Financial Section

This section contains the Department's financial statements and related Independent Auditor's Report, and other information pertaining to the Department's financial management. For more information on this section, please contact the Office of Financial Policy, Reporting, and Analysis at (202) 261-8620.

INTRODUCTION TO PRINCIPAL FINANCIAL STATEMENTS

The Principal Financial Statements (Statements) have been prepared to report the financial position and results of operations of the U.S. Department of State (Department). The Statements have been prepared from the books and records of the Department in accordance with formats prescribed by the Office of Management and Budget (OMB) in OMB Circular A-136, *Financial Reporting Requirements.* The Statements are in addition to financial reports prepared by the Department in accordance with OMB and U.S. Department of the Treasury (Treasury) directives to monitor and control the status and use of budgetary resources, which are prepared from the same books and records. The Statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity. The Department has no authority to pay liabilities not covered by budgetary resources. Liquidation of such liabilities requires enactment of an appropriation. Comparative data for 2004 are included.

The **Consolidated Balance Sheet** provides information on assets, liabilities, and net position similar to balance sheets reported in the private sector. Intra-departmental balances have been eliminated from the amounts presented.

The **Consolidated Statement of Net Cost** reports the components of the net costs of the Department's operations for the period. The net cost of operations consists of the gross cost incurred by the Department less any exchange (i.e., earned) revenue from our activities. Intra-departmental balances have been eliminated from the amounts presented.

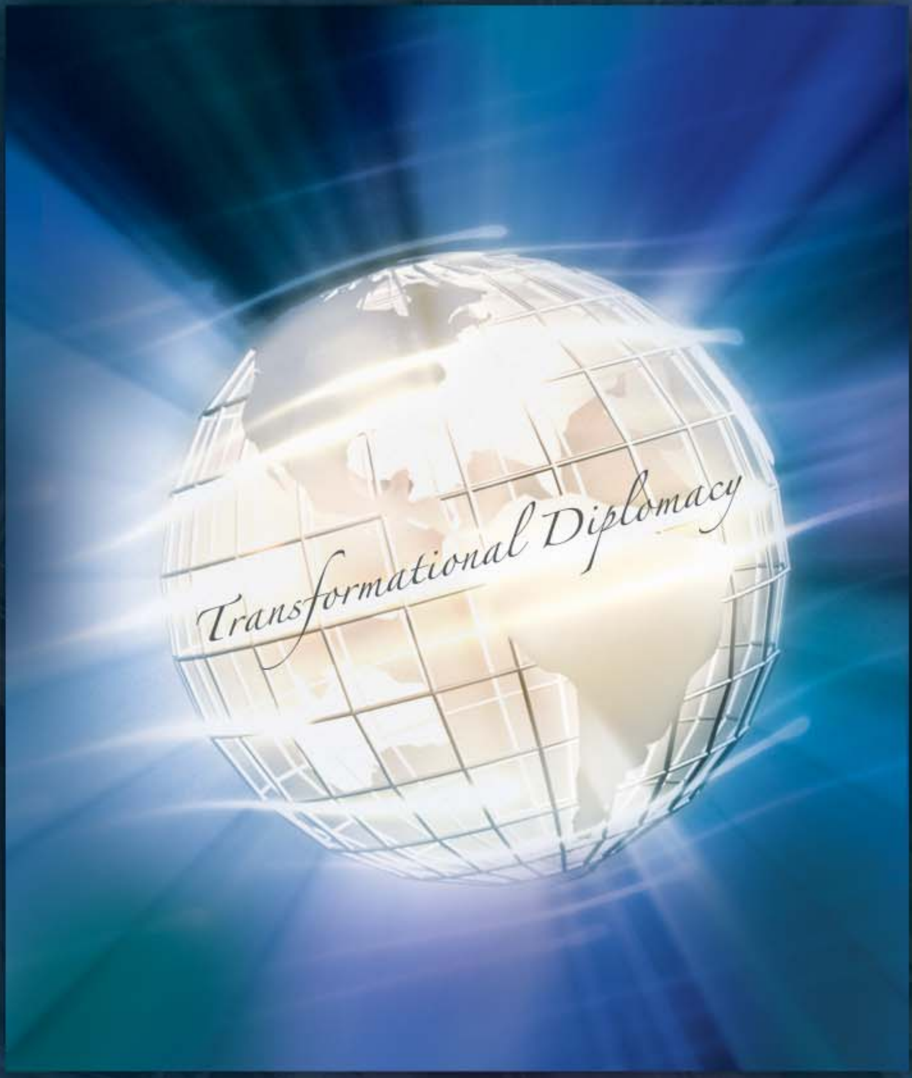
The **Consolidated Statement of Changes in Net Position** reports the beginning net position, the transactions that affect net position for the period, and the ending net position. The components of net position are separately displayed in two columns: Cumulative Results of Operations and Unexpended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

The **Combined Statement of Budgetary Resources** provides information on how budgetary resources were made available and their status at the end of the year. Information in this statement is reported on the budgetary basis of accounting. Intra-departmental transactions have not been eliminated from the amounts presented.

The **Consolidated Statement of Financing** reports the relationship between budgetary transactions and financial transactions.

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

Independent Auditor's Report



United States Department of State
and the Broadcasting Board of Governors

Inspector General

December 15, 2005

UNCLASSIFIED

INFORMATION MEMORANDUM TO THE SECRETARY

FROM: OIG – Mr. Howard J. Krongard

SUBJECT: *Audit of the U.S. Department of State 2005 and 2004 Principal Financial Statements* (Report AUD/FM-06-12A)

In compliance with the Chief Financial Officers Act, as amended, the Office of Inspector General (OIG) contracted with Leonard G. Birnbaum and Company, LLP (LGB), an independent certified public accounting firm, to audit the Department's principal financial statements as of September 30, 2005 and 2004, and for the years then ended.

During FY 2005, the Department, OIG, and LGB became aware that certain financial information in the FY 2004 financial statements, primarily related to personal property, may have been misstated. The Department could not complete its work on personal property by the deadline imposed by OMB for issuing the audited FY 2005 financial statements. Therefore, in a report dated November 14, 2005, LGB reported that:

> except for the effects, if any, as might have been determined to be necessary had LGB been able to examine evidence regarding personal property, the Department's 2005 and 2004 Principal Financial Statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

The Department has now completed its work on issues related to personal property. Based on its examination of the additional information provided by the Department, LGB's present opinion on the Department's 2005 and 2004 Principal Financial Statements is different from that expressed in the previous report. LGB has satisfied itself that the financial statements were presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

UNCLASSIFIED

During its audit, LGB found:

- two material weaknesses in the Department's internal controls, one related to personal property and the second related to the domestic information system network's vulnerability to unauthorized access;
- three reportable conditions related to internal controls over the financial and accounting system, the management of undelivered orders, and the implementation of managerial cost accounting standards;
- instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management system; and
- the Department to be not in substantial compliance with the Federal Financial Management Improvement Act of 1996.

LGB's report is attached for your review. LGB is responsible for this report and the opinions and conclusions expressed therein. OIG is responsible for technical and administrative oversight regarding performance under the terms of the contract. OIG's review, as differentiated from an audit in accordance with *Government Auditing Standards,* was not intended to enable OIG to express, and OIG does not express, an opinion on the Department's principal financial statements or conclusions about the effectiveness of internal control and compliance with certain laws and regulations, including the Federal Financial Management Improvement Act.

The Bureau of Resource Management's comments are included as Appendix A to the report. In addition to this report, OIG will transmit a separate management letter discussing several other matters that were identified during the audit.

OIG appreciates the cooperation extended to it and its contractors by the Department's managers and staff during the audit.

Attachment: Tab 1

UNCLASSIFIED

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INDEPENDENT AUDITOR'S REPORT

To the Secretary, Department of State:

We have audited the Department of State's (Department) Consolidated Balance Sheets, Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, Combined Statements of Budgetary Resources, and Consolidated Statements of Financing as of, and for the years ended, September 30, 2005 and 2004 (collectively the Principal Financial Statements); we have examined internal control over financial reporting in place as of September 30, 2005; and we have examined compliance with applicable laws and regulations.

In our report dated November 14, 2005, we expressed an opinion that except for the effects, if any, as might have been determined to be necessary had we been able to examine evidence regarding personal property, the Department's 2005 and 2004 Principal Financial Statements were presented fairly in all material respects in conformity with accounting principles generally accepted in the United States of America.

During FY 2005, the Department became aware of potentially material amounts of property in the hands of contractors that had not been properly reported in its financial statements. While examining this issue, the Department learned of other issues related to the accuracy of amounts reported as personal property. These issues affected FY 2005 and 2004 balances and activity. Although the Department had performed significant work to resolve the issues, that work was not sufficiently completed to enable us to satisfy ourselves as to the accuracy of the amounts reported as personal property in time to meet the November 15, 2005, deadline imposed by the Office of Management and Budget (OMB) for issuing our audit report. Further, since the issues affected FY 2004 balances and activities, our opinion on the Department's 2004 Principal Financial Statements, as presented in our report dated November 14, 2005 was different from that expressed in our original report on the Department's 2004 Principal Financial Statements.

The Department has since completed its work on issues related to personal property and has provided documentation to support the amounts reported on the financial statements. We have satisfied ourselves that the amounts presented as personal property in the Department's 2005 and 2004 Principal Financial Statements are presented fairly, in all material respects in conformity with accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the Department's 2005 and 2004 Principal Financial Statements, as presented herein, is different from that expressed in our previous report.

In our opinion, the Department's 2005 and 2004 Principal Financial Statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

We found:

- material weaknesses in the Department's internal controls,
- reportable conditions on weaknesses in the Department's internal controls,
- instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management system, and
- the Department to be not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996.

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

PRINCIPAL FINANCIAL STATEMENTS

In our opinion, the Department's 2005 and 2004 Consolidated Balance Sheets, Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, Combined Statements of Budgetary Resources, and Consolidated Statements of Financing, including the notes thereto, present fairly, in all material respects, the Department's financial position as of September 30, 2005 and 2004, and the net cost of operations, the changes in net position, the use of budgetary resources, and the use of financing, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

INTERNAL CONTROL

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

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

- transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over assets;
- funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition;

- transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that OMB, Department management, or the Inspector General have identified as being significant for which compliance can be objectively measured and evaluated; and

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

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

We noted the following two matters that we consider to be material weaknesses as defined above.

- We have identified significant weaknesses related to the recording of personal property and related depreciation expense and accumulated depreciation. The Department does not have a system of controls to identify and record property in the hand of contractors. Further, the Department's controls over aircraft, vehicles, and other personal property are ineffective. Our tests disclosed (1) significant discrepancies between inventories of property reported by posts and bureaus and those maintained centrally and used as a source for reporting for financial statement purposes, (2) posts not submitting inventories of property with no investigation by responsible Department officials, (3) property not reported by posts and bureaus, (4) significant unreported vehicle armoring costs, and (5) errors in depreciation resulting from incorrect in-service dates.

- We have identified weaknesses related to information system security that we believe could be exploited to have a detrimental effect on the information used to prepare the financial statements. We believe that the information system networks for domestic operations are vulnerable to unauthorized access. Consequently, systems, including the Department's financial management system, that process data using these networks may also be vulnerable. These deficiencies were cited as material weaknesses in our audit of the Department's 1997 Principal Financial Statements and subsequent audits through 2002. In response, the Department initiated a program to assess its information systems security on a comprehensive and continuing basis. As a result, we downgraded these deficiencies to a reportable condition in connection with our audit of the Department's 2003 Principal Financial Statements. Our review of information system security in connection with our audit of the Department's 2005 Principal Financial Statements disclosed that the Department is no longer assessing information system security to the same extent as it was during 2003 and 2004. Accordingly, we have reclassified this deficiency to a material weakness.

We are required to review the Department's current Federal Managers' Financial Integrity Act report and disclose differences with the material weaknesses in our report. The Department's 2005 report did not identify either control over personal property or information system security as material weaknesses.

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

- The Department's financial and accounting system, as of September 30, 2005, was inadequate. There is a risk of materially misstating financial information under the current conditions. The principal areas of inadequacy were:

  - Certain elements of the financial statements, including, but not limited to, personal property, capital leases, and certain accounts payable, are developed from sources other than the general ledger. The use of sources other than the general ledger to generate elements of the financial statements increases the potential for omission of significant transactions.

  - During 2005, the Department used several systems for the management of grants and other types of financial assistance. These lacked standard data classifications and common processes and were not integrated with the Department's centralized financial management system. Further, the Department could not produce reliable financial information that defined the universe of grants and other federal financial assistance. The Department has undertaken an initiative jointly with the U.S. Agency for International Development to establish a grants management system. Subject to funding approval, implementation of such a system is expected to begin in the FY 2006-2007 time frame.

  - The Department is unable to produce year-end financial data to be included in its Performance and Accountability Report (PAR) in a timely manner.

- The Department's internal control process related to the management of undelivered orders was inadequate. The Department has made significant improvements in this area over the past two years. The Department has actively worked with bureaus to validate undelivered orders and has successfully cleared up a significant number of obligations that were outstanding from past years. However, the Department needs to perform additional work to correct this weakness. Our tests indicated that over $340 million of undelivered orders should have been deobligated as of September 30, 2005. Also, we noted that the Department's undelivered orders balance has grown significantly to $8.6 billion, as of September 30, 2005. The Budget and Accounting Procedures Act of 1950 requires that the Department's accounting system provide effective control over funds. Failure to deobligate funds in a timely manner may result in the loss of availability of those funds.

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

- Although the Department complied with certain aspects of Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Standards* - for instance, it chose reasonable responsibility segments, recognized the cost of goods and services that it receives from other entities, and used an appropriate allocation methodology - it did not implement an effective process to routinely collect managerial cost accounting information or establish outputs for each responsibility segment. Until this is done, we do not believe the information will be useful as a management decisionmaking tool. This was first reported in our audit of the Department's 2000 Principal Financial Statements.

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

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

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

We noted certain other internal control issues that we have reported to the Department's management in a separate letter dated November 14, 2005.

COMPLIANCE WITH LAWS AND REGULATIONS

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

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

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

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

- *Budget and Accounting Procedures Act of 1950.* This requires an accounting system to provide full disclosure of the results of financial operations; adequate financial information needed in the management of operations and the formulation and execution of the budget; and effective control over income, expenditures, funds, property, and other assets. However, we found that the Department's financial system (1) does not provide effective control over personal property, (2) does not manage undelivered orders effectively, and (3) is unable to issue year-end financial data to be included in its PAR in a timely manner.

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

- *Chief Financial Officers Act of 1990.* This requires the development and maintenance of an integrated accounting and financial management system that: (1) complies with applicable accounting principles, standards and requirements, and internal control standards; (2) complies with such policies and requirements as may be prescribed by the Director of OMB; (3) complies with any other requirements applicable to such systems; and (4) provides for (i) complete, reliable, consistent, and timely information that is prepared on a uniform basis and that is responsive to the financial information needs of agency management; (ii) the development and reporting of cost information; (iii) the integration of accounting and budgeting information; and (iv) the systematic measurement of performance. However, we found that the Department's financial system did not provide complete information in that certain elements of the financial statements are developed from sources other than the general ledger. Nor does the Department's financial management system produce year-end financial data to be included in its PAR in a timely manner.

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

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

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

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

The results of our tests disclosed instances, described below, where the Department's financial management systems did not, in our view, substantially comply with the requirement to follow the federal financial management system requirements, nor did it comply with applicable accounting standards. OMB implementation guidance states that, to be in substantial compliance with this requirement, the Department must adhere to all applicable SFFASs, meet specific requirements of OMB Circular A-127, including the computer security controls required by OMB Circular A-130, *Management of Federal Information Resources,* and receive an unqualified opinion on its financial statements which discloses no material weaknesses in internal control that affect the Department's ability to prepare financial statements and related disclosures.

- SFFAS No. 4, as noted above, requires implementation of an effective process to routinely collect managerial cost accounting information and establish outputs for each responsibility segment. We found, as discussed above, that the Department had not met this requirement.

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

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

- Our audit of the Department's 2005 and 2004 Principal Financial Statements resulted in a qualified opinion which disclosed material weaknesses in internal control that affect the Department's ability to prepare financial statements and related disclosures.

The Department's Bureau of Resource Management (RM) has overall responsibility for the Department's financial management systems. The foregoing noncompliance has its roots in the lack of organization and integration of the Department's financial management systems. In our audits of the Department's Principal Financial Statements since 1997, we observed that the Department's financial management systems were not in compliance with FFMIA and recommended, in connection with our audits of the Department's 1997 and 1998 Principal Financial Statements, that a remediation plan be prepared. RM submitted its plan to remediate noncompliance with FFMIA to OMB on March 16, 2000. Although RM has made significant progress in completing several phases of its plan, the plan has not effectively dealt with the issues related to managerial cost accounting or eliminated the weaknesses in systems security.

We noted certain other instances of noncompliance that we reported to the Department's management in a separate letter dated November 14, 2005.

