$ 459,894	$ 39,240	$ 93,277	$ 4,299,542	$ 341,067	$ 203	$ (130,507)	$ 5,102,716
Earned Revenue	(51,835)	(3,565)	(9,164)	(250,546)	(27,261)	(24)	130,507	(211,888)
Net Program Costs	408,059	35,675	84,113	4,048,996	313,806	179	0	4,890,828
American Citizens and U.S. Borders								
Total Cost	0	0	187	918,739	226,421	678,345	(262,836)	1,560,856
Earned Revenue	0	0	(31)	(191,398)	(38,544)	(1,082,455)	262,836	(1,049,592)
Net Program Costs	0	0	156	727,341	187,877	(404,110)	0	511,264
Humanitarian Response								
Total Cost	0	0	845,150	33	58	0	(36)	845,205
Earned Revenue	0	0	418	0	0	0	36	454
Net Program Costs	0	0	845,568	33	58	0	0	845,659
Law Enforcement								
Total Cost	0	0	647,152	65,750	2,268	0	(2,408)	712,762
Earned Revenue	0	0	(11,442)	(3,742)	(23)	0	2,408	(12,799)
Net Program Costs	0	0	635,710	62,008	2,245	0	0	699,963
Executive Direction and Other Costs Not Assigned								
Total Cost	3,736	3,242	60,734	3,226,783	440,256	4,065	(1,122,520)	2,616,296
Earned Revenue	(2,296)	(1,993)	(37,328)	(2,010,766)	(271,413)	(2,498)	1,101,023	(1,225,271)
Net Program Costs	1,440	1,249	23,406	1,216,017	168,843	1,567	(21,497)	1,391,025
Total Cost	**463,630**	**42,482**	**1,646,500**	**8,510,847**	**1,010,070**	**682,613**	**(1,518,307)**	**10,837,835**
Total Revenue	**(54,131)**	**(5,558)**	**(57,547)**	**(2,456,452)**	**(337,241)**	**(1,084,977)**	**1,496,810**	**(2,499,096)**
Total Net Cost	**$ 409,499**	**$ 36,924**	**$ 1,588,953**	**$ 6,054,395**	**$ 672,829**	**$ (402,364)**	**$ (21,497)**	**$ 8,338,739**

Program	2002 Total Prior to Eliminations	2002 Intra-Departmental Eliminations	2002 Total	2001 Total Prior to Eliminations	2001 Intra-Departmental Eliminations	2001 Total
Costs:						
Executive Direction	$ 1,681,836	$ 117,887	$ 1,563,949	$ 1,443,466	$ 95,253	$ 1,348,213
FSRDF	1,057,328	314,864	742,464	1,048,597	309,143	739,454
ICASS	906,142	692,376	213,766	798,319	625,548	172,771
International Commissions	93,510	(2,607)	96,117	85,668	4,107	81,561
Total Costs	$ 3,738,816	$ 1,122,520	$ 2,616,296	$ 3,376,050	$ 1,034,051	$ 2,341,999
Earned Revenue:						
Executive Direction	$ 235,115	$ 117,887	$ 117,228	$ 205,239	$ 95,253	$ 109,986
FSRDF	1,157,436	293,367	864,069	1,127,325	285,318	842,007
ICASS	920,918	692,376	228,542	854,320	625,548	228,772
International Commissions	12,825	(2,607)	15,432	21,023	4,107	16,916
Total Earned Revenue	$ 2,326,294	$ 1,101,023	$ 1,225,271	$ 2,207,907	$ 1,010,226	$ 1,197,681
Total Net Cost for Executive Direction and Other Costs Not Assigned	$ 1,412,522	$ 21,497	$ 1, 391,025	$ 1,168,143	$ 23,825	$ 1,144,318

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 Diplomatic Readiness charges for central support functions performed in 2002 and 2001 under the Under Secretary for Management by the following organizations (Dollars in Thousands):

Bureau (or equivalent)	2002	2001
Bureau of Diplomatic Security	$ 782,344	$ 730,771
Office of Overseas Buildings Operations	643,675	634,550
Bureau of Administration	513,562	432,687
Bureau of Information Resource Management	298,470	187,592
Bureau of Personnel	265,282	216,416
Bureau of Resource Management	(95,662)	241,122
Foreign Service Institute	106,424	87,861
Medical Services and Other	157,442	194,672
Total Central Support Costs	$ 2,671,537	$ 2,725,671

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 2002 and 2001 was as follows (Dollars in Thousands):

Program Receiving Allocation	**2002**	**2001**
Diplomatic Relations	$ 947,337	$ 1,009,655
American Citizens and Border Security	721,816	671,127
Executive Direction and Other Costs not Assigned	770,751	806,809
International Organizations	193,610	198,655
Law Enforcement	38,011	39,412
Humanitarian Response	12	13
Total	$ 2,671,537	$ 2,725,671

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 and U.S. Borders 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	**2002**	**2001**
Political Affairs	$ 2,817,597	$ 3,118,384
Public Diplomacy	502,608	505,136
Management (Consular Affairs)	344,715	361,051
Arms Control, International Security Affairs	191,111	164,841
Global Affairs	63,456	110,010
Economic, Business and Agriculture Affairs	18,090	17,782
Total	$ 3,937,577	$ 4,277,204

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, 2002 and 2001. (Dollars in Thousands):

Inter-Entity Cost	**2002**	**2001**
Other Post-Employment Benefits:		
Civil Service Retirement Program	$ 17,912	$ 17,245
Federal Employees Health Benefits Program	52,179	43,574
Federal Employees Group Life Insurance Program	114	195
Litigation funded by Treasury Judgment Fund	13,875	9,600
Subtotal – Imputed Financing Source	$ 84,080	$ 70,614
Future Workers' Compensation Benefits	7,619	6,729
Total Inter-Entity Costs	$ 91,699	$ 77,343

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, 2002 and 2001, consist of the following (Dollars in Thousands):