RESPONSIBILITIES AND METHODOLOGY

Department management has the responsibility for:

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

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

In order to fulfill these responsibilities, we:

- examined on a test basis, to the extent possible, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the Principal Financial Statements;

- with respect to the Department's internal control over financial reporting, obtained an understanding of the design of internal controls, determined whether they had been placed in operation, assessed control risk, and performed tests of controls;
- with respect to performance measures included in Management's Discussion and Analysis, obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether they had been placed in operation;
- obtained an understanding of the process by which the agency identifies and evaluates weaknesses required to be reported under FMFIA and related agency implementing procedures;
- tested compliance with selected provisions of laws and regulations that may have a direct and material effect on the financial statements;
- obtained written representations from management; and
- performed other procedures as we considered necessary in the circumstances.

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

The Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information are not a required part of the Principal Financial Statements, but are supplementary information required by OMB Circular A-136, *Financial Reporting Requirements,* and the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

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

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

Leonard G. Birnbaum and Company, LLP
Alexandria, Virginia

December 14, 2005

United States Department of State

Assistant Secretray and Chief Financial Officer

Washington, D.C. 20520

December 15, 2005

MEMORANDUM

TO: OIG – Mr. Howard J. Krongard

FROM: RM – Sidney L. Kaplan, Acting

SLK

SUBJECT: Draft Audit Report on the Department of State's 2005 and 2004 Principal Financial Statements

This is in response to your request for comments on the draft report titled "Audit of the U.S. Department of State 2005 and 2004 Principal Financial Statements" (Report).

For the tenth consecutive year, we would like to extend our appreciation to your staff and to your contractor, Leonard G. Birmbaum and Company, LLP, for the professional and cooperative manner in which they conducted the audit.

In relation to internal control, the Report cites material weaknesses in (1) the recording and related depreciation of personal property and (2) the Department's security of information systems networks. In addition, the report cites three reportable conditions: (1) the inadequacy of the Department's financial management systems, (2) the management of unliquidated obligations, and (3) the implementation of Managerial Cost Accounting Standards. The Department's financial management systems are also reported as noncompliant with laws and regulations, including the Federal Financial Management Improvement Act of 1996 (FFMIA).

Each of the matters identified in the Independent Auditor's Report will be addressed as well as additional deficiencies noted during the audit process. In October 2005, the Department's Management Control Steering Committee (MCSC) – the body charged with overseeing the Department's management control program under the Federal Managers' Financial Integrity Act (FMFIA) -- created a subcommittee to address these weaknesses in the property area. The subcommittee is responsible for developing recommendations for MCSC approval in December 2005 regarding the scope and severity of identified deficiencies along with corrective actions needed to address these issues Department-wide. For information systems security, the Department has been tracking this area through the MCSC for several years and will re-double its efforts to resolve these weaknesses.

Compliance with Federal financial systems requirements remains a top priority. By the close of 2004, all financial management systems were certified and accredited. In 2005, the overseas Regional Financial Management System was upgraded to the most current version of commercial off-the-shelf (COTS) software used by this system. The Department also expanded the number of on-line overseas users, added and/or enhanced a number of interfaces, and deployed improved reporting capabilities.

Strengthening the management of undelivered orders (UDOs) is an important financial management initiative, and the Independent Auditor's Report notes that there have been improvements in this area. New capabilities in the Department's Central Financial Management System allow for the automatic deobligation of UDOs based on a wide range of criteria (e.g., age, object class, dollar amount). We have started charting the percentage of UDOs with no activity for the past 12 months as part of the President's Management Agenda Initiative for Improved Financial Performance and have conducted meetings with individual bureaus to raise their awareness of their responsibilities to review and deobligate invalid UDOs. The noted actions resulted in the deobligation of 37,000 UDOs with a dollar value exceeding $220 million during FY 2005.

The Department continues to make progress in implementing Managerial Cost Accounting Standards (MCAS), but acknowledges that additional work is needed to fully comply with these standards. In FY 2005, the Department established a project team, which includes consultants with experience implementing Cost Accounting Systems. A project plan has been developed that includes developing survey instruments to identify outputs and assess each bureau's need for managerial cost information, preparing a detailed Concept Paper and implementing managerial cost data for pilot bureau(s) by the end of FY 2006.

We thank you for the opportunity to comment on the draft report and for working with us in a collaborative manner on the FY 2005 financial statements. We believe considerable progress has been made on over the past several years, and the Department remains committed to improving the management of its programs and the quality of its financial reporting.

Financial Statements

PRINCIPAL FINANCIAL STATEMENTS

DEPARTMENT OF STATE
CONSOLIDATED BALANCE SHEET

(Dollars in Thousands)

As of September 30,	**Notes**	**2005**	**Restated (Note 21) 2004**
ASSETS	3		
Intragovernmental Assets:			
Fund Balances With Treasury	4	$ 14,023,542	$ 11,900,569
Investments, Net	5	13,389,090	12,846,060
Accounts Receivable, Net	6	594,237	464,300
Interest Receivable		189,721	190,263
Total Intragovernmental Assets		28,196,590	25,401,192
Accounts and Loans Receivable, Net	6	70,357	76,388
Cash and Other Monetary Assets	7	159,202	31,603
Property and Equipment, Net	8	7,244,965	6,323,916
Other Assets	9	66,232	90,448
Total Assets		$ 35,737,346	$ 31,923,547

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	2005	Restated (Note 21) 2004
LIABILITIES	10		
Intragovernmental Liabilities:			
Accounts Payable		$ 814	$ 37,046
Other Liabilities		26,374	43,640
Total Intragovernmental Liabilities		27,188	80,686
Accounts Payable		1,268,980	1,213,096
Foreign Service Retirement Actuarial Liability	11	13,429,300	13,317,900
Liability to International Organizations	12	1,178,130	897,381
Capital Lease Liability	13	39,497	45,627
Funds Held in Trust and Deposit Accounts	10	130,081	13,208
Federal Employees' Compensation Act Benefits	10	60,288	59,984
Accrued Annual Leave	10	224,401	211,860
Environmental Liabilities	10	392,300	206,000
Other Liabilities	10	329,833	286,453
Total Liabilities		17,079,998	16,332,195
Commitments and Contingencies	14		
NET POSITION			
Unexpended Appropriations	15	11,430,639	9,279,214
Cumulative Results of Operations		7,226,709	6,312,138
Total Net Position		18,657,348	15,591,352
Total Liabilities and Net Position		$ 35,737,346	$ 31,923,547

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

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF NET COST (NOTE 16)

(Dollars in Thousands)

As of September 30,	**2005**	**Restated (Note 21) 2004**
Achieve Peace and Security		
Regional Stability		
Total Cost	$ 1,369,422	$ 1,067,396
Earned Revenue	(77,898)	(54,171)
Net Program Costs	1,291,524	1,013,225
Counterterrorism		
Total Cost	1,088,955	848,785
Earned Revenue	(61,943)	(43,076)
Net Program Costs	1,027,012	805,709
Homeland Security		
Total Cost	666,109	519,197
Earned Revenue	(37,891)	(26,349)
Net Program Costs	628,218	492,848
Weapons of Mass Destruction		
Total Cost	622,465	485,179
Earned Revenue	(35,409)	(24,622)
Net Program Costs	587,056	460,557
International Crime and Drugs		
Total Cost	1,899,698	1,651,238
Earned Revenue	(418,888)	(32,198)
Net Program Costs	1,480,810	1,619,040
American Citizens		
Total Cost	2,330,441	2,020,883
Earned Revenue	(1,990,390)	(1,584,171)
Net Program Costs	340,051	436,712
Advance Sustainable Development and Global Interests		
Democracy and Human Rights		
Total Cost	673,263	524,775
Earned Revenue	(38,298)	(26,633)
Net Program Costs	634,965	498,142
Economic Prosperity and Security		
Total Cost	1,100,403	857,708
Earned Revenue	(62,596)	(43,530)
Net Program Costs	1,037,807	814,178
Social and Environment Issues		
Total Cost	303,363	236,455
Earned Revenue	(17,256)	(12,000)
Net Program Costs	286,107	224,455
Humanitarian Response		
Total Cost	1,034,885	973,797
Earned Revenue	(51)	(143)
Net Program Costs	1,034,834	973,654
Promote International Understanding		
Public Diplomacy and Public Affairs		
Total Cost	1,786,467	1,515,852
Earned Revenue	(122,055)	(94,789)
Net Program Costs	1,664,412	1,421,063
Executive Direction and Other Costs Not Assigned		
Total Cost	3,239,122	3,040,843
Earned Revenue	(1,269,141)	(1,297,321)
Net Program Costs	1,969,981	1,743,522
Total Cost	**16,114,593**	**13,742,108**
Total Revenue	**(4,131,816)**	**(3,239,003)**
Total Net Cost	$ **11,982,777**	**$ 10,503,105**

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, 2005		Restated (Note 21) September 30, 2004	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	$ 6,312,138	$ 9,279,214	$ 5,504,514	$ 7,608,996
Budgetary Financing Sources:				
Appropriations Received	—	15,526,920	—	11,784,671
Appropriations Transfered In	—	529,997	—	1,966,746
Rescissions and Other Adjustments	—	(321,364)	—	(190,442)
Appropriations Used	13,584,128	(13,584,128)	11,890,757	(11,890,757)
Nonexchange Revenue	17,639	—	16,648	—
Donations	4,246	—	4,304	—
Other Financing Sources:				
Transfers In/Out Without Reimbursements (+/-)	(828,137)	—	(692,297)	—
Imputed Financing From Costs Absorbed by Others	119,472	—	91,317	—
Total Financing Sources	12,897,348	2,151,425	11,310,729	1,670,218
Net Cost of Operations (+/-)	(11,982,777)	—	(10,503,105)	—
Ending Balances	**$ 7,226,709**	**$ 11,430,639**	**$ 6,312,138**	**$ 9,279,214**

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

DEPARTMENT OF STATE
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 17)

(Dollars in Thousands)

For the Year Ended September 30,	2005	Restated (Note 21) 2004
Budgetary Resources:		
Budget Authority:		
Appropriations received	$ 16,747,367	$ 12,971,455
Borrowing Authority	306	—
Contract Authority	—	—
Net Transfers	6,251	1,785,231
Other	—	244,000
Unobligated Balances:		
Beginning of period	3,473,333	2,625,376
Net Transfers	288,953	181,735
Anticipated Transfers Balances	—	—
Spending Authority from Offsetting Collections:		
Earned		
Collected	4,099,439	3,137,184
Receivable from Federal Sources	239,257	325,810
Change in Unfilled Customer Orders		
Advances Received	(16)	(91)
Without Advance from Federal Sources	1,565	—
Anticipated for rest of year	—	—
Transfers from Trust Funds	—	—
Recoveries of Prior Year Obligations		
Actual	1,119,164	802,055
Anticipated for rest of year	—	—
Temporarily Not Available Pursuant to Public Law	(712,349)	(539,288)
Permanently Not Available	(305,616)	(201,246)
Total Budgetary Resources	**$ 24,957,654**	**$ 21,332,221**

DEPARTMENT OF STATE
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 17) *(continued)*

(Dollars in Thousands)

For the Year Ended September 30,	**2005**	**Restated (Note 21) 2004**
Status of Budgetary Resources:		
Obligations Incurred:		
Direct	$ 16,749,740	$ 15,147,816
Reimbursable	3,936,808	2,711,072
Unobligated Balance:		
Apportioned	3,850,488	3,256,138
Exempt from Apportionment	10,415	28,273
Other Available	—	—
Unobligated Balance Not Available	$ 410,203	$ 188,922
Total Status of Budgetary Resources	**$ 24,957,654**	**$ 21,332,221**
Relationship of Obligations to Outlays:		
Obligated Balance, Net, beginning of period	$ 8,552,661	$ 7,280,369
Obligated Balance Transferred, Net	—	—
Obligated Balance, Net, end of period:		
Accounts Receivable	(934,352)	(683,935)
Unfilled Customer Orders from Federal Sources	(4,217)	(2,795)
Undelivered Orders	8,626,459	7,591,305
Accounts Payable	1,652,603	1,648,086
Outlays:		
Disbursements	18,534,808	15,472,593
Collections	(4,095,501)	(3,150,954)
Less: Offsetting Receipts	(247,958)	(242,547)
Net Outlays	**$ 14,191,349**	**$ 12,079,092**

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF FINANCING (NOTE 18)

(Dollars in Thousands)

For the Year Ended September 30,	**2005**	**Restated (Note 21) 2004**
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 20,686,548	$ 17,858,887
Less: Spending Authority from offsetting collections and recoveries	(5,459,409)	(4,264,955)
Obligations net of offsetting collections and recoveries	15,227,139	13,593,932
Less: Offsetting receipts	(247,958)	(242,547)
Net obligations	14,979,181	13,351,385
Other Resources		
Donations	$ 4,246	$ —
Transfers in/out without reimbursement	(828,137)	(692,297)
Imputed financing from costs absorbed by others	119,472	91,317
Net other resources used to finance activities	(704,419)	(600,980)
Total Resources used to Finance Activities	**$ 14,274,762**	**12,750,405**
Resources Used to Finance Items not Part of Net Cost of Operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet received	1,033,731	1,335,211
Resources that fund expenses recognized in prior periods	7,882	23,071
Budgetary offsetting collections and receipts that do not affect net cost of operations	6,830	(7,971)
Resources that finance the acquisition of assets	1,390,661	698,014
Other resources or adjustments to net obligated resources that do not affect net cost of operations	23,994	(274)
Total Resources used to Finance Items not Part of the Net Cost of Operations	2,463,098	2,048,051
Total Resources Used to Finance the Net Cost of Operations	$ 11,811,664	$ 10,702,354

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

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF FINANCING (NOTE 18)

(Dollars in Thousands)

For the Year Ended September 30,	**2005**	**Restated (Note 21) 2004**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components requiring or generating resources in future periods		
Increase in annual leave liability	$ 12,524	$ 12,996
Increase in actuarial liability	111,400	224,100
Increase in contingent liabilities	186,300	205,450
Other, net	344,240	37,302
Total components of Net Cost of Operations that will require or generate resources in future periods	654,464	479,848
Components not Requiring or Generating Resources:		
Depreciation and Amortization	$ 500,503	$ 306,982
Trust Fund Interest and Benefit Revenue	(981,781)	(967,525)
Other	(2,073)	(18,554)
Total components of Net Cost of Operations that will not require or generate resources	(483,351)	(679,097)
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	171,113	(199,249)
Net Cost of Operations	$ 11,982,777	$ 10,503,105

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

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 Funds 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) Circular A-136, *Financial Reporting Requirements*. OMB Circular A-136 defines the form and content for annual financial statements that are required to be submitted to the Director of OMB. The statements presented herein are in addition to the financial reports prepared by the Department in accordance with OMB and U.S. Department of the Treasury (Treasury) directives to monitor and control the status and use of budgetary resources.

The statements have been prepared from the Department's books and records, and are in accordance with the Department's accounting policies (the significant policies are summarized below in this Note). The Department's accounting policies follow accounting principles generally accepted in the United States of America (GAAP). GAAP for Federal entities is the hierarchy of accounting principles prescribed in the American Institute of Certified Public Accountants' Statement of Auditing Standards No. 91, *Federal GAAP Hierarchy*, which is also incorporated in OMB Circular A-136.

Basis of Accounting

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

Budgets and Budgetary Accounting

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

Revenues and Other Financing Sources

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

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

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

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

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

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

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

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

Fund Balances with Treasury

The Fund Balances with Treasury are available to pay accrued liabilities and finance authorized commitments relative to goods, services, and benefits. The Department does not maintain cash in commercial bank accounts for the funds reported in the Balance Sheet, except for the Emergencies in the Diplomatic and Consular Services, Office of Foreign Missions, Foreign Service National Defined Contributions Retirement Fund, and the International Center, which maintains a commercial account for lease fees held in trust — see Note 7, "Cash and Other Monetary Assets." Treasury processes domestic receipts and disbursements. During 2005 and 2004, the Department operated two Financial Service Centers, which are located in Bangkok, and Charleston, South Carolina, and provide financial support for the Department and other Federal agencies' operations overseas. (The Paris operations were relocated to Charleston and Bangkok during 2003). The U.S. Disbursing Officer at each Center has the delegated authority to disburse funds on behalf of the Treasury.

Accounts Receivable

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

Accounts Receivable from non-Federal entities are subject to the full debt collection cycle and mechanisms, e.g., salary offset, referral to collection agents, and Treasury offset. In addition, Accounts Receivable from non-Federal entities are assessed interest, penalties and administrative fees if they become delinquent. Interest and penalties are assessed at the Current Value of Funds Rate established by Treasury. Except for amounts assessed on FSRDF accounts and repatriation loans, 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. Amounts assessed on repatriation loans disbursed after 1991 are retained and credited to the loan program's financing fund.

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 Accounts 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."

Judith Miller
Water Lillies/Greenbrook Sanctuary #1

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

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

Inventories

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

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

Property and Equipment—Real Property

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

Since 1997, additions to the real property asset accounts have been based on historical costs. Construction-in-Progress represents the costs incurred for new facilities, major rehabilitations, or other improvements in the design or construction stage. After these projects are completed, costs are transferred to Buildings and Structures or Leasehold Improvements as appropriate. The Department capitalizes construction of new buildings and all building acquisitions regardless of cost. The Department also capitalizes improvements greater than $250,000.

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

The Department also owns several domestic real properties, including the National Foreign Affairs Training Center (Arlington, Va.); the International Center (Washington, D.C.); the Charleston Financial Services Center (S.C.); the Beltsville Information Management Center (Md.); the Florida Regional Center (Ft. Lauderdale); and consular centers in Charleston (S.C.); Portsmouth (N.H.) and Williamsburg (K.Y.). 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.

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.

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 as well as ADP software costing over $500,000 with a useful life of two or more years. Also capitalized are repairable aircraft items costing $100,000 or more, and certain other aircraft parts costing $50,000 or more.

Depreciation of property and equipment is typically calculated on a straight-line basis over the asset's estimated life with salvage values generally ranging from zero to 10%. Depreciation begins when the item is put into service. Vehicles are generally depreciated over periods ranging from 2 to 6 years. Other personal property and equipment is depreciated over periods generally ranging from 5 to

8 years. Telecommunication equipment is depreciated over 20 years. ADP software is generally amortized over the lesser of its estimated useful life or seven years. Aircraft repairable and other parts are not depreciated since they are held as replacements and not placed in service.

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; unreimbursed grant expenditures; and unearned revenue from the sale of real property. The Department changed its method for estimating the value of domestic accounts payable beginning in FY 2003. In addition to payables recorded through the Department's normal business activities, domestic accounts payable also includes an estimate of unbilled payables existing at year end for which payment will be made in the subsequent period based on an average of actual disbursements over a five-year period. Before this change, the accrual for unbilled domestic accounts payable was based on actual post-year end disbursements. Beginning in FY 2005, the Department revised its method of estimating unbilled overseas accounts payable at year end, based on analysis of past payment trends applied towards current expenses.

Annual, Sick and Other Leave

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

Employee Benefit Plans

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

Employees covered under CSRS contribute 7% of their salary; the Department contributes 7%. Employees covered under CSRS also contribute 1.45% of their salary to Medicare insurance; the Department makes a matching contribution. On January 1, 1987, FERS went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, were allowed to join FERS or remain in CSRS. Employees participating in FERS contribute 0.80% of their salary, with the Department making contributions of 11.20%. FERS employees also contribute 6.20% to Social Security and 1.45% to Medicare insurance. The Department makes matching contributions to both. A primary feature of FERS is that it offers a Thrift Savings Plan (TSP) into which the Department automatically contributes 1% of pay and matches employee contributions up to an additional 4%.

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

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

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

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

Other Post Employment Benefits: The Department does not report CSRS, FERS, FEHBP or FEGLIP assets, accumulated plan benefits, or unfunded liabilities applicable to its employees; OPM reports this information. As required by SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, the Department reports the full cost of employee benefits for the programs that OPM administers. The Department recognizes an expense and imputed financing source for the annualized unfunded portion of CSRS, post-retirement health benefits, and life insurance for employees covered by these programs. The Department recognized $119.2 and $90.5 million in 2005 and 2004, 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 2005 and 2004 was computed using discount rates of 4.5% for year one and 5.0% for all years thereafter. In 2005 and 2004, the Department's liability changed by ($3.1) million and $(1.6) million, respectively. The total actuarial liability for which the Department is responsible totaled $60.2 million and $60.0 million as of September 30, 2005 and September 30, 2004, respectively.

Valuation of FSN Separation Liability

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

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

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

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

Under existing law, an actuary from the Treasury determines the Pension Actuarial Liability. For FY 2004 and FY 2005, in order to meet its statutory requirement, Treasury contracted with independent actuaries to prepare the valuations. The Pension Actuarial Liability is calculated by applying actuarial assumptions to adjust the projected plan benefits to reflect the discounted time value of money and the probability of payment (by means of decrements such as death, disability, withdrawal or retirement) between the valuation date and the expected date of payment.

The economic assumptions used for valuing the Plan are the same as the economic assumptions adopted by the Civil Service Board of Actuaries for valuing CSRS and FERS. The Plan uses the aggregate entry age normal actuarial cost method, whereby the present value of projected benefits for each employee is allocated on a level basis (such as a constant percentage of salary) over the employee's service between entry age and assumed exit age. The portion of the present value allocated to each year is referred to as the normal cost.

The calculation of normal cost considers both economic and demographic assumptions. Based on the new economic assumptions, the plan actuary revised the normal cost percentages. The table below presents the normal costs for FY 2005 and FY 2004.

	FY 2005	FY 2004
Normal Cost:		
FSRDS	28.86%	28.59%
FSPS	24.24%	21.57%

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

Net Position

The Department's net position contains the following components:

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

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

Foreign Currency

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

2 REPORTING IMPROVEMENTS

As prescribed by OMB Circular A-136, *Financial Reporting Requirements*, the Department implements financial statement reporting requirements and new Statement of Federal Financial Accounting Standards (SFFAS) when they become effective. No new SFFASs were implemented during FY 2005 and FY 2004.

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 foreign donations of monetary assistance received in response to Hurricane Katrina relief efforts. Total non-entity assets at September 30, 2005 and 2004 were $130.1 million and $13.2 million, respectively. These items are included in amounts reported as Cash and Other Monetary Assets (See Note 7, " Cash and Other Monetary Assets " for further information).

4 FUND BALANCES WITH TREASURY

Fund Balances with Treasury at September 30, 2005 and 2004, are summarized below (Dollars in Thousands).

Fund Balances	2005	Restated 2004
Appropriated Funds	$ 13,516,620	$ 11,541,528
Revolving Funds	303,818	123,697
Trust Funds	102,317	109,064
Special Funds	12,844	11,726
Deposit & Receipt Accounts	87,943	114,554
Total	$ 14,023,542	$ 11,900,569

Status of Fund Balance	2005	Restated 2004
Unobligated Balances		
Available	$ 3,860,903	$ 3,284,411
Unavailable	410,203	188,922
Obligated Balances not yet Disbursed	$ 9,664,493	8,312,682
Total Unobligated and Obligated	$ 13,935,599	$ 11,786,015
Deposit & Receipt Accounts	87,943	114,554
Total	$ 14,023,542	$ 11,900,569

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 7, " 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 FY 2006 through 2019, and interest rates range from 3.50% to 8.125%.

Israeli-Arab Scholarship, Eisenhower Exchange Fellowship Program, and Middle Eastern-Western Dialogue Trust Funds

The Israeli-Arab Scholarship, Eisenhower Exchange Fellowship Program, and Middle Eastern-Western Dialogue 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 FY 2006 to 2014; interest rates range from 2.25% to 7.00%.

Gift Funds

The Gift Funds invest in U.S. Government non-marketable, market-based securities, which are issued at either a premium or a discount, and are redeemable for par at maturity. The discounts and premiums on these investments are amortized over the life of the Treasury bill using the straight-line method. These securities mature in FY 2006; interest rates range from 1.54% to 1.57%.

Summary of Investments

Investments at September 30, 2005 and 2004, are summarized below (Dollars in Thousands). All investments are classified as Intragovernmental Securities.

At September 30, 2005:	Par	Amortization Method	Unamortized (Discount)	Investments (Net)	Market Value
Non-Marketable, Par Value:					
FSRDF Certificates of Indebtedness	$ 5,095,483	N/A	$ —	$ 5,095,483	$ 5,095,483
FSRDF Special Bonds	8,264,003	N/A	—	8,264,003	8,264,003
Subtotal	$ 13,359,486		$ —	$ 13,359,486	$ 13,359,486
Non-Marketable, Market Based:					
Israeli-Arab Scholarship, Notes	4,974	Interest	21	4,995	5,034
Eisenhower Exchange Fellowship, Notes	7,516	Interest	11	7,527	7,650
Middle Eastern–Western Dialogue, Note	12,367	Interest	729	13,096	12,902
Gift Funds, Bills	4,010	Straight-line	(24)	3,986	4,020
Subtotal	$ 28,867		$ 737	$ 29,604	$ 29,606
Total Investments	$ 13,388,353		$ 737	$ 13,389,090	$ 13,389,092

At September 30, 2004:	Par	Amortization Method	Unamortized (Discount)	Investments (Net)	Market Value
Non-Marketable, Par Value:					
FSRDF Certificates of Indebtedness	$ 3,812,351	N/A	$ —	$ 3,812,351	$ 3,812,351
FSRDF Special Bonds	9,015,277	N/A	—	9,015,277	9,015,277
Subtotal	$ 12,827,628		$ —	$ 12,827,628	$ 12,827,628
Non-Marketable, Market Based:					
Israeli-Arab Scholarship, Notes	4,277	Interest	42	4,319	4,409
Eisenhower Exchange Fellowship, Notes	7,534	Interest	(51)	7,483	9,112
Middle Eastern–Western Dialogue, Note	5,771	Interest	859	6,630	6,624
Subtotal	$ 17,582		$ 850	$ 18,432	$ 20,145
Total Investments	$ 12,845,210		$ 850	$ 12,846,060	$ 12,847,773

6 ACCOUNTS AND LOANS RECEIVABLE, NET

The Department's Accounts Receivable and Loans Receivable at September 30, 2005 and 2004, are summarized here (Dollars in Thousands). All are entity receivables.

	2005			Restated 2004		
	Entity Receivables	Allowance for Uncollectible Receivables or Subsidy Allowance	Net Receivables	Entity Receivables	Allowance for Uncollectible Receivables or Subsidy Allowance	Net Receivables
Intragovernmental Accounts Receivable	$ 622,575	$ (28,338)	$ 594,237	$ 486,815	$ (22,515)	$ 464,300
Non-Federal Accounts and Loans Receivable	79,154	(8,797)	70,357	86,010	(9,622)	76,388
Total Receivables	$ 701,729	$ (37,135)	$ 664,594	$ 572,825	$ (32,137)	$ 540,688

Included in Non-Federal Accounts and Loans Receivable above, net of allowance for uncollectible loans or subsidy allowance, are approximately $417 thousand and $827 thousand, in 2005 and 2004, respectively, of Repatriation Loans made under a program administered by the Department that enables destitute American citizens overseas to return to the United States. Repatriation direct loans made prior to 1992 are reported net of an allowance for uncollectible loans based upon historical experience. The Federal Credit Reform Act of 1990 (the Act), as amended, governs Repatriation loan obligations made after 1991, and the resulting direct loans. The Act requires that the present value of all costs (i.e., interest rate differentials, estimated delinquencies and defaults) associated with a loan be recognized and funded completely in the year the loan is disbursed. This value is termed the "subsidy cost" for the year, and is expressed as a percentage of the total face amount of loans disbursed that year. Funding for subsidy costs for loans made after 1991 establishes the subsidy allowance against which future collections and future loan write-offs are netted. Per the provisions of the Act, we borrow from Treasury the difference between the face value of loans disbursed and their calculated subsidy costs. Additionally, we budget and receive funding for administrative costs separately.

7 CASH AND OTHER MONETARY ASSETS

The Cash and Other Monetary Assets at September 30, 2005 and 2004, are summarized below (Dollars in Thousands). There are no restrictions on entity cash. Non-Entity cash is restricted as discussed below.

	2005			2004		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Hurricane Katrina Relief Efforts	$ —	$ 116,418	$ 116,418	$ —	$ —	$ —
Chancery Development						
Trust Account:						
Cash	—	—	—	—	—	—
Treasury Bills, at par	—	13,826	13,826	—	13,278	13,278
Unamortized Discount	—	(163)	(163)	—	(70)	(70)
Cash-Imprest and Other Funds	29,121	—	29,121	18,395	—	18,395
Total	$ 29,121	$ 130,081	$ 159,202	$ 18,395	$ 13,208	$ 31,603

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 six-month 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 and Deposit Accounts.

Hurricane Katrina made landfall near New Orleans, Louisiana, on August 29, 2005. In response to the ensuing widespread devastation in the Gulf Coast region, the United States received a generous outpouring of assistance from foreign governments and other foreign entities. Under the International Coordination Support Annex of the National Response Plan, the Department, in collaboration with the U.S. Agency for International Development (USAID), "acts as the intermediary for foreign offers of assistance to the U.S. Government…" As called for in the Plan, the Department and USAID, "work with other U.S. Government departments and agencies to respond appropriately to such requests" and to "expedite delivery of assistance that is accepted." The Department facilitated the consideration of offers of foreign assistance as well as the collection of donations of monetary assistance, which are being directed to the Department's custodial Treasury deposit account pending transfer to entities assisting in the recovery efforts. Pledged monetary donations as of September 30, 2005 are not reflected in the Department's financial statements due to the uncertainty of collection. The Department did not receive any in-kind contributions relating to Hurricane Katrina. A corresponding liability for the amount of monetary assistance collected by the Department as of September 30, 2005 is reflected as Funds Held in Trust and Deposit Accounts.

8 PROPERTY AND EQUIPMENT, NET

Property and equipment balances at September 30, 2005 and 2004, are shown in the following table (Dollars in Thousands):

	2005			2004		
Major Classes	**Cost**	**Accumulated Depreciation**	**Net Value**	**Cost**	**Accumulated Depreciation**	**Net Value**
Real Property:						
Overseas —						
Land and Land Improvements	$ 1,982,304	$ (272)	$ 1,982,032	$ 1,955,595	$ (224)	$ 1,955,371
Buildings and Structures	4,362,838	(2,642,525)	1,720,313	3,889,344	(2,503,792)	1,385,552
Construction-in-Progress	2,165,515	—	2,165,515	1,792,133	—	1,792,133
Assets Under Capital Lease	55,707	(27,257)	28,450	62,074	(28,332)	33,742
Leasehold Improvements	74,985	(27,068)	47,917	61,372	(22,996)	38,376
Domestic —						
Structures, Facilities and Leaseholds	583,944	(218,316)	365,628	564,809	(203,793)	361,016
Construction-in-Progress	21,006	—	21,006	37,703	—	37,703
Land and Land Improvements	80,733	(4,774)	75,959	80,681	(4,461)	76,220
Subtotal — Real Property	$ 9,327,032	$ (2,920,212)	$ 6,406,820	$ 8,443,711	$ (2,763,598)	$ 5,680,113
Personal Property:						
Vehicles	$ 317,652	$ (169,120)	$ 148,532	$ 255,911	$ (155,015)	$ 100,896
Communication Equipment	59,981	(38,289)	21,692	53,137	(16,432)	36,705
ADP Equipment	56,177	(45,319)	10,858	23,022	(19,379)	3,643
Reproduction Equipment	12,933	(10,434)	2,499	13,262	(10,987)	2,275
Security	87,138	(44,178)	42,960	85,104	(41,331)	43,773
Software	194,666	(86,243)	108,423	114,299	(43,719)	70,580
Software-in-Development	99,539	—	99,539	108,928	—	108,928
Other Equipment	754,003	(350,361)	403,642	388,483	(111,480)	277,003
Subtotal — Personal Property	$ 1,582,089	$ (743,944)	$ 838,145	$ 1,042,146	$ (398,343)	$ 643,803
Total	$ 10,909,121	$ (3,664,156)	$ 7,244,965	$ 9,485,857	$ (3,161,941)	$ 6,323,916

Real and personal property holdings increased from $6.3 billion in FY 2004 to $7.2 billion in FY 2005. Overseas real property land and buildings is the single largest component of property owned by the Department of State. The overseas real property net value increased from $5.2 billion in FY 2004 to $5.9 billion in FY 2005. This increase is attributed to acquisitions, initiation of new construction projects, and deliveries of newly completed buildings in overseas locations. Security upgrades and capitalized leasehold improvements overseas also contributed to the increase.

Personal property consists of several asset categories with vehicles and other equipment being the largest. Most vehicles require armoring and for some locations large utility vehicles are used instead of conventional sedans. With the increased presence in Iraq and Afghanistan, the costs for the vehicles, armoring and shipping resulted in increases in this asset segment in FY 2005. Other property consists of a variety of equipment items including aircraft and support equipment for International Crime and Drug programs.

9 OTHER ASSETS

The Department's other assets at September 30, 2005 and 2004, are summarized below (Dollars in Thousands).

	2005	2004
Salary Advances to Employees	$ 8,140	$ 8,321
Travel Advances to Employees	37,472	62,311
Other Advances and Prepayments	14,262	13,995
Inventory Held for Current Sale	6,358	5,821
Total Other Assets	$ 66,232	$ 90,448

10 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, 2005 and 2004, are summarized below (Dollars in Thousands).