	2002			2001		
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	$ 523,863	$ —	$ 523,863	$ 535,568	$ —	$ 535,568
Machine Readable Visa	368,875	—	368,875	417,517	—	417,517
Expedited Passport	65,286	—	65,286	65,950	—	65,950
Fingerprint Processing, Diversity Lottery, and Affadavit of Support	12,289	—	12,289	4,091	—	4,091
Subtotal – Consular Fees	$ 970,313	$ —	$ 970,313	$ 1,023,126	$ —	$ 1,023,126
FSRDF	$ 1,157,436	$ 293,367	$ 864,069	$ 1,127,325	$ 285,318	$ 842,007
ICASS	920,918	692,376	228,542	854,320	625,548	228,772
Reimbursable Agreements With Federal Agencies	692,225	338,911	353,314	769,694	377,066	392,628
Working Capital Fund	252,037	172,157	79,880	159,497	134,555	24,942
Other	2,978	—	2,978	4,227	—	4,227
Total	$ 3,995,907	$ 1,496,811	$ 2,499,096	$ 3,938,189	$ 1,422,487	$ 2,515,702

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 7.00% (7.40% prior to January 14, 2001) of their base salary, and each employing agency contributes 8.51%; FSPS participants contribute 1.30% (1.70% prior to January 14, 2001) of their base salary and each employing agency contributes 20.34%. Employing agencies report employee/employer contributions biweekly. Total employee/employer contributions for 2002 and 2001 were $171.3 million and $160.6 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 2002 and 2001 were $216.0 million and $210.4 million, respectively. FSRDF cash resources are invested in special non-marketable securities issued by the Treasury. Total interest earned on these investments in 2002 and 2001 was $770.1 million and $755.8 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 2002* (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 2002* 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, 2002 and 2001 (Dollars in Thousands and reported net of intra-departmental eliminations):

	2002			2001		
Budget Functional Classification	**Gross Cost**	**Earned Revenue**	**Net Cost**	**Gross Cost**	**Earned Revenue**	**Net Cost**
International Affairs	$ 9,691,926	$ 1,621,693	$ 8,070,233	$ 9,024,425	$ 1,652,795	$ 7,371,630
Income Security	1,065,979	864,069	201,910	890,635	849,341	41,294
Natural Resources	79,960	13,334	66,626	71,783	13,566	58,217
Total	$10,837,865	$ 2,499,096	$ 8,338,769	$ 9,986,843	$ 2,515,702	$ 7,471,141

19 STATEMENT OF BUDGETARY RESOURCES

The Statement of Budgetary Resources reports information on how budgetary resources were made available and their status as of September 30, 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 2002, the Department received approximately $17.8 billion in budgetary resources, primarily consisting of the following:

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

The Department received permanent indefinite appropriations of $35.5 million and $34.7 million for 2002 and 2001, 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 2003* – 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 "2002 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 "2002 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 $1.2 billion the Department received for 2002 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 $305 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 $112.0 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 (2000 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 $80.4 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 (2001 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 $230 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 $305 million adjustment (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 $230 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, etc.) 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 on pages 245 -246 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	**2002**
Budget Authority	
Appropriations	1,219
Borrowing Authority	153
Unobligated Balance, beginning of Year	2,056
Spending Authority from Offsetting Collections	
Earned	
Collected	287
Receivable from Federal Sources	362
Total Budgetary Resources	4,077
Obligations Incurred:	
Direct Obligations	1,929
Unobligated Balance, Available:	
Exempt from Apportionment	1,524
Unobligated Balance Not Available:	
Other	624
Total Status of Budgetary Resources	4,077
Obligated Balance, Net as of 10/1/01	169
Obligated Balance, 9/30/02	
Undelivered Orders	957
Accounts Payable	1
Outlays:	
Disbursements	779
Collections	(288)

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

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 year ended September 30, 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 2002 and 2001, the Department collected $6.2 million and $4.3 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 costs for administering FSRDF was $2.9 million in both 2002 and 2001. 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, 2002 and 2001, 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, 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

	FSRDF	FSNSLTF	Gift Funds	Israeli-Arab Scholarship	Eisenhower Exchange Fellowship	Misc. Trust Funds
For the year ending September 30, 2001:						
Assets:						
Fund Balances with Treasury	$ 6	$ 91,770	$ 8,046	$ 608	$ 1	$ 3,321
Investments	11,191,614	—	3,190	4,515	7,083	—
Other Assets	199,501	84	23	105	—	4
Total Assets	11,391,121	91,854	11,259	5,228	7,084	3,325
Liabilities:						
Payable to Beneficiaries	39,459	—	—	—	—	—
Actuarial Liability	11,766,900	—	—	—	—	—
Other Liabilities	9,646	2,613	3,011	—	—	27
Total Liabilities	11,816,005	2,613	3,011	0	0	27
Net Position (Deficit)	(424,884)	89,241	8,248	5,228	7,084	3,298
Total Liabilities and Net Position	$ 11,391,121	$ 91,854	$ 11,259	$ 5,228	$ 7,084	$ 3,325
Revenues and Financing:						
Exchange Revenue:						
Intragovernmental	$ 1,101,795	$ 8,814	$ —	$ —	$ —	$ —
Governmental	25,530	—	—	—	—	—
Non Exchange Revenue:						
Intragovernmental	—	—	127	466	476	18
Governmental	—	—	2,703	—	—	—
Other Financing Sources	—	—	—	(466)	—	—
Total Revenues and Financing	1,127,325	8,814	2,830	—	476	18
Expenses:						
Program Expenses	—	7,962	7,229	382	382	1,037
Actuarial Expenses	882,673	—	—	—	—	—
Other Expenses	—	—	—	—	—	—
Total Expenses	$ 882,673	$ 7,962	$ 7,229	$ 382	$ 382	$ 1,037

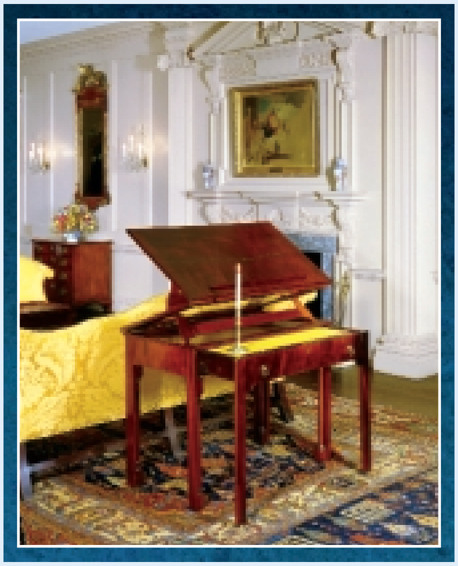
DEPARTMENT OF STATE
REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION
HERITAGE ASSETS

FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2002 AND 2001

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 made up 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.