	2005	Restated 2004
Intragovernmental Liabilities –		
Accounts Payable	$ —	$ —
Other Liabilities	16,813	18,565
Total Intragovernmental Liabilities	$ 16,813	$ 18,565
Foreign Service Retirement Actuarial Liability	(72,528)	345,831
Liability to International Organizations	1,178,130	897,381
Capital Lease Liability	39,497	45,627
Funds Held in Trust and Deposit Accounts	130,081	13,208
Federal Employees' Compensation Act Benefits	60,288	59,984
Accrued Annual Leave	224,401	211,860
Environmental Liabilities	392,300	206,000
Total Liabilities not Covered by Budgetary Resources	$ 1,968,982	$ 1,798,456
Total Liabilities Covered by Bugetary Resources	$ 15,111,016	$ 14,533,739
Total Liabilities	$ 17,079,998	$ 16,332,195

Other Liabilities on the Balance Sheet at September 30, 2005 and 2004 were $329.8 million and $286.5 million, respectively, and consist primarily of accrued employee benefits. The Environmental Liabilities on the Balance Sheet at September 30, 2005 and 2004 were $392.3 million and $206.0 million, respectively, and represent the estimated cost of upgrades, constructions, and projected operation and maintenance costs of wastewater treatment plants owned and operated by IBWC.

11 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, 2005 and 2004 (Dollars in Millions).

For the Year Ended September 30,	2005	2004
Pension Actuarial Liability, Beginning of Year	$ 13,317.9	$ 13,093.8
Add Pension Expense:		
Normal Cost	237.6	220.7
Interest on Pension Liability	818.7	804.8
Prior Service Costs	—	—
Actuarial Losses/(Gains)	(267.8)	(147.9)
Total Pension Expense	788.5	877.6
Less Payments to Beneficiaries (annuities and refunds)	(677.1)	(653.5)
Pension Actuarial Liability, End of Year	13,429.3	13,317.9
Less: Net Assets Available for Benefits	(13,501.8)	(12,972.1)
Actuarial Unfunded Pension Liability for Projected Plan Benefits	$ (72.5)	$ 345.8
Actuarial Assumptions:		
Rate of Return on Investments	6.25%	6.25%
Rate of Inflation	3.25%	3.25%
Salary Increase	4.00%	4.00%

Net Assets Available for Benefits at September 30, 2005 and 2004, consist of the following (Dollars in Thousands):

	2005	2004
Fund Balances with Treasury	$ 78	$ 2
Receivables	198,701	198,512
Investments in USG Securities	13,359,486	12,827,628
Total Assets	13,558,265	13,026,142
Less: FSRDF Liabilities	(56,437)	(54,074)
Net Assets Available for Benefits	$ 13,501,828	$ 12,972,068

12 LIABILITY 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 $60.0 million for both 2005 and 2004 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, 2005, a total of $926 million had been appropriated by Congress for payment of the U.S. arrearage.

The financial statements also report an unfunded liability of $1.1 billion and $837.4 million at September 30, 2005 and 2004, respectively, for the current year 2005 and 2004 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 2005 calendar year assessment is paid from the Department's 2006 appropriation). The Liability to International Organizations at September 30, 2005 and 2004, is summarized below (Dollars in Thousands).

	2005	2004
Accumulated Arrears	$ 60,029	$ 60,029
Unfunded Annual Assessments	1,118,101	837,352
Liability to International Organizations	$ 1,178,130	$ 897,381

13 LEASES

The Department is committed to over 10,000 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 $55.3 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).

	2005	2004
Net Assets Under Capital Leases:		
Land and Buildings	$ 55,707	$ 62,074
Accumulated Depreciation	(27,257)	(28,332)
Net Assets under Capital Leases	$ 28,450	$ 33,742

Future Minimum Lease Payments:

	2005		2004	
	Fiscal Year	**Lease Payments**	**Fiscal Year**	**Lease Payments**
	2006	$ 2,616	2005	$ 3,271
	2007	2,670	2006	2,923
	2008	2,719	2007	2,977
	2009	3,099	2008	3,026
	2010	2,772	2009	3,406
	2011 and thereafter	99,377	2010 and thereafter	123,945
Total Minimum Lease Payments		$ 113,253		$ 139,548
Less: Amount Representing Interest		(73,756)		(93,921)
Obligations under Capital Leases		$ 39,497		$ 45,627

During FY 2004, the Department performed a periodic review of its lease portfolio to ensure consistency with GAAP for federal entities. As a result of this process, certain leases were determined to be operating leases. This resulted in a decrease in *Net Assets under Capital Leases* and *Obligations under Capital Leases* of $34 million and $39 million, respectively, as of September 30, 2004, which did not materially affect the Department's principal financial statements.

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, 2005 for each of the next 5 years and in aggregate are as follows (Dollars in Thousands).

Year Ended September 30	Operating Lease Amounts
2006	$ 375,729
2007	264,784
2008	178,993
2009	110,211
2010	71,411
2011 and thereafter	133,047
Total Minimum Future Lease Payments	$ 1,134,175

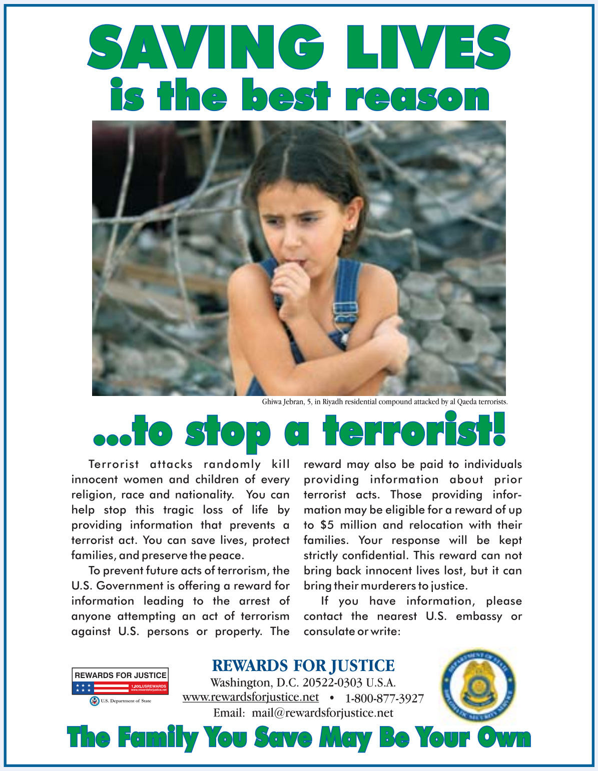
14 COMMITMENTS AND CONTINGENCIES

Commitments

In addition to the future lease commitments discussed in Note 13, "Leases," the Department is committed under obligations for goods and services which have been ordered but not yet received (undelivered orders — see Note 15, "Unexpended Appropriations" and Note 17, "Statement of Budgetary Resources") at fiscal year end. In FY 2005 appropriations, the Department of State received $6 million to subsidize the cost of a direct loan of up to $1.2 billion to the United Nations to cover the cost of renovating its headquarters in New York City. As of the date of this Report, the loan agreement had not been ratified.

Contingencies

Rewards for Justice Program. The Department operates rewards programs for information critical to combating international terrorism, narcotics trafficking, and war crimes. The Terrorism Information Rewards Program offers rewards up to $25 million for information leading to: the arrest or conviction in any country of persons committing (or conspiring or attempting to commit, or aiding or abetting the commission of) acts of international terrorism against United States persons or property;



the prevention, frustration or favorable resolution of such acts; the identification or location of key leaders of a terrorist organization; or the disruption of financial mechanisms of a foreign terrorist organization. The Narcotics Information Rewards Program offers rewards up to $5 million for information leading to: the arrest or conviction in any country of persons committing (or conspiring or attempting to commit, or aiding and abetting the commission of) major foreign violations of U.S. narcotics laws or the killing or kidnapping of U.S. narcotics law enforcement officers or their family members; or the prevention, frustration or favorable resolution of such criminal acts. The War Crimes Information Rewards Program currently offers rewards up to $5 million for information leading to the arrest, transfer, or conviction of persons indicted by the International Criminal Tribunal for the Former Yugoslavia or the International Criminal Tribunal for Rwanda for serious violations of international humanitarian law, or their arrest or conviction in any country for such violations. Authority exists to create a similar war crimes program for information related to indictees of the Special Court of Sierra Leone.

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

Claims Filed in Response to Embassy Bombings: Nearly 4,000 Kenyan nationals filed administrative tort claims against the Department alleging that Department negligence was responsible for the damages they suffered when terrorists bombed the American Embassy in Nairobi, Kenya on August 7, 1998. These claims are for sums ranging from $150 to $10,000,000 and total approximately $1.5 billion. Two lawsuits, in the amounts of $1 billion and $500 million, arising from these tort claims were dismissed this year by the Federal District Court in Washington, D.C. Both of the cases have been appealed to the D.C. Circuit Court of Appeals. After that court affirmed the District Court's dismissal of the $1 billion action in July 2003, the plaintiffs in the other, almost identical, suit abandoned their appeal. The plaintiffs in the first case have petitioned the Supreme Court for certiorari, which was denied. 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.

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 six claims submitted to arbitration and three claims not yet submitted under Chapter 11 of NAFTA. These claims total approximately $2.8 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 2005 and 2004 had a material effect on the financial position or results of operations of the Department.

15 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.

16 STATEMENT OF NET COST

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

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

The presentation of program results by strategic objectives and strategic goals is based on the Department's current Strategic Plan established pursuant to the Government Performance and Results Act of 1993.

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

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

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

DEPARTMENT OF STATE
CONSOLIDATING SCHEDULE OF NET COST

For the year ended September 30, 2005

(Dollars in Thousands)

STRATEGIC GOAL	Under Secretary for Arms Control, Int'l Security	Economic, Business and Agriculture	Global Affairs	Political Affairs	Public Diplomacy and Public Affairs	Management - Consular Affairs	Eliminations	Total
Regional Stability								
Total Cost	$ 156,421	$ 11,370	$ 34,694	$ 1,216,640	$ —	$ (20)	$ (49,683)	$ 1,369,422
Earned Revenue	(22,473)	(1,264)	(3,752)	(100,064)	—	(28)	49,683	(77,898)
Net Program Costs	133,948	10,106	30,942	1,116,576	—	(48)	—	1,291,524
Counterterrorism								
Total Cost	124,385	9,041	27,589	967,464	—	(16)	(39,508)	1,088,955
Earned Revenue	(17,871)	(1,005)	(2,983)	(79,570)	—	(22)	39,508	(61,943)
Net Program Costs	106,514	8,036	24,606	887,894	—	(38)	—	1,027,012
Homeland Security								
Total Cost	76,086	5,531	16,876	591,793	—	(10)	(24,167)	666,109
Earned Revenue	(10,931)	(615)	(1,825)	(48,673)	—	(14)	24,167	(37,891)
Net Program Costs	65,155	4,916	15,051	543,120	—	(24)	—	628,218
Weapons of Mass Destruction								
Total Cost	71,101	5,168	15,770	553,018	—	(9)	(22,583)	622,465
Earned Revenue	(10,215)	(575)	(1,705)	(45,484)	—	(13)	22,583	(35,409)
Net Program Costs	60,886	4,593	14,065	507,534	—	(22)	—	587,056
International Crime and Drugs								
Total Cost	—	—	1,858,968	47,620	2,046	—	(8,936)	1,899,698
Earned Revenue	—	—	(421,489)	(6,293)	(42)	—	8,936	(418,888)
Net Program Costs	—	—	1,437,479	41,327	2,004	—	—	1,480,810
American Citizens								
Total Cost	—	—	65	956,422	304,857	1,232,783	(163,686)	2,330,441
Earned Revenue	—	—	(2,098)	(173,455)	(42,871)	(1,935,652)	163,686	(1,990,390)
Net Program Costs	—	—	(2,033)	782,967	261,986	(702,869)	—	340,051
Democracy and Human Rights								
Total Cost	76,903	5,590	17,057	598,149	—	(10)	(24,426)	673,263
Earned Revenue	(11,049)	(622)	(1,844)	(49,195)	—	(14)	24,426	(38,298)
Net Program Costs	65,854	4,968	15,213	548,954	—	(24)	—	634,965
Economic Prosperity and Security								
Total Cost	125,693	9,136	27,879	977,634	—	(16)	(39,923)	1,100,403
Earned Revenue	(18,059)	(1,016)	(3,015)	(80,406)	—	(23)	39,923	(62,596)
Net Program Costs	107,634	8,120	24,864	897,228	—	(39)	—	1,037,807
Social and Environment Issues								
Total Cost	34,651	2,519	7,686	269,517	—	(4)	(11,006)	303,363
Earned Revenue	(4,978)	(280)	(831)	(22,167)	—	(6)	11,006	(17,256)
Net Program Costs	29,673	2,239	6,855	247,350	—	(10)	—	286,107
Humanitarian Response								
Total Cost	—	—	1,032,991	2,147	87	—	(340)	1,034,885
Earned Revenue	—	—	(400)	10	(1)	—	340	(51)
Net Program Costs	—	—	1,032,591	2,157	86	—	—	1,034,834
Public Diplomacy and Public Affairs								
Total Cost	152,008	11,049	33,716	1,182,315	455,680	(19)	(48,282)	1,786,467
Earned Revenue	(21,839)	(1,229)	(3,646)	(97,241)	(46,355)	(27)	48,282	(122,055)
Net Program Costs	130,169	9,820	30,070	1,085,074	409,325	(46)	—	1,664,412
Executive Direction and Other Costs Not Assigned								
Total Cost	3,335	4,099	80,557	4,265,518	459,022	2,480	(1,575,889)	3,239,122
Earned Revenue	(1,899)	(2,358)	(35,110)	(2,508,028)	(266,255)	(1,427)	1,545,936	(1,269,141)
Net Program Costs	1,436	1,741	45,447	1,757,490	192,767	1,053	(29,953)	1,969,981
Total Cost	820,583	63,503	3,153,848	11,628,237	1,221,692	1,235,159	(2,008,429)	16,114,593
Total Revenue	(119,314)	(8,964)	(478,698)	(3,210,566)	(355,524)	(1,937,226)	1,978,476	(4,131,816)
Total Net Cost	701,269	$ 54,539	$ 2,675,150	$ 8,417,671	$ 866,168	$ (702,067)	$ (29,953)	$11,982,777

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, 2005 and 2004, these consist of costs and earned revenue summarized below (Dollars in Thousands).

	2005			2004 Restated		
Program	Total Prior to Eliminations	Intra-Departmental Eliminations	Total	Total Prior to Eliminations	Intra-Departmental Eliminations	Total
Costs:						
Executive Direction	$ 2,577,586	$ 327,607	$ 2,249,979	$ 2,307,455	$ 284,605	$ 2,022,850
FSRDF	788,524	385,508	403,016	877,574	369,338	508,236
ICASS	1,174,812	859,989	314,823	1,075,703	862,758	212,945
International Commissions	274,089	2,785	271,304	298,178	1,366	296,812
Total Costs	$ 4,815,011	$ 1,575,889	$ 3,239,122	$ 4,558,910	$ 1,518,067	$ 3,040,843
Earned Revenue:						
Executive Direction	$ 436,405	$ 327,607	$ 108,798	$ 492,876	$ 284,605	$ 208,271
FSRDF	1,206,883	355,555	851,328	1,185,546	337,227	848,319
ICASS	1,158,916	859,989	298,927	1,095,169	862,758	232,411
International Commissions	12,873	2,785	10,088	9,686	1,366	8,320
Total Earned Revenue	$ 2,815,077	$ 1,545,936	$ 1,269,141	$ 2,783,277	$ 1,485,956	$ 1,297,321
Total Net Cost for Executive Direction and Other Costs Not Assigned	$ 1,999,934	$ 29,953	$ 1,969,981	$ 1,775,633	$ 32,111	$ 1,743,522

Program Costs

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

Indirect Costs: Indirect costs consist primarily of Management and Organizational Excellence charges for central support functions performed in 2005 and 2004 under the Under Secretary for Management by the following organizations (Dollars in Thousands):

Bureau (or equivalent)	2005	2004 Restated
Bureau of Diplomatic Security	$ 1,577,271	$ 965,145
Office of Overseas Buildings Operations	1,066,393	1,082,432
Bureau of Administration	608,459	654,033
Bureau of Information Resource Management	283,294	306,249
Bureau of Personnel	337,069	311,659
Bureau of Resource Management	287,581	761,382
Foreign Service Institute	127,178	121,908
Medical Services and Other	210,719	185,195
Total Central Support Costs	$ 4,497,964	$ 4,388,003

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 2005 and 2004 was as follows (Dollars in Thousands):

Program Receiving Allocation	2005	Restated 2004
Regional Stability	$ 384,704	$ 385,357
Counterterrorism	305,914	306,434
Homeland Security	187,126	187,444
Weapons of Mass Destruction	174,865	175,162
International Crime and Drugs	57,030	65,899
American Citizens	1,026,953	1,023,009
Democracy and Human Rights	189,136	189,457
Economic Prosperity and Security	309,130	309,655
Social and Environmental Issues	85,222	85,366
Humanitarian Response	20	20
Public Diplomacy and Public Affairs	373,850	374,485
Executive Direction and Other Costs Not Assigned	1,404,014	1,285,715
Total	$ 4,497,964	$ 4,388,003

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

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

Under Secretary	2005	Restated 2004
Political Affairs	$ 4,905,502	4,569,079
Public Diplomacy	666,619	692,126
Management (Consular Affairs)	711,964	586,646
Arms Control, International Security Affairs	445,251	328,789
Global Affairs	216,155	150,662
Economic, Business and Agriculture Affairs	34,596	34,451
Total	$ 6,980,087	6,361,753

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 years ended September 30, 2005 and 2004 (Dollars in Thousands):

Inter-Entity Cost	**2005**	**Restated 2004**
Other Post-Employment Benefits:		
Civil Service Retirement Program	$ 25,272	$ 25,603
Federal Employees Health Benefits Program	93,648	64,621
Federal Employees Group Life Insurance Program	269	246
Litigation funded by Treasury Judgment Fund	283	847
Subtotal – Imputed Financing Source	$ 119,472	$ 91,317
Future Workers' Compensation Benefits	10,198	6,245
Total Inter-Entity Costs	$ 129,670	$ 97,562

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, 2005 and 2004, consist of the following (Dollars in Thousands):

	2005			Restated 2004		
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	$ 826,058	$ —	$ 826,058	$ 673,719	$ —	$ 673,719
Machine Readable Visa	636,478	—	636,478	623,679	—	623,679
Expedited Passport	154,745	—	154,745	108,563	—	108,563
Passport and Visa Surcharges	92,345	—	92,345	—	—	—
Fingerprint Processing, Diversity Lottery, and Affadavit of Support	59,197	—	59,197	21,631	—	21,631
Subtotal – Consular Fees	$ 1,768,823	$ —	$ 1,768,823	$ 1,427,592	$ —	$ 1,427,592
FSRDF	$ 1,206,883	$ 345,581	$ 861,302	$ 1,185,546	$ 337,227	$ 848,319
ICASS	1,162,774	859,989	302,785	1,095,169	862,758	232,411
Other Reimbursable Agreements	1,647,508	591,287	1,056,221	994,741	493,150	501,591
Working Capital Fund	297,410	171,645	125,765	307,290	138,973	168,317
Other	26,894	9,974	16,920	60,773	—	60,773
Total	$ 6,110,292	$ 1,978,476	$ 4,131,816	$ 5,071,111	$ 1,832,108	$ 3,239,003

Pricing Policies

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

The FSRDF finances the operations of the Foreign Service Retirement and Disability System (FSRDS) and the Foreign Service Pension System (FSPS). The FSRDF receives revenue from employee/employer contributions, a U.S. Government contribution, and interest on investments. By law, FSRDS participants contribute 7.25% of their base salary, and each employing agency contributes 7.25%; FSPS participants contribute 1.35% of their base salary and each employing agency contributes 20.22%. Employing agencies report employee/employer contributions biweekly. Total employee/employer contributions for 2005 and 2004 were $214.9 million and $203.5 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 2005 and 2004 were $225.1 million and $218.0 million, respectively. FSRDF cash resources are invested in special non-marketable securities issued by the Treasury. Total interest earned on these investments in 2005 and 2004 was $766.8 million and $763.9 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 2005* (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 2005* presents gross costs and earned revenue by BFC. Following is the Department's gross cost and earned revenue for both federal and non-federal vendors by BFC for the years ended September 30, 2005 and 2004 (Dollars in Thousands and reported net of intra-departmental eliminations):

	2005			Restated 2004		
Budget Functional Classification	**Gross Cost**	**Earned Revenue**	**Net Cost**	**Gross Cost**	**Earned Revenue**	**Net Cost**
International Affairs	$ 15,053,892	$ 3,096,147	$ 11,957,745	$ 12,902,359	$ 2,363,237	$ 10,539,122
Income Security	800,603	1,029,206	(228,603)	557,961	871,031	(313,070)
Natural Resources	260,098	6,463	253,635	281,788	4,735	277,053
Total	$ 16,114,593	$ 4,131,816	$ 11,982,777	$ 13,742,108	$ 3,239,003	$ 10,503,105

17 STATEMENT OF BUDGETARY RESOURCES

The Statement of Budgetary Resources reports information on how budgetary resources were made available and their status as of and for the years ended September 30, 2005 and 2004. 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 2005 and 2004, the Department received approximately $25.0 billion and $21.3 billion in budgetary resources, respectively, primarily consisting of the following:

Source of Budgetary Resources	2005	2004
Budget Authority:		
Direct or related appropriations	$ 15.6 billion	$ 13.6 billion
Authority financed from Trust Funds	1.2 billion	1.2 billion
Spending authority from providing goods and services	4.3 billion	3.5 billion
Unobligated Balances – Beginning of Year	3.5 billion	2.6 billion
Other	0.4 billion	0.4 billion
Total Budgetary Resources	$ 25.0 billion	$ 21.3 billion

The Department received permanent indefinite appropriations of $41.9 million and $39.2 million for 2005 and 2004, 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. The amount of budgetary resources obligated for undelivered orders for all activities as of September 30, 2005 and 2004 was approximately $8.6 billion and $7.6 billion, respectively. This includes amounts of $320 million for September 30, 2005 and $650 million for September 30, 2004, pertaining to revolving funds, trust funds, and substantial commercial activities.

Information on U.S. Government agencies' budgets is reported in the *Budget of the United States Government, Fiscal Year 2006* – 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*. Amounts shown on the 2005 Statement of Budgetary Resources will differ from "2005 Actual" reported in the *P&F Schedules* for the Department's accounts as follows:

- The Budget Authority and Net Outlays reported on the Statement of Budgetary Resources includes $1,268 and $1,395 million, respectively, the Department received in 2005 to administer programs related to International Security Assistance. Amounts for these programs are not presented under the Department in the *Appendix*, but are reported in the *Appendix* under the section titled International Assistance Programs.

- The Unobligated Balances and Obligated Balance, Net – Beginning of Year reported on the Statement of Budgetary Resources includes a $64 million increase and a $90 million decrease, respectively, pertaining to undelivered orders that will not be reported in the *Appendix*.

- The Unobligated Balances – Beginning of Year and End of Year reported on the Statement of Budgetary Resources includes $222 million and $225 million, respectively, of unavailable unobligated balances (primarily for expired annual accounts) that will not be reported in the *Appendix*. These unavailable unobligated balances in expired accounts (2004 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. The P&F Schedule reports only available unobligated balances (versus unavailable) as budgetary resources available for obligation.

- The Unobligated Balance, Available and Unavailable and Obligated Balance, Net– End of Year reported on the Statement of Budgetary Resources includes a $333 million adjustment (increase and decrease, respectively) pertaining to undelivered orders that will not be reported in the *Appendix*.

- The Department's 2005 Statement of Budgetary Resources reflects Offsetting Receipts consistent with the requirements of OMB Circular A-136. However, the Department also receives "General Funds Receipts" that are not included in the Statement of Budgetary Resources, which is consistent with Circular A-136, even though they are included in the *Appendix* for the Department. General Fund Receipts for 2005 are approximately $822 million primarily for passport and visa services.

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

18 CONSOLIDATED STATEMENT OF FINANCING

Accrual-based measures used in the Statement of Net Cost differ from the obligation-based measures used in the Statement of Budgetary Resources. The Statement of Financing for the years ended September 30, 2005 and 2004, 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 result is Net Cost of Operations as reported on the Statement of Net Cost.

19 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, civil penalties and forfeitures; and other miscellaneous receipts. In 2005 and 2004, the Department collected $15.3 million and $13.0 million, respectively, in custodial revenues that were transferred to the Treasury.

20 DEDICATED COLLECTIONS

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

Foreign Service Retirement and Disability Fund (19X8186)

The Foreign Service Retirement and Disability Fund (FSRDF) was established in 1924 to provide pensions to retired and disabled members of the Foreign Service. The FSRDF's revenues consist of contributions from active participants and their U.S. Government agency employers; appropriations; and interest on investments. Monthly annuity payments are made to eligible retired employees or their survivors. Separated employees without title to an annuity may take a refund of their contributions. P.L. 96-465 limits the amount of administrative expense that can be charged to the fund to $5,000. The total cost for administering FSRDF was $3.6 million in both 2005 and 2004, respectively. Cash is invested in U.S. Treasury securities until it is needed for disbursement.

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

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

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

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

Israeli-Arab Scholarship Program (19X8271)

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

Eisenhower Exchange Fellowship Program Trust Fund (95X8276)

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

Miscellaneous Trust Funds, Information and Exchange Programs (19X8166, 19X8167, 19X8272, and 19X8813)

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. In FY 04, DOS received an appropriation to establish a trust fund for operation of an International Center for Middle Eastern – Western Dialogue in Istanbul, Turkey (19x8813). The center will develop programs of cooperative study, training, and research for students and scholars to exchange views and ideas.

State Secretary of the German Foreign Office Klaus Scharioth, German Minister of the Interior Otto Schily, Ambassador of the United States in Germany Daniel Coats, Director of Overseas Buildings Operations of the U.S. Department of State Charles Williams and the Governing Mayor of Berlin Klaus Wowereit, from left, during the groundbreaking ceremony of the new U.S. Embassy next to the Brandenburg Gate in Berlin. © AP/ Wide World

(Dollars in Thousands)	FSRDF	FSNSLTF	Gift Funds	Israeli-Arab Scholarship	Eisenhower Exchange Fellowship	Misc. Trust Funds
As of September 30, 2005:						
Assets:						
Fund Balances with Treasury	$ 78	$ 89,796	$ 9,930	$ (191)	$ 1	$ 2,704
Investments	13,359,486	—	3,986	4,995	7,527	13,096
Other Assets	198,701	—	16	72	46	190
Total Assets	13,558,265	89,796	13,932	4,876	7,574	15,990
Liabilities:						
Payable to Beneficiaries	45,914	—	—	—	—	—
Actuarial Liability	13,429,300	—	—	—	—	—
Other Liabilities	10,523	—	174	—	—	—
Total Liabilities	13,485,737	—	174	—	—	—
Net Position (Deficit)	72,528	89,796	13,758	4,876	7,574	15,990
Total Liabilities and Net Position	$ 13,558,265	$ 89,796	$ 13,932	$ 4,876	$ 7,574	$ 15,990
For the year ended September 30, 2005:						
Revenues and Financing:						
Exchange Revenue:						
Intragovernmental	$ 1,180,922	$ 9,974	$ —	$ —	$ —	$ —
Governmental	25,961	—	—	—	—	—
Non Exchange Revenue:						
Intragovernmental	—	—	86	164	848	7,247
Governmental	—	—	4,246	—	—	—
Other Financing Sources	—	—	—	—	—	—
Total Revenues and Financing	1,206,883	9,974	4,332	164	848	7,247
Expenses:						
Program Expenses	10	13,113	3,962	218	764	166
Actuarial Expenses	788,514	—	—			
Total Expenses	$ 788,524	$ 13,113	$ 3,962	$ 218	$ 764	$ 166

(Dollars in Thousands)	FSRDF	FSNSLTF	Gift Funds	Israeli-Arab Scholarship	Eisenhower Exchange Fellowship	Misc. Trust Funds
As of September 30, 2004:						
Assets:						
Fund Balances with Treasury	$ 2	$ 92,935	$ 13,385	$ 506	$ 6	$ 2,230
Investments	12,827,628	—	—	4,319	7,483	6,630
Other Assets	198,512	—	21	105	—	51
Total Assets	13,026,142	92,935	13,406	4,930	7,489	8,911
Liabilities:						
Payable to Beneficiaries	44,086	—	—	—	—	—
Actuarial Liability	13,317,900	—	—	—	—	—
Other Liabilities	9,987	—	18	—	—	2
Total Liabilities	13,371,973	—	18	—	—	2
Net Position (Deficit)	(345,831)	92,935	13,388	4,930	7,489	8,909
Total Liabilities and Net Position	$ 13,026,142	$ 92,935	$ 13,406	$ 4,930	$ 7,489	$ 8,911
For the year ended September 30, 2004:						
Revenues and Financing:						
Exchange Revenue:						
Intragovernmental	$ 1,159,673	$ 10,086	$ —	$ —	$ —	$ —
Governmental	25,873	—	—	—	—	—
Non Exchange Revenue:						
Intragovernmental	—	—	39	255	—	6,927
Governmental	—	—	4,302	—	—	—
Other Financing Sources	—	—	—	—	—	—
Total Revenues and Financing	1,185,546	10,086	4,341	255	—	6,927
Expenses:						
Program Expenses	—	7,088	(306)	303	—	589
Actuarial Expenses	877,574	—	—	—	—	—
Total Expenses	$ 877,574	$ 7,088	$ (306)	$ 303	$ —	$ 589

21 RESTATEMENTS

The accompanying FY 2004 financial statements have been restated to correct errors of unrecorded transactions for (1) collections of passport fees, (2) receivables for value added taxes, and (3) overseas disbursements. In FY 2004, the Department transitioned its financial operations from Arlington, Virginia to Charleston, South Carolina. During the transition, Consular Affair (CA) revenues totaling $117 million for passport fees collected at lockboxes throughout the United States were not recorded in the Department's financial systems. Although the funds were deposited with the U.S. Treasury in FY 2004, the transactions were not recorded until FY 2005. These fees are deposited directly to Treasury and are not retained or available for use by the Department. These amounts are treated as earned revenue on the Statement of Net Cost and as a transfer-out of financing sources on the Statement of Changes in Net Position. As a result, revenues and transfers-out were increased in FY 2004 by $117 million.

The FY 2004 financial statements also did not include a receivable of $20 million for value added taxes (VAT) receivable from foreign countries. VAT are sales taxes the U.S. Government is not required to pay, but because it is typically included in the cost of items purchased overseas, the Department must request a refund from the foreign government. The restatement also corrects a $26 million overstatement in accounts payable and Fund Balance with Treasury for overseas disbursements made in FY 2004 that were not recorded in the Department's general ledger.

The net effect of these corrections on the Department's FY 2004 financial statements is as follows:

- Total Assets decreased $6.3 million;
- Total Liabilities decreased $25.9 million;
- Total Net Position increased $19.6 million;
- Total Net Cost decreased $137 million; and
- Net Outlays increased 25.9 million.

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION HERITAGE ASSETS

FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2005 AND 2004

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

Diplomatic Reception Rooms

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

Photo: Richard Cheek

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

Thomas Jefferson State Reception Room.

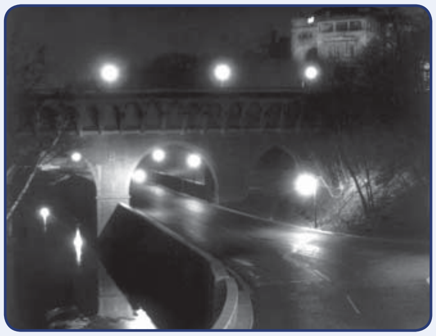
Photo: Richard Cheek

The Benjamin Franklin State Dining Room.