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

Photo: Richard Cheek

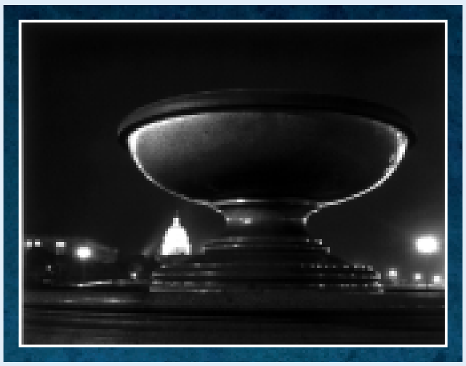
Thomas Jefferson State Reception Room.

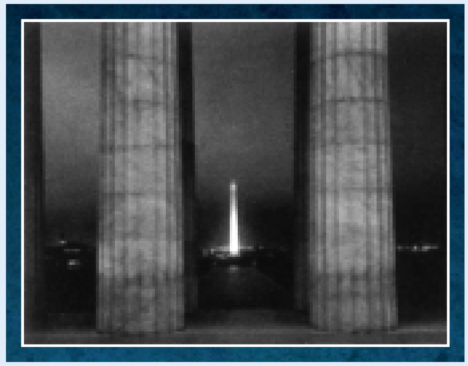
Photo: Richard Cheek

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 off of 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.

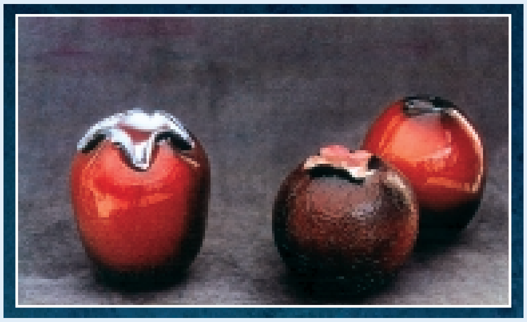
Curatorial Services Program

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 Overseas Buildings Operations Bureau, 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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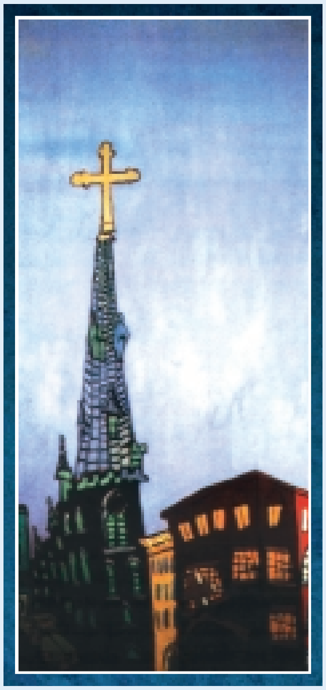


3

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

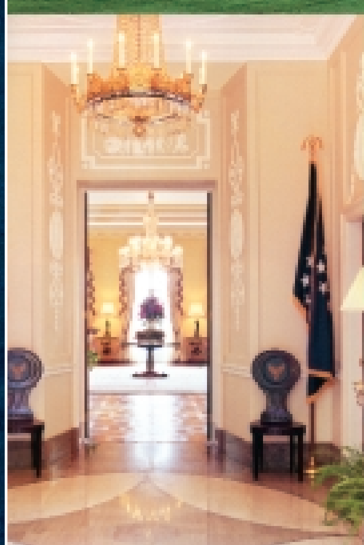
"There are many ways to conduct diplomacy. The Art in Embassies Program is a special way. Works of American art, on display around the world, share our beloved country, our values, our history, our culture, our deep belief in freedom of expression, and in the creative power of the individual. Each work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

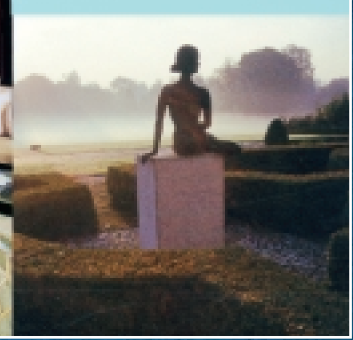
Colin L. Powell

U.S. Secretary of State

Secetary 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 – 09/30/2000	3,397	1,911	853	4,071	91	---
Acquisitions	8	103	42	24	---	8
Adjustments	(1)[1]	---	---	(8) [2]	88 [2]	---
Disposals	(2)	(3)	---	(42)	---	---
Number of Items – 09/30/2001	3,402	2,011	895	4,045	179	8
Acquisitions	3	90	82	443		
Adjustments		4[2]			856[2]	---
Disposals		(43)	(24)	(74)		---
Number of Items – 09/30/2002	3,405	2,062	953	4,414	1,035	8
Deferred Maintenance	N/A	N/A	N/A	N/A	N/A	$14,527,851

1Adjustments due to item either on loan or not owned by the Department.
2 Adjustments due to physical inventories.