Art Bank

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

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



Rare & Special Book Collection

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

Curatorial Services Program

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

Art in Embassies

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

1. 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

Secretary of State's Register of Culturally Significant Property

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

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 – 09/30/2003	3,412	2,121	962	4,458	1,033	8
Acquisitions	10	48	6	10	—	—
Adjustments	(1)	—	7	—	—	—
Disposals	10	—	—	—	—	—
Number of Items – 09/30/2004	3,411	2,169	975	4,468	1,033	8
Deferred Maintenance – 09/30/2004	N/A	N/A	N/A	N/A	N/A	$19,247,587
Acquisitions	2	46	5	8	—	—
Adjustments	—	(72)	2	—	—	—
Disposals	—	—	3	1	—	—
Number of Items – 09/30/2005	3,413	2,143	979	4,475	1,033	8
Deferred Maintenance – 09/30/2005	N/A	N/A	N/A	N/A	N/A	$4,459,522

REQUIRED SUPPLEMENTARY INFORMATION

DEPARTMENT OF STATE
COMBINING SCHEDULE OF BUDGETARY RESOURCES
For the Year Ended September 30, 2005
(Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Budgetary Authority:						
Appropriations received	$ 9,064,465	$ 2,352,000	$ 64,130	$ 1,173,994	$ 4,092,778	$ 16,747,367
Borrowing Authority	306	—	—	—	—	306
Net transfers	25,174	(50,000)	—	93,361	(62,284)	6,251
Other	—	—	—	—	—	—
Unobligated Balance:						
Beginning of period	2,629,659	544	5,349	430,226	407,555	3,473,333
Net Transfers	223,704	—	—	45,354	19,895	288,953
Anticipated Transfers, PY balance	—	—	—	—	—	—
Spending Authority from Offsetting Collections:						
Earned						
Collected	3,798,704	—	6,926	251,881	41,928	4,099,439
Receivable from Federal sources	82,918	—	(759)	(5,509)	162,607	239,257
Change in unfilled customer orders						
Advances Received Federal sources	—	—	(16)	—	—	(16)
Without advance from Federal sources	—	—	1,565	—	—	1,565
Anticipated for rest of year	—	—	—	—	—	—
Recoveries from Prior Year Obligations:						
Actual	825,767	28,707	3,780	144,437	116,473	1,119,164
Anticipated	—	—	—	—	—	—
Temporarily Not Available Pursuant to Public Law:	(699,796)	—	—	—	(12,553)	(712,349)
Permanently Not Available:	(219,181)	(31,675)	(1,097)	(16,344)	(37,319)	(305,616)
Total Budgetary Resources	15,731,720	2,299,576	79,878	2,117,400	4,729,080	24,957,654

DEPARTMENT OF STATE
COMBINING SCHEDULE OF BUDGETARY RESOURCES *continued*
For the Year Ended September 30, 2005
(Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Obligations Incurred:						
Direct	9,292,245	2,299,183	64,575	1,401,536	3,692,201	16,749,740
Reimbursable	3,470,051	67	6,040	224,056	236,594	3,936,808
Unobligated Balance:						
Apportioned	2,687,625	240	7,774	442,090	712,759	3,850,488
Exempt from apportionment	—	—	—	—	10,415	10,415
Other Available	—	—	—	—	—	—
Unobligated Balance Not Available:	281,799	86	1,489	49,718	77,111	410,203
Total Status of Budgetary Resources	15,731,720	2,299,576	79,878	2,117,400	4,729,080	24,957,654
Obligated Balance, Net,Beginning of Year:	4,347,951	490,967	18,960	952,464	2,742,319	8,552,661
Obligated Balance Transferred, Net	—	—	—	—	—	—
Obligated Balance, Net, End of Year:						
Accounts Receivable	(760,908)	67	—	(3,420)	(170,091)	(934,352)
Unfilled customer orders	—	—	(4,217)	—	—	(4,217)
Undelivered orders	4,809,614	—	23,079	603,901	3,189,865	8,626,459
Accounts payable	748,657	72,516	—	192,572	638,858	1,652,603
Outlays:						
Disbursements	11,400,278	2,688,927	66,126	1,646,075	2,733,402	18,534,808
Collections	(3,794,783)	—	(6,909)	(251,881)	(41,928)	(4,095,501)
Less: Offsetting receipts	(247,475)	—	—	—	(483)	(247,958)
Net Outlays	$ 7,358,020	$ 2,688,927	$ 59,217	$ 1,394,194	$ 2,690,991	$ 14,191,349

Intragovernmental Amounts

Intragovernmental amounts represent transactions between Federal entities included in the *Financial Report of the United States Government – Fiscal Year 2005* (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, 2005 and 2004, are summarized below (Dollars in Thousands).

As of September 30, 2005:

	ASSETS				LIABILITIES	
Trading Partner	**Fund Balance With Treasury**	**Investments**	**Interest Receivable**	**Accounts Receivable, Net**	**Accounts Payable**	**Other Liabilities**
Department of Agriculture				$ 6,508	$ 1	
Department of Commerce				10,144	1	
Department of Defense				227,021	735	
Department of Justice				26,274	—	
Department of Labor				11	7	$ 16,813
Department of the Treasury	$ 14,023,542	$ 13,389,090	$ 189,721	3,372	13	1,488
Agency for International Development				24,672	—	—
Environmental Protection Agency				106	—	63
Office of Personnel Management				51	—	6,796
Other Agencies				296,078	57	1,214
Total	$ 14,023,542	$ 13,389,090	$ 189,721	$ 594,237	$ 814	$ 26,374

As of September 30, 2004:

	ASSETS				LIABILITIES	
Trading Partner	**Fund Balance With Treasury**	**Investments**	**Interest Receivable**	**Accounts Receivable, Net**	**Accounts Payable**	**Other Liabilities**
Department of Agriculture				$ 4,300	$ 71	
Department of Commerce				6,676	326	
Department of Defense				111,970	16,234	
Department of Justice				23,184	7,964	
Department of Labor				26	—	$ 18,565
Department of the Treasury	$ 11,900,569	$ 12,846,060	$ 190,263	6,805	—	13,614
Agency for International Development				22,459	153	—
Environmental Protection Agency				336	—	—
Office of Personnel Management				17	10,377	5,406
Other Agencies				288,527	1,921	6,055
Total	$ 11,900,569	$ 12,846,060	$ 190,263	$ 464,300	$ 37,046	$ 43,640

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, 2005 and 2004, are summarized below (Dollars in Thousands). The gross cost to generate intragovernmental revenue represents costs, for both federal and non-federal vendors, the Department incurred to provide goods and services to other Federal entities. This differs from the intra-governmental expenses presented on the following page. Intragovernmental expenses represent costs the Department incurred for goods and services received from other federal entities.

Intragovernmental Earned Revenues

For the Year Ended September 30,	2005	2004
Trading Partner	**Earned Revenue**	**Earned Revenue**
Executive Office of the President	$ 11,682	$ 6,022
Department of Agriculture	43,945	24,075
Department of Commerce	31,165	28,900
Department of Defense	688,993	211,760
Department of Energy	9,536	10,242
Department of Health and Human Services	17,209	13,352
Department of Justice	65,996	79,536
Department of Transportation	3,201	1,165
Department of the Treasury	774,312	765,711
Agency for International Development	124,537	191,418
Environmental Protection Agency	1,136	436
Social Security Administration	11,838	10,777
Other Agencies	491,992	462,378
Total	$ 2,275,542	$ 1,805,772

For the Year Ended September 30,	2005			2004		
Budget Functional Classification	**Gross Cost to Generate Revenue**	**Earned Revenue**	**Net Cost**	**Gross Cost to Generate Revenue**	**Earned Revenue**	**Net Cost**
International Affairs	$ 1,483,298	$ 1,436,945	$ 46,353	$ 958,080	$ 970,435	$ (12,355)
Income Security	788,332	835,281	(46,949)	872,896	832,533	40,363
Natural Resources	27,217	3,316	23,901	6,387	2,804	3,583
Total	$ 2,298,847	$ 2,275,542	$ 23,305	$ 1,837,363	$ 1,805,772	$ 31,591

The amounts of intragovernmental non-exchange revenues classified by trading partner for the years ended September 30, 2005 and 2004 are summarized below (Dollars in Thousands).

For the Year Ended September 30,	2005	2004
Trading Partner	**Non-Exchange Revenue**	**Non-Exchange Revenue**
Department of the Treasury	$ 1,441	$ 294

The amounts of intragovernmental expenses classified by trading partner and by budget functional classification for the years ended September 30, 2005 and 2004, are summarized below (Dollars in Thousands).

For the Year Ended September 30,	2005	2004
Trading Partner	**Expenses**	**Expenses**
Department of Agriculture	$ 152	$ 1,829
Department of Commerce	9,668	7,954
Department of Defense	91,166	51,089
Department of Energy	14,933	9,003
Department of Justice	10,155	3,848
Department of Labor	1,622	7,211
Department of the Treasury	8,756	9,376
General Services Administration	325,564	549,709
Government Printing Office	119	17
Office of Personnel Management	291,887	269,592
U.S. Postal Service	3,219	7,420
Other Agencies	14,368	35,326
Total	$ 771,609	$ 952,374

For the Year Ended September 30,	2005	2004
Budget Functional Classification	**Expenses**	**Expenses**
International Affairs	$ 763,440	$ 945,987
Natural Resources	8,169	6,387
Income Security	—	—
Total	$ 771,609	$ 952,374

Deferred Maintenance For the Fiscal Year Ended September 30, 2005

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 $521.4 million for buildings and facilities-related equipment that have not been funded. This figure is less than the $644.7 million reported for 2004. 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.

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.

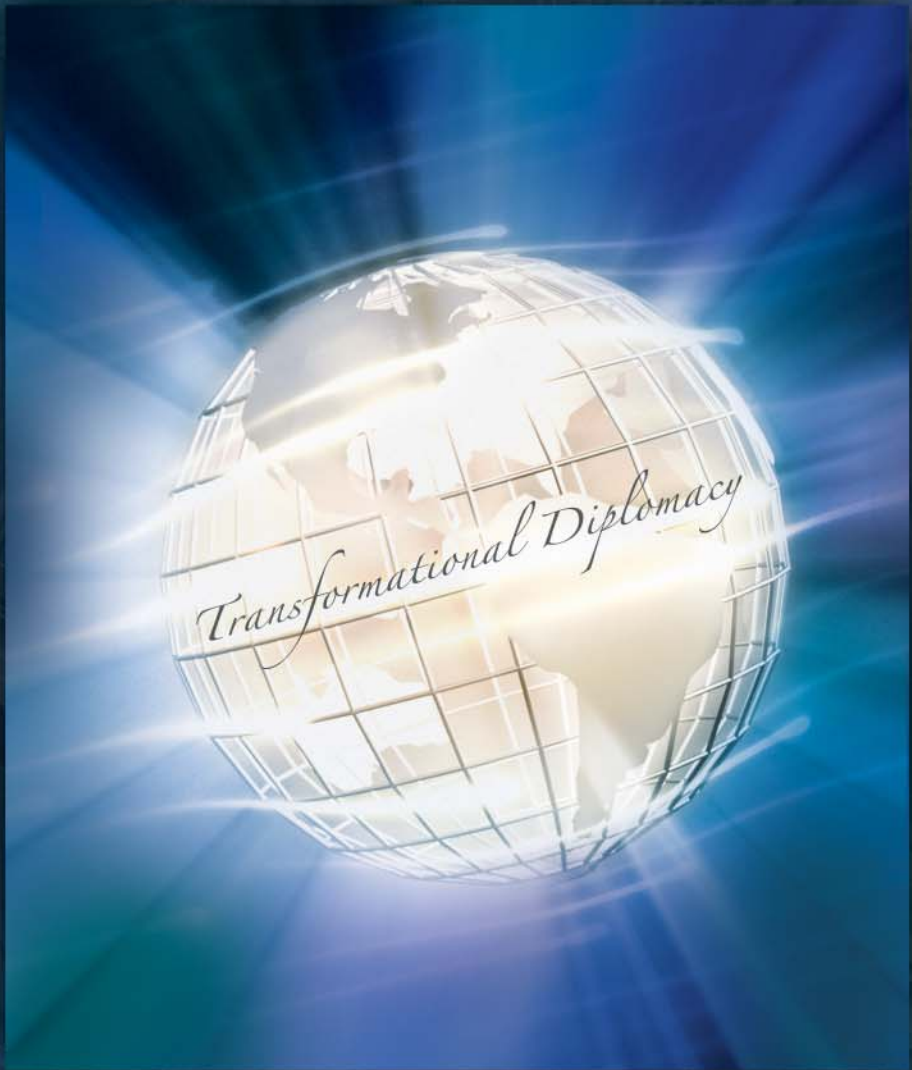
The WCF balance sheet at September 30, 2005 and 2004, is presented below (Dollars in Thousands).

	2005			2004		
	WCF	**ICASS**	**Total**	**WCF**	**ICASS**	**Total**
Assets:						
Fund Balances with Treasury	$ 71,197	$ 226,854	298,051	$ 23,917	$ 101,736	$ 125,653
Accounts Receivable, Net	20,862	136,878	157,740	58,172	276,603	334,775
Plant, Property and Equipment, Net	17,703	44,023	61,726	32,845	40,297	73,142
Other Assets	6,532	5,787	12,319	5,884	6,543	12,427
Total Assets	116,294	413,542	529,836	120,818	425,179	545,997
Liabilities:						
Accounts Payable	26,673	50,144	76,817	32,638	59,705	92,343
Other Liabilities	3,119	59,762	62,881	2,323	61,215	63,538
Total Liabilities	29,792	109,906	139,698	34,961	120,920	155,881
Cumulative Results of Operations	$ 86,502	$ 303,636	$ 390,138	$ 85,857	$ 304,259	$ 390,116

The cost of providing services and the exchange revenue earned for the years ended September 30, 2005 and 2004 are presented below (Dollars in Thousands). These amounts do not include intra-departmental eliminations.

	WCF	**ICASS**	**Total**
2005			
Costs	$ 295,853	$1,178,809	$1,474,662
Exchange Revenue	(297,410)	(1,162,774)	(1,460,184)
Other Financing Sources	912	(15,412)	(14,500)
Net Cost (Revenue)	$ (645)	$ 623	$ (22)
2004			
Costs	$ 320,844	$1,075,703	$1,396,547
Exchange Revenue	(307,290)	(1,095,169)	(1,402,459)
Other Financing Sources	(1,476)	(6,708)	(8,184)
Net Cost (Revenue)	$ 12,078	$ (26,174)	$ (14,096)

Supplemental Information and Other Reporting Requirements



FINANCIAL MANAGEMENT PLANS AND REPORTS

OVERVIEW

INTRODUCTION

The Department's Bureau of Resource Management (RM), headed by the Assistant Secretary for Resource Management and Chief Financial Officer (CFO), employs over 500 people around the globe--in Washington, Charleston, South Carolina, and Bangkok, Thailand. With five major operating units, the CFO oversees all strategic and performance planning, State operations and foreign assistance budgeting and resource management, global accounting, disbursing and payroll, financial systems, and issuance of the financial statements and "annual report" of the Department. The CFO also coordinates and leads the remediation of vulnerabilities within the Department's global critical infrastructure. RM produces a number of essential documents including the Department's Strategic Plan, Joint Performance Plan with USAID, Performance and Accountability Report, Budget-in-Brief, and the Congressional Budget Justification Document.

RM's customers are all embassies, consulates, and missions overseas, nearly 40 other U.S. Government agencies overseas, all domestic bureaus and employees of the State Department, and the Broadcasting Board of Governors. RM's services to its customers are critical in order that they can do their job to create a more secure, democratic, and prosperous world.

MISSION

"To integrate strategy, budgeting, and performance management, and secure and manage the resources necessary to accomplish the Department of State's mission."

The CFO's mission statement is incorporated into the Department's strategic goal for Management and Organizational Excellence as Performance Goal 5. This Performance Goal has two initiatives, one each for the President's Management Agenda's initiatives for Improved Financial Performance and Budget and Performance Integration.

IMPROVED FINANCIAL PERFORMANCE

GOALS AND STRATEGIES

INITIATIVE GOAL STATEMENT

Provide world-class financial services that support strategic decision-making, mission performance, the President's Management Agenda, and improved accountability to the American people.

Improving financial performance means that the Department knows where every dollar comes from and where every dollar goes in a timely and accurate manner. Accurate and timely information is critical to managing our programs on a day-to-day basis, obtaining the best performance, and ensuring accountability to the American public. It is also a core competency of world–class organizations.

To do this, RM will:

- Produce on-time, accurate and useful financial statements on a routine basis.
- Obtain an unqualified ("clean") opinion on annual Departmentwide financial statements.
- Produce award winning Performance and Accountability Reports.
- Implement seamless financial systems and processes that meet Federal and Department requirements.
- Ensure effective internal controls are in place and functioning.
- Consolidate and standardize financial operations.
- Leverage best business practices and electronic technologies (E-Gov).
- Build a top-notch finance team.
- Undertake other value-added activities that support strategic decision-making and mission performance.

Key measures of our success in this area are aligned with how OMB scores financial management related to achieving a "green" status rating on the President's Management Agenda. Other measures of success include:

- Are we on target in our consolidation of financial services to the Charleston Financial Services Center?
- Are we implementing the President's mandate to effectively adopt E-Gov solutions, especially in the areas of payroll, travel and grants?
- Are we adequately investing in our greatest asset – our people?

PERFORMANCE

At the end of FY 2004, the Department had met seven of the nine OMB-established criteria and achieved a "Yellow" score for status. During FY 2005, the Department satisfied the remaining two criteria. As a result, in the first quarter of FY 2005, the Department achieved its goal of obtaining a "Green" status score for improved financial performance.

- ☑ *Receives an unqualified audit opinion on its annual financial statements;*
- ☑ *Meets financial statement reporting deadlines;*
- ☑ *Reports in its audited annual financial statements that its systems are in compliance with the Federal Financial Management Improvement Act;*
- ☑ *Has no chronic or significant Anti-Deficiency Act Violations;*
- ☑ *Has no material auditor-reported internal control weaknesses;*
- ☑ *Has no material non-compliance with laws or regulations;*
- ☑ *Has no material weaknesses or non-conformances reported under Section 2 and Section 4 of the Federal Managers' Financial Integrity Act that impact the agency's internal control over financial reporting or financial systems;*
- ☑ *Currently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operations; and*
- ☑ *Is implementing a plan to continuously expand the scope of its routine data use to inform management decision-making in additional areas of operations.*

Consolidating and Standardizing our Worldwide Financial Operations

While we modernize our major corporate financial management systems, we are also consolidating our worldwide financial operations to our Charleston and Bangkok Financial Service Centers (FSC) to provide world-class financial services. The recent highlights of RM consolidation efforts are:

- Completed relocation of the Department's Washington DC – based financial operations to Charleston FSC.
- Continued hiring, staffing and training of the Charleston FSC staff.

Customer Service

Customer service is the hallmark of the Bureau of Resource Management. As the Department moves to a single world-class financial system, RM has redoubled its emphasis on customer service and support. The Overseas Post Support Desk, in addition to helping posts with implementation of new financial systems and changes, has been expanded to become a state-of-the-art help desk for financial management professionals in the Department and in other agencies we service. As part of this effort, RM is moving the customer support function towards a 24/7 operation, leveraging our presence in time zones roughly equidistant around the globe (Charleston, Bangkok and Paris), and integrating former Washington-based operations into our customer support regime. For example, the former American Payroll Resolution Center is now operational in Charleston.

Building a Top-Notch Finance Team

Establishing a worldwide cadre of qualified financial managers presents a difficult challenge to the CFO. Unlike most other Government agencies, the CFO must manage the dynamics of three personnel systems that include financial management personnel: Foreign Service, Civil Service and Foreign Service Nationals (FSNs). Our primary strategy is to maintain a vigorous and active training program for financial management practitioners. We view the training program as critical — in implementing new systems, establishing RM as the lead bureau within the Department on financial management issues, and also in ensuring that information in the field is current and authoritative. In 2005, the training program was strengthened to provide overseas customers a full line-up of training opportunities — offering 107 separate courses, for a total of 1,605 training seats available in 14 different locations around the globe. Our training program enjoys customer approval ratings in excess of 90 percent.

THE ROAD AHEAD

Looking ahead, State will continue to achieve fundamental "compliance" results. Moving beyond compliance-based results, State management is making decisions based on meaningful financial information to achieve better performance results in the form of lower costs, improved efficiencies and/or improved outcomes for agency mission.

State will also undertake other value added activities that support effective strategic decision-making and mission performance. These activities include:

- **Enhancing management and internal controls.** The Department maintains a robust system of management controls overseen by senior leadership and administered by RM. The Department's strong commitment to management controls has served as a positive catalyst for change and there are no material weaknesses reported under FMFIA or by the independent auditors. Recent events in the private sector have increased concerns related to financial management, and in particular on internal controls. To address these concerns, Congress passed the Sarbanes-Oxley Act of 2002, which establishes new demands for corporate accountability and includes several important sections related to internal controls for public companies. In December 2004, OMB revised Circular A-123, *Management's Responsibility for Internal Control,* to strengthen internal control in the Federal government. The Department is well-positioned to fully implement the requirements of revised circular A-123 in FY 2006, as required.
- **Streamlining and consolidating global financial operations.** In FY 2005, State completed a multi-year effort to consolidate and streamline our worldwide financial operations in our Charleston, South Carolina and Bangkok, Thailand locations.
- **Leveraging best business practices and electronic technologies (E-Gov).** The Department will select and begin implementation of an electronic Travel (eTS) program, beginning with our overseas locations. The program will be piloted at several overseas locations by July 2005. In addition, working with the Department of Agriculture's National Finance Center, State will reach a decision for migrating its current Consolidated American Payroll Processing System (that pays both civil service and foreign service employees).
- **Partnering with other Federal agencies.** The Joint Financial Management System (JFMS) investment is a cooperative effort by the Department of State and USAID to improve service and save money through collaboration on financial systems and functions. USAID and State are working together to migrate from two separate financial systems operations that use commercial off-the-shelf (COTS) software and different technical architectures to a common technical environment. The end goal of the JFMS is to create a common financial systems platform for State and USAID to manage all domestic and overseas financial management activities starting in FY 2006.

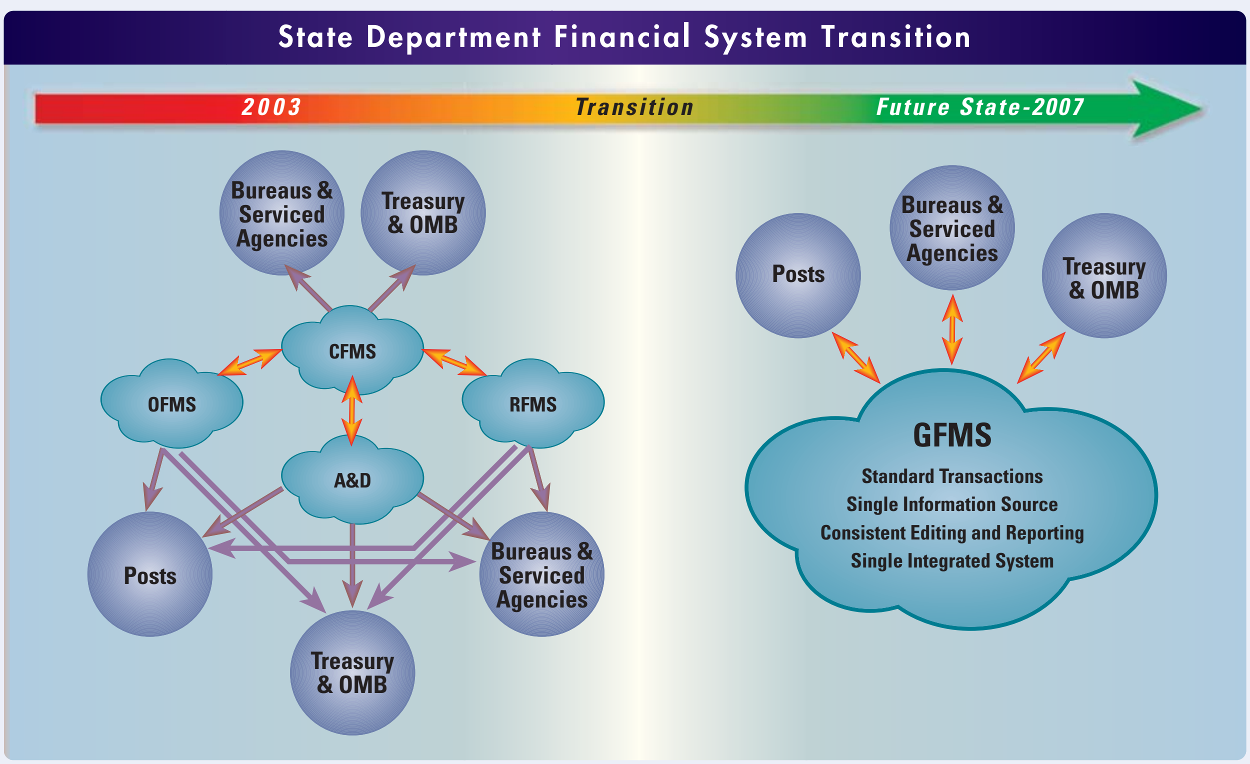
FINANCIAL MANAGEMENT SYSTEMS

IMPLEMENT A GLOBAL FINANCIAL MANAGEMENT SYSTEM (GFMS)

For the past two decades, the Department accounted for its resources through multiple outdated and disjointed legacy financial systems. Some posts effectively conducted operations through the integration of little more than a collection of Excel spreadsheets. Often, it could take up to 45 days after a financial event occurred for overseas financial data to update the Department's Central Financial Management System (CFMS).

The Global Financial Management System (GFMS) project integrates the Department's overseas and domestic financial operations onto common financial management software platform in Charleston. The GFMS program replaces the Department's 20-year-old overseas systems and legacy mainframe systems with modern open systems technology and COTS software certified by JFMIP. The platform will provide a single integrated view of financial data through data standardization, common business processes, and the seamless exchange of information through the Department's financial and administrative sectors. This will dramatically improve operations and reduce costs by eliminating system redundancies and replacing obsolete and unsupported financial systems. It will also provide the infrastructure for integrating other administrative activities within the Department, such as the Integrated Logistics Management System (ILMS).

The diagram below depicts the state of our financial systems at the beginning of FY 2003 and the end state of our global vision for the beginning of FY 2007.



The following implementations will become the Department's Global Financial Management System.

Regional Financial Management System (RFMS)

RFMS is the new global accounting and disbursing system that has been implemented for posts around the world, and the building block of GFMS. RFMS is comprised of a commercial-off-the-shelf, accounting system for funds management, obligation, and voucher processing, and the RFMS/D disbursing system developed by the Department for Treasury disbursing services. The worldwide implementation of RFMS replaced the obsolete Paris Accounting and Disbursing system (mainframe-based) used at FSC Paris and the Overseas Financial Management System (Wang-based) used at FSCs Charleston and Bangkok. RFMS incorporates State's standard account structure and improves transaction standardization and timeliness between RFMS and CFMS, which results in the consistent, timely processing and recording of financial data on a worldwide basis. In addition, the overseas interface was reengineered for RFMS and now provides daily updates of overseas financial transactions to CFMS. These daily updates allow headquarters managers to ascertain the worldwide balance of our accounts on a daily basis, something never before possible.

In addition, RFMS implemented a new reporting tool, called R/Viewer which provides daily updates on all financial transactions to 168 posts overseas and allows them to analyze, and "slice and dice" their financial data for local reporting purposes using modern reporting and query tools on their local workstation.

Central Financial Management System (CFMS)

CFMS is the Department's primary and central accounting system in Washington. It is a mainframe-based COTS product that will be upgraded to the RFMS-based software beginning in FY 2006. Upon completion of this conversion, the Department will have in place a common worldwide core financial management system software platform.

Global Direct Connect

Global Direct Connect will move posts that have operationally practical and reliable network connections (estimated at over 85 percent of our embassies) from their current batch processing environment to a real time, on line connection with GFMS. Currently, there are 28 posts using Global Direct Connect. Our plan is to 20 to 25 more posts to Global Direct Connect by the end of FY 2006.

Becoming a Financial Line of Business Center of Excellence

In FY2004, the Administration asked agencies with the skills and capabilities to function as government-wide service providers in the area of Financial Management to submit business cases for doing so as part of the Fiscal Year 2006 budget process. After assessing potential service providers' in several areas, including but not limited to past performance, current capabilities, and ability to operate a customer-focused organization, four agencies were designated Financial Management (FM) Line of Business (LoB) Centers of Excellence (COEs).

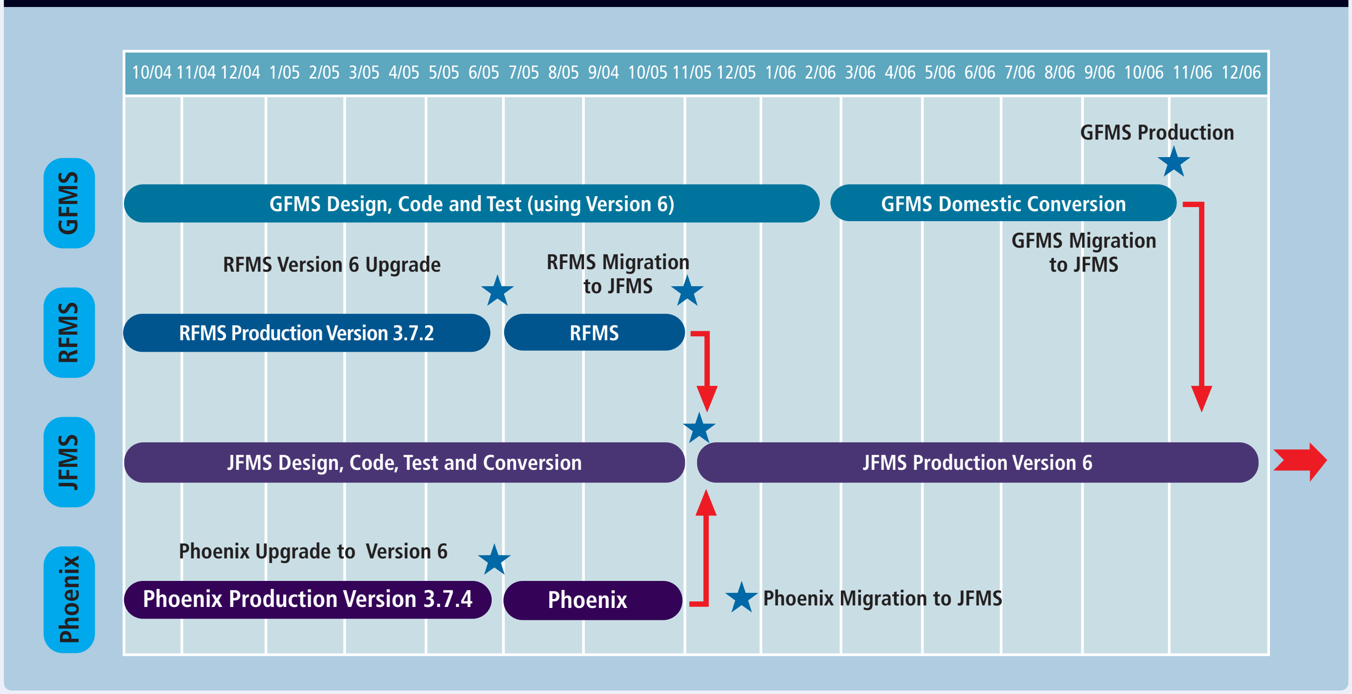
Recognizing that the offerings of these four service providers were geared toward domestic operations, the Department prepared an FY07 Exhibit 300 business case and application to become a COE for foreign affairs agencies. The Department welcomes this opportunity to continue to service the foreign affairs community and further the President's Management Agenda and has prepared and submitted a proposal to become a Financial Line of Business Center of Excellence.

Joint Financial Management System (JFMS) with USAID

The Joint Financial Management System (JFMS) investment is a cooperative effort by the Department of State and USAID to improve service and save money through collaboration on financial systems and functions. At issue was the pursuit of separate implementations of the same financial system software when a joint effort would improve efficiency based on economies of scale.

The goal of the JFMS is to create a common financial systems platform for State and USAID to manage all domestic and overseas financial management activities starting in FY 2006. The JFMS investment combines the Department's Global Financial Management System (GFMS) and USAID's Phoenix investment.

Joint Financial Management System (JFMS) with USAID



Joint Assistance Management System (JAMS) with USAID

USAID and the Department of State are implementing a Joint Assistance Management System (JAMS). The system will collect assistance information and will interface with the Joint Financial Management System being implemented by the two agencies. JAMS will be based on a commercial product called "Grantium." Grantium was selected from a field of commercial products because of its ability to be easily configured for assistance processes. Other features include a robust reporting capability.

First Quarter FY 2006 will be devoted to an analysis of current assistance processes at both agencies. Processes will be mapped to determine similarities and differences so that common processes can be developed to the maximum extent practicable. State and USAID are identifying subject matter experts and other team members for the project. Current plans are to perform a proof of concept of JAMS during FY 2006.

MANAGEMENT OF OBLIGATIONS TO THE DEPARTMENT

DEBT MANAGEMENT

Outstanding debt from non-Federal sources (net of allowances) increased from $56.9 million in 2004 to $70.3 million in 2005. 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, $4.9 million is for the Repatriation Loan Program. These are loans given to destitute American citizens stranded overseas to allow them to return to the United States. The loans are given only if the individual cannot obtain funds from relatives, friends, employers, or another source. The Department acts as the lender of last resort. The loan becomes delinquent 60 days after repatriation to the United States. Due to their poor economic situation, most of these individuals are unable to repay the loans on time.

The Department uses installment agreements, salary offset, and restrictions on passports as tools to collect its receivables. It also receives collections through its cross-servicing agreement with the Department of the Treasury. In 1998, the Department entered into a cross-servicing agreement with the Department of the Treasury for collection of delinquent receivables. In accordance with the agreement and the Debt Collection Improvement Act of 1996 (Public Law 104-134), the Department referred $955,714 to Treasury for cross-servicing in 2005. *The 2002 first quarter anthrax related U.S. mail disruptions affected the Department's ability to receive payments and to provide debtors proper due process notification. Thus, the Department was unable to refer debts to Treasury for most of 2002*. Of the current and past debts referred to Treasury, $349,038 was collected in 2005.

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

	FY 2005	FY 2004	FY 2003
Number of Accounts	638	253	927
Amounts Referred (In Thousands)	$ 956	$ 261	$ 960

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 which 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 an export application.