DEPARTMENT OF STATE

COMBINING SCHEDULE OF BUDGETARY RESOURCES

For the Year Ended September 30, 2002

(Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Budgetary Authority:						
Appropriations received	$ 7,037,874	$ 1,831,173	$ 60,546	$ 770,100	$ 1,734,465	$11,434,158
Net transfers	265,564	0	0	456,231	318,383	1,040,178
Other	4,647	475,000	0	0	36	479,683
Unobligated Balance:						
Beginning of period	1,865,103	131,386	9,412	59,669	303,493	2,369,063
Net Transfers	42,850	0	0	(5,231)	(77,051)	(39,432)
Spending Authority from Offsetting Collections:						
Earned						
Collected	2,019,230	0	7,978	38,603	15,866	2,081,677
Receivable from Federal sources	247,294	(67)	2,471	(24,040)	(8,040)	217,618
Change in unfilled customer orders						
Without advance from Federal sources	0	0	2,435	0	0	2,435
Subtotal	2,266,524	(67)	12,884	14,563	7,826	2,301,730
Recoveries from Prior Year Obligations:						
Actual	714,564	39,362	335	(4,589)	131,155	880,827
Temporarily Not Available Pursuant to Public Law:	(575,067)	0	0	0	0	(575,067)
Permanently Not Available:	(52,985)	(29,687)	(1,190)	(6,786)	(5,901)	(96,549)
Total Budgetary Resources	11,569,074	2,447,167	81,987	1,283,957	2,412,406	17,794,591

DEPARTMENT OF STATE

COMBINING SCHEDULE OF BUDGETARY RESOURCES

For the Year Ended September 30, 2002

(Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Obligations Incurred:						
Direct	8,387,818	2,386,760	61,406	1,151,034	1,683,112	13,670,130
Reimbursable	1,302,767	0	10,484	3,043	228,860	1,545,154
Subtotal	9,690,585	2,386,760	71,890	1,154,077	1,911,972	15,215,284
Unobligated Balance:						
Apportioned	1,718,391	57,582	8,869	122,390	453,018	2,360,250
Exempt from apportionment	0	0	0	0	0	0
Other available	43,061	0	0	0	55,772	98,833
Unobligated Balance Not Available:	117,037	2,825	1,228	7,490	(8,356)	120,224
Total Status of Budgetary Resources	11,569,074	2,447,167	81,987	1,283,957	2,412,406	17,794,591
Obligated Balance, Net,Beginning of Year:	2,636,212	668,440	21,723	187,896	1,128,722	4,642,993
Obligated Balance, Net, End of Year:						
Accounts Receivable	(629,998)	67	(2,416)	(3,112)	(578)	(636,037)
Unfilled customer orders			(1,618)			(1,618)
Undelivered orders	3,873,422	688,155	17,985	327,804	1,421,225	6,328,591
Accounts payable	279,197	0	1,389	966	17,834	299,386
Outlays:						
Disbursements	7,842,317	2,327,683	73,031	1,044,946	1,479,098	12,767,075
Collections	(2,019,231)	0	(7,977)	(38,603)	(15,866)	(2,081,677)
Subtotal	5,823,086	2,327,683	65,054	1,006,343	1,463,232	10,685,398
Less: Offsetting receipts	(806,316)				(490)	(806,806)
Net Outlays	$ 5,016,770	$ 2,327,683	$ 65,054	$ 1,006,343	$ 1,462,742	$ 9,878,592

Intragovernmental Amounts

Intragovernmental amounts represent transactions between federal entities included in the *Financial Report of the United States Government – Fiscal Year 2002* (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, 2002 and 2001, are summarized below (Dollars in Thousands).

As of September 30, 2002:

Trading Partner	ASSETS Fund Balance With Treasury	Investments	Interest Receivable	Accounts Receivable, Net	LIABILITIES 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

As of September 30, 2001:

Trading Partner	ASSETS Fund Balance With Treasury	Investments	Interest Receivable	Accounts Receivable, Net	LIABILITIES Accounts Payable	Other Liabilities
Department of Agriculture				$ 2,770	$ —	$ —
Department of Commerce				5,406	8	
Department of Defense				49,440	5,534	
Department of Justice				23,671	20	
Department of Labor						18,015
Department of the Treasury	$ 7,652,119	$11,206,403	$ 189,677	4,160	1	7,391
Agency for International Development				9,733	53	
Environmental Protection Agency					37	
Office of Personnel Management						6,359
Other Agencies				75,205	309	5,236
Total	$ 7,652,119	$11,206,403	$ 189,677	$ 170,385	$ 5,962	$ 37,001

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, 2002 and 2001, 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 page 249. 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,	**2002**	**2001**
Trading Partner	**Earned Revenue**	**Earned Revenue**
Executive Office of the President	$ 16,779	$ 5,165
Department of Agriculture	17,083	16,490
Department of Commerce	28,379	28,902
Department of Defense	375,957	150,983
Department of Energy	4,812	2,344
Department of Health and Human Services	10,518	10,117
Department of Justice	58,620	58,784
Department of Transportation	4,093	3,941
Department of the Treasury	802,522	769,329
Agency for International Development	115,769	118,476
Environmental Protection Agency	4,513	8,383
Social Security Administration	7,863	4,537
Other Agencies	416,447	345,273
Total	$ 1,863,355	$ 1,522,724

For the Year Ended September 30,		**2002**			**2001**	
Budget Functional Classification	**Gross Cost to Generate Revenue**	**Earned Revenue**	**Net Cost**	**Gross Cost to Generate Revenue**	**Earned Revenue**	**Net Cost**
International Affairs	$1,010,891	$1,016,069	$ (5,178)	$ 683,044	$ 689,234	$ (6,190)
Income Security	831,966	837,822	(5,856)	818,692	823,807	(5,115)
Natural Resources	9,464	9,464	—	9,683	9,683	—
Total	$1,852,321	$1,863,355	$ (11,034)	$1,511,419	$1,522,724	$ (11,305)

The amounts of intragovernmental non-exchange revenues classified by trading partner for the years ended September 30, 2002 and 2001 are summarized below (Dollars in Thousands).

For the Year Ended September 30,	**2002**	**2001**
Trading Partner	**Non-Exchange Revenue**	**Non-Exchange Revenue**
Department of the Treasury	$ 1,096	$ 887

The amounts of intragovernmental expenses classified by trading partner and by budget functional classification for the years ended September 30, 2002 and 2001, are summarized below (Dollars in Thousands).

For the Year Ended September 30,	2002	2001
Trading Partner	**Expenses**	**Expenses**
Department of Agriculture	$ 888	$ 1,401
Department of Commerce	2,128	1,218
Department of Defense	71,847	21,205
Department of Energy	24,753	9,085
Department of Justice	55,106	51,401
Department of Labor	8,993	9,693
Department of the Treasury	29,882	19,998
General Services Administration	431,054	280,310
Government Printing Office	16,576	12,646
Office of Personnel Management	191,379	179,899
U.S. Postal Service	8,446	6,888
Other Agencies	54,127	68,174
Total	$ 895,179	$ 661,918

For the Year Ended September 30,	2002	2001
Budget Functional Classification	**Expenses**	**Expenses**
International Affairs	$ 884,872	$ 656,371
Natural Resources	10,229	5,547
Income Security	78	
Total	$ 895,179	$ 661,918

Deferred Maintenance
For the Fiscal Year Ended September 30, 2002

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 $723.2 million for buildings and facilities-related equipment that have not been funded. This figure is significantly more than the $122.3 million reported for 2001 because previously, the Department had used, for financial statement reporting purposes, a narrow interpretation of deferred maintenance. 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, $133 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, 2002 and 2001, is presented below (Dollars in Thousands).

	2002			2001		
	WCF	ICASS	Total	WCF	ICASS	Total
Assets:						
Fund Balances with Treasury	$ 39,096	$ 117,570	$ 156,666	$ 4,101	$ 121,668	$ 125,769
Accounts Receivable, Net	46,539	242,924	289,463	21,596	210,218	231,814
Plant, Property and Equipment, Net	24,169	30,059	54,228	22,412	35,291	57,703
Other Assets	7,800	3,689	11,489	6,977	3,009	9,986
Total Assets	117,604	394,242	511,846	55,086	370,186	425,272
Liabilities:						
Accounts Payable	12,255	77,406	89,661	28,168	73,052	101,220
Other Liabilities	5,113	55,088	60,201	6,062	54,240	60,302
Total Liabilities	17,368	132,494	149,862	34,230	127,292	161,522
Cumulative Results of Operations	$ 100,236	$ 261,748	$ 361,984	$ 20,856	$ 242,894	$ 263,750

The cost of providing services and the exchange revenue earned for the years ended September 30, 2002 and 2001 are presented below (Dollars in Thousands). These amounts do not include intra-departmental eliminations.

	WCF	ICASS	Total
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)
2001			
Costs	$ 184,743	$ 796,672	$ 981,415
Exchange Revenue	(184,136)	(821,632)	(1,005,768)
Net Cost (Revenue)	$ 607	$ (24,960)	$ (24,353)

Fiscal Year 2002 Performance and Accountability Report

Inspector General

Clark Kent Ervin
Inspector General

MANAGEMENT AND PERFORMANCE CHALLENGES

OIG concludes the most serious management and performance challenges to the Department are the following areas:

- Protection of our people and facilities,
- Information security,
- Financial management,
- Human resources,
- Counterterrorism and border security, and
- Strategic and performance planning.

PROTECTION OF OUR PEOPLE AND FACILITIES

As noted in OIG's assessment of management and performance challenges in 2001, and in the aftermath of the September 11, 2001 attacks, protection of its facilities and people from terrorist threat remains one of the highest priorities for the Department. The Department has embarked upon an ambitious effort, the largest in its history, to construct or upgrade diplomatic missions that are inadequate and, in some cases, unsafe. This fiscal year, the Department's Office of Overseas Buildings Operations is constructing 23 new embassy compounds and upgrading security at existing missions at a cost of approximately $400,000,000. Despite the Department's aggressive efforts, many embassies cannot expect new and safer buildings in the short term, and they must upgrade their current facility using existing resources. To this end, OIG continued its security inspections throughout last year to identify physical security problems at embassies and propose ways to resolve or mitigate them. The September 11, 2001 attacks also highlighted the need to improve security at U.S. domestic installations, and the Department has initiated efforts to improve security at the Harry S Truman, or "Main State," headquarters building.

Funding has been requested and partially granted for the Department's comprehensive building plan and OIG is currently reviewing the Department's progress in the plan's implementation. OIG has also established an ongoing review of the Department's construction of a new embassy in China. To date, the project is on schedule and has had interagency coordination and concurrence on building design and construction.

OIG completed 49 full and limited scope security oversight inspections in 2002. The Department has made the most progress in physical security, with increased or strengthened setback at many posts. In addition, Department and post-initiated projects have resulted in improved compound access controls, internal security barriers, guard patrols, and screening procedures. Emergency preparedness, while generally improved, needs more attention. OIG found not all required emergency reaction drills are being conducted at all diplomatic facilities, and some emergency preparedness plans are out of date or incomplete. As noted by survivors of the most recent large vehicle bomb attack against the U.S. Consulate in Karachi, Pakistan, the lack of personnel injury was attributed to the instinctive response by staff as a result of frequent emergency procedure drills.

OIG's review of security at the Harry S.Truman building found the need for permanent setback and improved access controls. The Department has responded positively and is working with the National Capital Planning Commission to install permanent barriers to increase setback.

INFORMATION SECURITY

The dramatic expansion in computer interconnectivity and the rapid increase in the use of the Internet are changing the way the government, the nation, and much of the world communicate and conduct business. However, without proper safeguards, these developments pose enormous risks that make it easier for people and groups with malicious intent to intrude into inadequately protected systems and use such access to obtain sensitive information, commit fraud, disrupt operations, or launch attacks against other computer networks and systems. Computer-supported Department operations are at risk. Previous General Accounting Office, OIG, and Bureau of Diplomatic Security reports have identified persistent computer security weaknesses that place a variety of critical and mission-essential Department operations at risk of disruption, fraud, and unauthorized disclosure.

The Department recognizes that much more must be done to develop fully and ensure continuity of its systems security program. In its September 2002 report on the Department's information security program, OIG identified several key areas of information security that still require management attention. Specifically, the Department has made slow progress in addressing information security weaknesses identified in OIG's 2001 review of the Department's implementation of the Government Information Security Reform Act. In response to the report, the Department developed a strategy to address a key deficiency, the lack of certification and accreditation of its information systems. However, the Department has not developed a timetable for certification and accreditation of all systems, and as of August 2002, only four percent of its systems had been certified and accredited. Further, although 72 percent of the Department's 358 systems are reported to have security-level determinations, only 15 percent are reported to have security plans.

OIG also focused on the overall protection of classified information at home and abroad. Domestically, OIG is examining the role of the unit security officers assigned to the regional bureaus and whether these people are properly trained and equipped to accomplish their tasks. Overseas, additional resources (specifically technical security engineers and specialists) are needed to maintain and repair technical security countermeasures that protect classified information abroad. The Bureau of Diplomatic Security's FY 2003 budget request has identified the technical security positions necessary for conducting required testing, preventive maintenance, and repair of these countermeasures.

FINANCIAL MANAGEMENT

One of the major challenges the Department faces is complying with the requirements of the Federal Financial Management Improvement Act (FFMIA). The Department continues to make significant strides in this area. It is ahead of schedule in moving the services provided by the Paris Financial Service Center to its operations in Charleston, South Carolina. On November 1, 2001, the new Regional Financial Management System became operational at Charleston, and as of September 30, 2002, 44 posts had been converted to the new system. Nevertheless, the Department continues to expend significant manual efforts and costs in preparing its financial statements, and has been unable to provide timely information for the audit process.

Recently, at the joint recommendation of the Department of State OIG and the USAID OIG, the two agencies embarked on a study of their accounting and other business processes to determine what could be altered or restructured to maximize the options for integration. Both organizations have selected the same commercial software as their corporate worldwide accounting systems.

The Department is also making progress in achieving substantial compliance with federal financial management systems requirements. The Department has completed 50 percent of its FFMIA remediation plan projects, and expects to complete all but one of the remaining projects by September 2003. The Central Financial Planning project has been restructured and the Department does not expect to complete the project until December 2004, and substantial additional funding will be required to do so.

Managing federal assistance funds -- including grants, cooperative agreements, and fund transfers for cultural and educational exchange programs, refugee programs, and law enforcement programs – also remains a major challenge. Management of federal assistance programs is decentralized within the Department, and the responsible bureaus do not use standardized accounting systems, policies, or procedures for this purpose, although the Department has adopted a standard payment system in compliance with the Financial Assistance Management Improvement Act of 1999. Presently, the Department lacks comprehensive and reliable information on funding provided to nongovernmental organizations.

HUMAN RESOURCES

Congress, the General Accounting Office, and the OIG have expressed concerns about the human resource issues that have faced the Department for several years. Among the challenges is the need to develop a workforce plan for the Foreign Service and Civil Service that reflects both the overseas and domestic staffing needs of the Department. The Department has made significant strides in recruiting new Foreign Service officers through the "Diplomatic Readiness Initiative," although staffing gaps remain. The Department is also committed to reducing the time it takes to bring on board qualified Foreign Service officers and to ensure that training extends in a rational way throughout officers' careers. It has also focused more attention on developing its Civil Service and to providing adequate training and support to its foreign service national employees (FSNs).

OIG has found that many overseas posts do not have sufficient consular personnel. As a result of the attacks of September 11, 2001, new visa policies and procedures were implemented to screen visa applicants more carefully. Consular sections are frequently understaffed or not appropriately staffed with experienced consular officers to carry out these new procedures. Another human resource challenge includes a perceived division between Foreign Service and Civil Service. The Department has initiated a leadership program for its Civil Service employees to attempt to address this concern. The initiative is ongoing and will require a serious commitment of resources and attention from the Department's senior managers to succeed. OIG applauds the Department's determination to resolve the problems related to FSN pensions in many countries and fully supports its continuing efforts to resolve this longstanding issue.

"Rightsizing" the staffs at our diplomatic mission remains a major challenge. OIG continued to review rightsizing issues during each post inspection in fiscal year 2002. At many posts, OIG recommended, where appropriate, either reductions or increases in staffing related to rightsizing considerations.

COUNTERTERRORISM AND BORDER SECURITY

Counterterrorism and border security remain among the Department's most important programs and greatest challenges. The September 11, 2001, attacks heightened awareness and scrutiny of these programs. Vulnerabilities in the visa and passport processes are the focus of significant Department attention. Resources needed to accommodate the new consular processes and procedures will require a careful review by the Department.

The Consular Lookout and Support System (CLASS) remains the principal mechanism for screening out terrorists and criminals attempting to obtain visas or U.S. passports. The number of names in the system has increased fourfold in the past year. The Bureau of Intelligence and Research (INR) evaluates data regarding suspected terrorists and criminals and decides what names should be entered into CLASS.

The Department is conducting ongoing reviews to identify and address areas of vulnerability in the visa and passport processes since they directly affect border security. To improve information sharing, the Department accelerated several projects that provide officers overseas as much available data as possible such as the Passport Lookout Tracking System and expansion of the Consular Lost and Stolen Passports database. These systems provide missions with access to several consular databases in real time. Access by FSNs to all consular databases, a concern last year, is now more restricted.

The Department has also moved to place additional controls on visa processing. The name clearance process now provides a secondary check for several categories of visa applicants. The number of personal appearance waivers has been reduced, and policy decisions presently in the final clearance process will further restrict such waivers. The use of third parties such as travel agents, banks, and courier services as a means of delivering visa applications to posts for issuance is being re-evaluated.

OIG applauds the above improvements, but concerns about consular staffing, training, and facilities, heightened by the events of September 11, caused OIG to recommend that the Department establish a material weakness in the area of visa processing. The Department needs an appropriate level of adequately trained staff and adequate secure and efficient office space to minimize vulnerabilities in the consular area. Despite OIG's recommendation, the Department established visa processing as a reportable condition.

STRATEGIC AND PERFORMANCE PLANNING

A major challenge for the Department is to establish strategic goals that provide clarity and direction for long-range planning and resource allocation and performance goals and indicators to serve as metrics of success in achieving those goals. The Department continues to improve its plans, and the Bureau of Resource Management, Office of Strategic and Performance Planning, is currently drafting a five-year strategic plan for the Department and working with other offices and bureaus to improve their performance plans. The Department is now emphasizing that all funding requests by bureaus and offices must be related to items reflected in the strategic plan.

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

The information on the Department's follow-up on audit recommendations covers 2002. 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 2002, the Department of State tracked 26 audit reports that were more than one year old and included a total of 134 recommendations in which final action was not taken, which would have brought closure to the reports. These audits contain over $195,000 in disallowed costs and recommended actions, which when implemented, could result in up to $70,000 of funds put to better use. The Department is working to bring closure to the 26 audits and recognizes that the follow-up actions and compliance to the recommendations are essential to improving the effectiveness and efficiency of program operations.

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

On October 1, 2001, there were five audits with recommendations to put funds to better use, with a dollar value of $2.2 million, in which management had not taken final action. During the year, four audits had final actions taken in 2002 resulting in savings of $2.0 million. Therefore, on September 30, 2002, there was one audit with recommendation to put funds to better use, which was awaiting final action with a dollar value of $70,000.

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

Program Area	Number of Audit Reports	Recommendations
Counter Intelligence	6	30
Financial Management	9	57
Security Oversight	6	34
Support Programs	2	6
Property Management and Procurement	1	3
Contracts and Grants	2	4
TOTALS	**26**	**134**

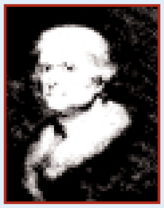
Status of Audits of Disallowed Costs

On October 1, 2001, there were two audits with management decision on which final action had not been taken with a dollar value of disallowed costs totaling $340,000. During the year, one audit with a value of $145,000 was resolved. Therefore, the balance at September 30, 2002 was reduced to $195,000.

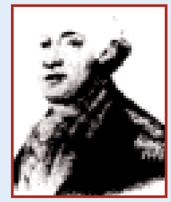
Funds Put to Better Use and Disallowed Costs in Audit Reports

	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	5	$2,219,330	2	$340,000
New Audits	-	-	-	-
Implemented Actions	(4)	(2,149,330)	1	(145,000)
Ending Balance	1	$70,000	1	$ 195,000

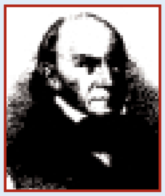
Department of State Personalities of Note



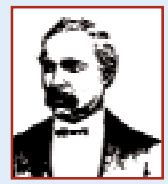
Thomas Jefferson, the first Secretary of State, began the distinction between the Diplomatic and Consular Services. He established the policy of neutrality in European conflicts. When he took office in 1790, the Department included 8 domestic employees, 2 diplomatic missions, and 10 consular posts.



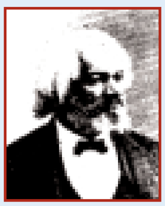
William Palfrey of Massachusetts was not only the first American consular officer but was also the first member of the diplomatic service to lose his life in the line of duty. A lieutenant colonel in the Continental Army and former Paymaster-General, Palfrey was appointed consul to France on November 4, 1780. He was lost at sea en route to his post. His name is the first on the plaque in the lobby of the Department of State listing the those whose have died on duty in the foreign service.



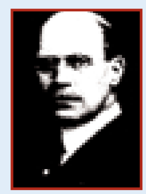
John Quincy Adams became the youngest American Chief of Mission when he was appointed Minister to the Netherlands in 1794, at the age of 27. As Secretary of State (1817-25), he negotiated a boundary settlement with Great Britain, acquired Florida from Spain, and helped formulate the Monroe Doctrine.



Ebenezer Don Carlos Bassett, America's first black diplomat, was Minister Resident and Consul General in Haiti from 1869 to 1877.



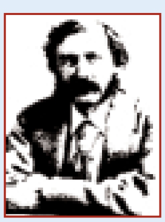
Frederick Douglass was born into slavery in Maryland. After escaping bondage, he became a leading abolitionist. Following the Civil War he received two diplomatic assignments. In 1871 he served as secretary of a commission sent to Santo Domingo to explore the possibility of annexing that island. More important, in 1889 he became Minister to Haiti and chargé d'affaires to Santo Domingo. In this capacity he became involved in an unsuccessful attempt to acquire the Mole St. Nicolas in Haiti as a coaling station. In 1891 Douglass resigned his office after critics alleged that he showed undue regard for the Haitian point of view.



Wilbur J. Carr (1870-1942) was born in Ohio and entered the Department of State as a clerk in 1892. He became Chief of the Consular Bureau in 1902, Chief Clerk in 1907, and served as Director of the Consular Service from 1909 to 1924. A believer in scientific management and administrative efficiency, Carr took pride in having brought Consular Service operations "as near to perfection as possible." He strove to extend professionalism and merit to all aspects of the Department, working for passage of the 1906 Consular Reorganization Act and helping to draft the Rogers Act.

Carr served as Assistant Secretary of State from 1924 to 1937. His duties included those of Chairman of the Board of Foreign Service Personnel and Budget Officer of the Department, a combination which allowed him to administer the transition from separate Diplomatic and Consular Services to a unified professional Foreign Service. His last assignment was Ambassador to Czechoslovakia from 1937 until the German occupation in 1939. "The Father of the Foreign Service" then retired from the Department, having served for 45 years under 17 Secretaries of State.

A number of distinguished U.S. authors including James Russell Lowell, Washington Irving, Stephen Vincent Benet, James Fenimore Cooper, and Nathaniel Hawthorne held diplomatic or consular posts.



Bret Harte, the author of "The Luck of Roaring Camp," "The Outcasts of Poker Flat," and "Tennessee's Partner," classic stories of the American West in the gold rush and frontier mining camp days, went to Washington in 1876 to seek employment as an overseas consul. He hoped to earn enough to support himself and his family and still have time to write.

Harte was sent to Crefeld, Germany, in 1878 thinking he was to be the consul, but discovered that he was only a commercial agent in a larger consular district. As there were no travel allowances, per diem, or dependent allotments for consular employees, his family remained behind and never joined him during his consular career. He suffered continually from the damp climate of Crefeld and was delighted to be appointed as consul in Glasgow, Scotland, in 1880. Glasgow was an important post with a large export trade, from which Harte sent the State Department extensive reports on all sorts of subjects. However, he also traveled frequently to London to lecture and write. Finally, in 1885 he was replaced, as some said, for "inattention to duty." He returned to live in London for the next 17 years, until his death in 1902.

FISCAL YEAR 2002 PERFORMANCE AND ACCOUNTABILITY REPORT

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
DELFT INSTRUMENTS N.V.	Concealing a material fact involving the transfer of U.S. –origin defense articles to Iraq and Jordan.	8/22/1997	$300,000	$200,000 initially, then $20,000 for five subsequent years
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
DR. WAH L. LIM	Unauthorized export of defense articles and defense services to the People's' Republic of China and misrepresentation and/or omission of material facts from information presented to the Department	1/10/2002	$50,000	$50,000
TOTAL		---	**$33,750,000**	---

COMPANY NAME	Balance Outstanding September 30, 2001	Fiscal Year 2002 Assessments	Fiscal Year 2001 Collections	Balance Outstanding September 30, 2002
DELFT INSTRUMENTS N.V.	$20,000	---	$20,000	---
BOEING COMPANY	$1,600,000	---	$800,000	$800,000
A&C INTERNATIONAL TRADE, INC.	$66,666.66	---	---	$66,666.66
LOCKHEED MARTIN CORPORATION	$5,000,000	---	$1,500,000	$3,500,000
BOEING COMPANY	$2,800,000	---	$1,000,000	$1,800,000
SPACE SYSTEMS/ LORAL, INC.	---	$14,050,000	$2,200,000	$11,800,000
DR. WAH L. LIM	---	$50,000	$50,000	---
TOTAL	$9,486,666.66	$14,050,000	$5,570,000	$17,966,666.66

DEBT MANAGEMENT

Outstanding debt from non-Federal sources (net of allowances) increased from $42.1 million in 2001 to $45.3 million in 2002. 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 ($3.8 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 (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 $194,000 to Treasury for cross-servicing in 2002. The decrease in the amount of receivables referred to Treasury for cross-servicing was due to anthrax-related U.S. mail disruptions during the last quarter of 2001. For approximately six months, the impact of these disruptions seriously affected the Department's ability to receive payments and to provide debtors a proper due process notification. Of the current and past debts referred to Treasury, $206,460 was collected in 2002.

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

	FY 2002	FY 2001	FY 2000
Number of Accounts	177	677	572
Amounts Referred (In Thousands)	$194	$795	$680

PAYMENTS MANAGEMENT

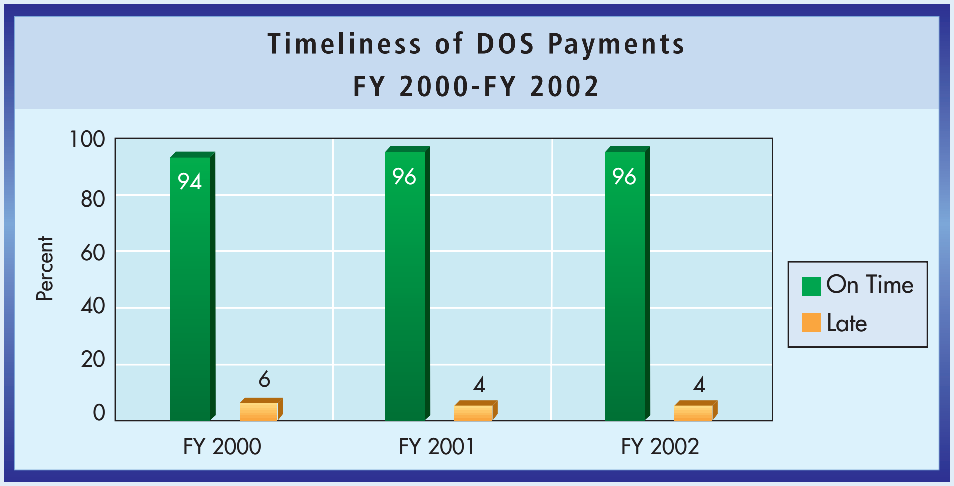
PROMPT PAYMENT ACT

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. The Department continues to show improvement in paying its bills on time.

96% of invoices were paid on time.

2% of invoices required interest penalties.



SELECTED PAYMENT DATA

	2002	2001	2000
Interest Paid ($000)	443	774	1,559
Interest Under $1 Not Due ($000)	4	8	10
Interest Due But Not Paid ($000)	-	-	-
Number of Procurement Card Transactions			
Domestic	53,379	47,032	42,016
Overseas	46,297	38,298	22,000

ELECTRONIC PAYMENTS

The Department successfully increased the number and percentage of payments it makes electronically. In 2002, 77% of all payments were made by electronic funds transfer (EFT). Domestically, 96% of payments were made electronically, exceeding the 77% EFT goal that Treasury established for 2002. The Department processed 60% of its 2002 overseas payments by EFT, an 4% increase from 2001.

EFT AND CHECK PAYMENT VOLUMES

	2002		2001		2000	
Payment Type	**Number**	**Percent**	**Number**	**Percent**	**Number**	**Percent**
EFT:						
Domestic	1,210,054		1,137,510		1,132,299	
Overseas	841,050		780,418		609,234	
EFT Subtotal	2,051,104	77	1,917,928	74	1,741,533	69
Checks:						
Domestic	56,668		74,811		46,396	
Overseas	560,026		606,128		749,598	
Checks Subtotal	616,694	23	680,939	26	795,994	31
Total Payments	**2,667,798**	**100**	**2,598,867**	**100**	**2,537,527**	**100**