COMPANY NAME	VIOLATION	DATE ASSESSED	AMOUNT ASSESSED	PAYMENT SCHEDULE
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
HUGHES ELECTRONICS CORP. & BOEING SATELLITE SYSTEMS	Violating the terms and conditions of the Department's munitions licenses and exporting defense services without munitions licenses or other authorizations (and conduct relating to two failed launches of rockets carrying spacecraft) to the People's Republic of China.	3/4/2003	$12,000,000	$1,500,000 for eight years
EDO CORPORATION	Violations incurred by Condor Systems, Inc. prior to the acquisition of business assets by EDO that included the terms and conditions of the Department's munitions license and exporting defense services without munitions license or other authorizations.	11/24/2003	$1,750,000	$583,334 initially, then $583,333 for two years
ITT CORPORATION	Exporting defense articles and services (night vision products and space remote sensing technical data and defense services) in violation of the terms or conditions of other approvals that were provided by the Department.	11/1/2004	$8,000,000	$1,000,000 initially, then $1,000,000 for two years
GENERAL MOTORS CORPORATION	Exporting defense articles and services (to foreign person employees of proscribed countries) in violation of the terms or conditions of other approvals that were provided by the Department.	11/1/2004	$20,000,000	$2,000,000 initially, then $1,500,000 for four years
ORBIT ADVANCED TECHNOLOGIES INC.	Violating the terms and conditions of the Department's munitions and licenses by agreeing to sell defense articles (Radome Measurement System – AL8098/AL8099) to the People's Republic of China	08/29/05	$500,000	$33,334 initially, then $33,333 over two years, then $200,000 over three years
TOTAL			**$56,250,000**	

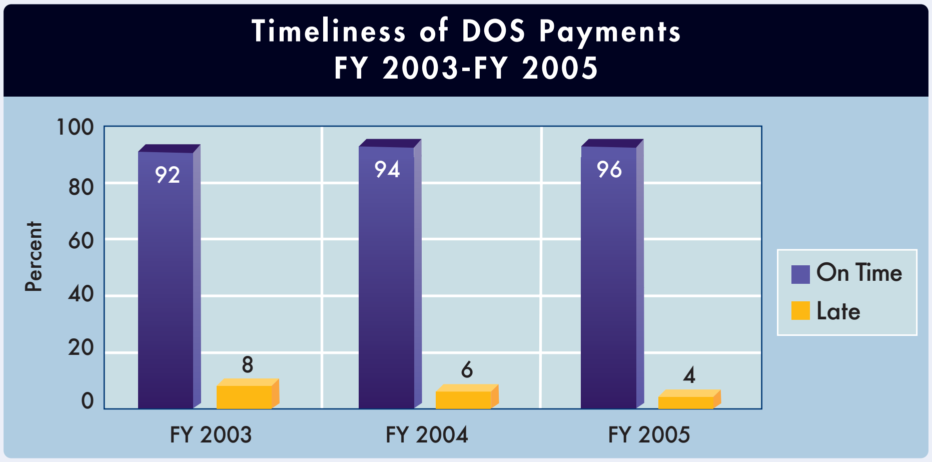
COMPANY NAME	Balance Outstanding September 30, 2004	Fiscal Year 2005 Assessments	Fiscal Year 2005 Collections	Balance Outstanding September 30, 2005
SPACE SYSTEMS/LORAL, INC.	$ 10,114,284	—	— (Chapter 11 Bankruptcy granted January 2004)	$ 10,114,284
HUGHES ELECTRONICS CORP. & BOEING SATELLITE SYSTEMS	$ 9,000,000	—	$ 4,000,000	$ 5,000,000
EDO CORPORATION	$ 1,166,666	—	$ 583,333	$ 583,333
ITT CORPORATION	$ —	$ 3,000,000	$ 1,000,000	$ 2,000,000
GENERAL MOTORS CORPORATION	$ —	$ 8,000,000	$ 2,000,000	$ 6,000,000
ORBIT ADVANCED TECHNOLOGIES INC.	$ —	$ 300,000	$ 33,334	$ 266,666
TOTAL	**$ 20,280,950**	**$ 11,300,000**	**$ 7,616,667**	**$ 23,964,283**

MANAGEMENT OF PAYMENTS

PROMPT PAYMENT ACT

TIMELINESS OF PAYMENTS

The Prompt Payment Act (PPA) requires Federal agencies to pay their bills on time or an interest penalty must be paid to vendors. During FY 2005, 96% of invoices were paid on time. Presented below is a chart that reflects the timeliness of the Department's payments from FY 2003 through FY 2005.



During FY 2005, 2% of invoices required interest penalties compared to 2% for FY 2004.

SELECTED PAYMENT DATA

	2005	2004	2003
Interest Paid ($000)	557	431	396
Interest Under $1 Not Due ($000)	—	—	—
Interest Due But Not Paid ($000)	—	—	—
Number of Procurement Card Transactions			
Domestic	54,061	61,838	57,312
Overseas	75,407	66,416	112,766

ELECTRONIC PAYMENTS

The Department successfully increased the percentage of payments it makes electronically. In 2005, 85% of all payments were made by electronic funds transfer (EFT). Domestically, 98% of payments were made electronically. The Department processed 77% of its 2005 overseas payments by EFT, a 10% increase from 2004.

EFT and Check Payment Volumes

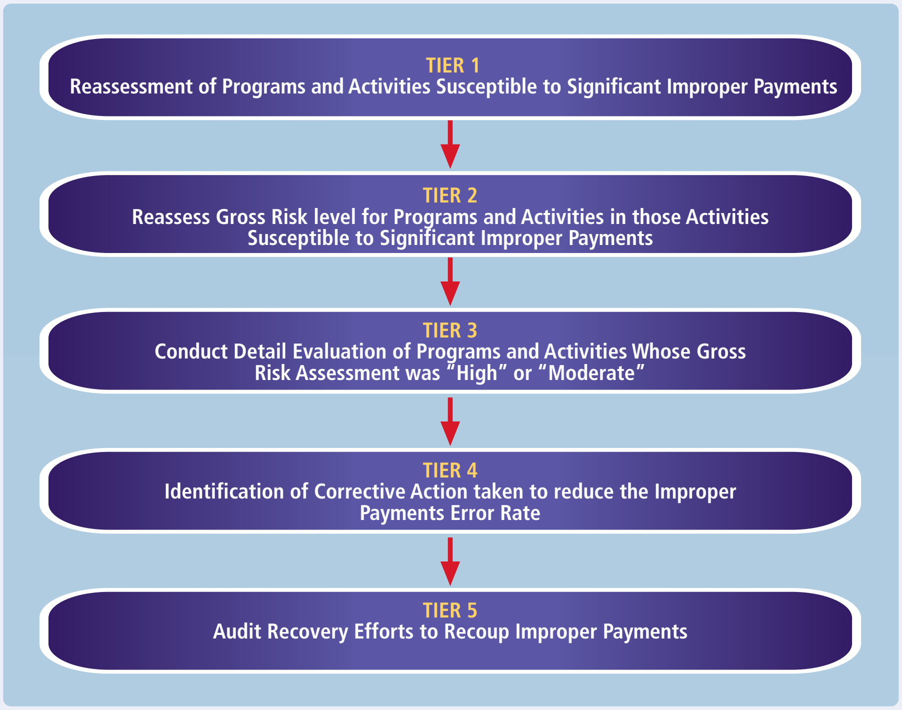
	2005		2004		2003	
Payment Type	**Number**	**Percent**	**Number**	**Percent**	**Number**	**Percent**
EFT:						
Domestic	1,120,735		981,427		1,248,335	
Overseas	1,309,530		885,623		988,329	
EFT Subtotal	2,430,265	85	1,867,050	80	2,236,664	79
Checks:						
Domestic	23,539		26,012		47,043	
Overseas	400,985		440,394		531,046	
Checks Subtotal	424,524	15	466,406	20	578,089	21
Total Payments	2,854,789	100	2,333,456	100	2,814,753	100

IMPROPER PAYMENTS INFORMATION ACT

The *Improper Payments Information Act of 2002* (Public Law No. 107-300) (IPIA) requires agencies to annually review their programs and activities to identify those susceptible to significant improper payments. OMB Circular A-136, *Financial Reporting Requirements,* requires a brief summary of actual and planned accomplishments towards implementing the IPIA, which is presented in the Management's Discussion and Analysis section of this Report. OMB also requires more detailed information relating to IPIA, which is provided on the following pages.

Risk Assessment Procedures and Processes.

For the identification and determination of significant improper payments in FY 2005, the Department implemented the approach as follows:



The first tier identifies the types of payments made by the Department. The second tier assesses the risk of these types of payments. The third tier relates to the testing of a sample of transactions for the payment classifications considered high or moderate risk for significant improper payments, and then analyzing the results of those tests to determine causes, effects and trends. The fourth tier relates to the identification of corrective actions needed to prevent and detect improper payments. The final tier relates to the Department's audit recovery efforts to recoup improper payments.

TIER 1: *Reassessment of Programs and Activities Susceptible to Significant Improper Payments*

WORK PERFORMED IN FY 2004

In FY 2004, the Department began to institute an effort that identified programs that were susceptible to significant improper payments. An assessment was performed based on a number of factors such as dollar volume, number of vendors or recipients, internal controls, audit reports of the programs, and management's institutional knowledge. Based on the results of this assessment, the Department classified all payments into the following three categories:

- Employee Pay
- Vendor Payments
- Federal Financial Assistance

The two types of payments that were identified as having a potential high risk for significant improper payments were Federal Financial Assistance Programs and Vendor Payments. The following programs were identified as high-risk and tested in FY 2004:

Federal Financial Assistance Area

- International Information Program (IIP) – U.S. Speaker and Specialist Program
- International Narcotics and Law Enforcement (INL) – Narcotics Program

Vendor Pay Area

- Other Contractual Services
- Structures & Equipment (test work in this area was started in FY 2004 and completed in FY 2005)

WORK PERFORMED IN FY 2005

In FY 2005, the Department performed a reassessment of risk to determine which categories identified in FY 2004 were still susceptible to significant improper payments. Based on the results of this reassessment of risk, the following was noted:

- Employee Pay - Based the Department's institutional knowledge and the results of past internal control reviews over this process, this category did not appear to be susceptible to significant improper payments in FY 2005. This category of payments will be considered for susceptibility to improper payments in the future.

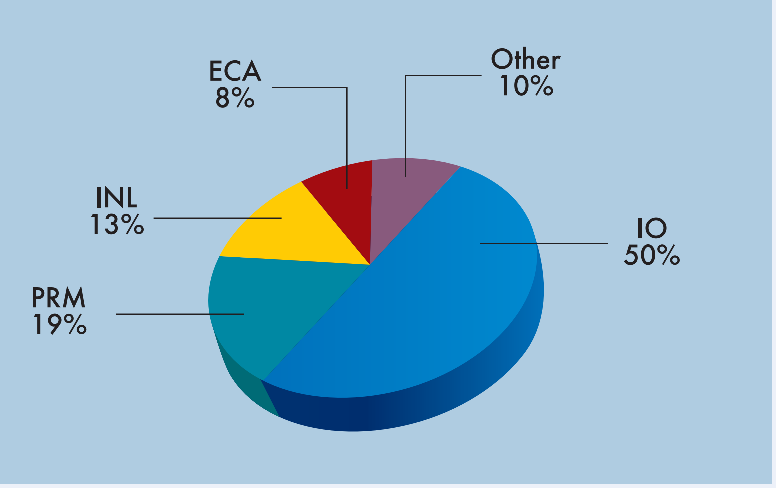
- Vendor Payments – This category was tested for improper payments in FY 2004. Based on the results of this test work (as summarized in Tiers 3 and 4 below) and the audit recovery work currently underway, this category of payments was also not considered to be susceptible to significant improper payments in FY 2005. This category of payments will be considered for susceptibility to improper payments in FY 2006.

- Federal Financial Assistance - This was the only category of payments considered to be susceptible to significant improper payments in FY 2005.

TIER 2: ***Reassess Gross Risk level for Programs and Activities in those Activities Susceptible to Significant Improper Payments***

Using data for the last quarter of FY 2004 and the first three quarters of FY 2005, the Department identified the population of Federal Financial Assistance payments by specific programs within each bureau. The following is a breakout of these expenditures by bureau:

Federal Financial Assistance Payments by Program



The OMB threshold of $10 million and 2.5% of program payments was applied to each program within the bureaus to identify those programs that could be susceptible to significant improper payments. For the programs meeting the threshold, the Department conducted a reassessment of risk to determine whether these programs had a High, Moderate, or Low risk of susceptibility to improper payments. In addition, the Department also identified three programs that did not meet the OMB threshold but, based on the Department's institutional knowledge, could be susceptible to significant improper payments. The Department evaluated each program and assessed a risk of High, Moderate, or Low for the following fourteen attributes:

Complexity of laws and regulations	Complexity of the calculation of payments
Emphasis on expediting payments	Expended amount in relation to other programs
Lack of audit requirements	Lack of monitoring procedures of program recipients
Need-based status of program	Significant volume and variability of transactions
Payments to ineligible recipients	Political sensitivity of the specific program's goals or objectives
Probability of growth of the specific program	The type and reputation of program recipients
The number of program recipients	Past history of material weaknesses, internal control deficiencies, and other financial miscues

The following is a list of the programs that were classified as being susceptible to significant improper payments and the overall risk assessment for each program based on the individual risk assigned to each of the fourteen attributes noted above:

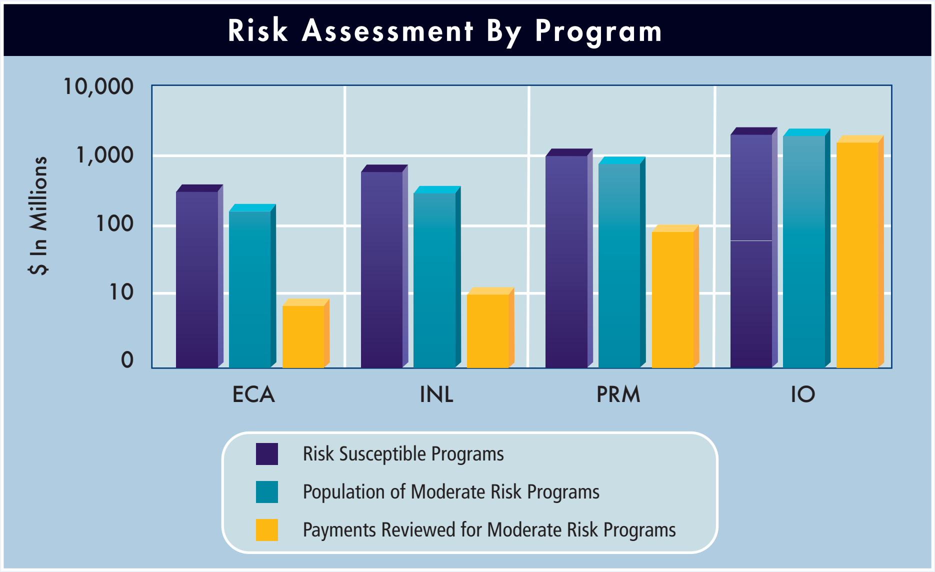
Program	Risk Assessment
Educational & Cultural Affairs (ECA) – Fulbright Program	Moderate
ECA – Teacher Exchange*	Low
ECA – Humphrey Program*	Low
ECA – Study of the U.S.*	Low
INL – Law Enforcement Support, Eradication, Aviation Support, & Support to the Military	Moderate
Population, Refugee and Migration (PRM) – Humanitarian Migration to Israel	Low
PRM – Refugee assistance through International Organizations	Low
PRM – Refugee Admissions	Low
PRM – Refugee Assistance (grants and contributions)	Moderate
International Organizations (IO) – Contributions to International Organizations and Peacekeeping	Moderate

** Although these programs did not meet the OMB threshold, the Department identified them as being susceptible to improper payments due to the similarity in the scope of these programs to the Fulbright Program. However, based on the results of the risk assessments, these programs were classified as having a low risk of susceptibility to improper payments.*

In addition, Structures and Equipment (classified under the Vendor Payments category in FY 2004) was classified as high-risk. The improper payments review for Structures and Equipment was started in FY 2004 and completed in FY 2005.

TIER 3: *Conduct Detail Evaluation of Programs and Activities Whose Gross Risk Assessment was "High" or "Moderate"*

As noted in Tier 2 above, no new high-risk programs were identified in FY 2005. As a result, the Department performed detailed evaluations for all programs classified as moderate risk and completed the review of Structures and Equipment which was classified as high-risk in FY 2004. Testing was conducted based on a statistical sample to determine if the transactions were proper or improper as defined in the OMB guidance. Improper transactions were reported as an error.



The following chart shows a breakdown of the Federal Financial Assistance dollars for the risk susceptible bureaus, the population of expenditures for moderate risk programs (identified above) for each risk susceptible bureau, and the payments reviewed for the moderate risk programs in FY 2005.

STATISTICAL SAMPLING PROCESS

Using OMB guidance, the Department assumed a 2.5 percent or less rate of error for each of the programs sampled since the Department had no historical error rate to use in calculating the sample sizes of the different populations. A sample size of 126 transactions was reviewed for each program (except for IO which is explained below). The sample size selected was based on the minimum required to yield an estimate with a 90% confidence level and a confidence interval of plus or minus 2.5%.

In selecting the sample for the IO program, the Department did not use a statistical sample. The population of IO payments is made up of large payments to a limited number of international organizations. As a result, the Department selected a sample of 37 of the largest payments that yielded 80% coverage of the entire population of payments.

RESULTS

One of the challenges faced during the testing of the Federal Financial Assistance Programs for improper payments is that the level of testing was performed based on the supporting documentation maintained at the Department. The Department did not extend the testing to the grantee level to obtain further supporting documentation to support whether the funds were spent in accordance with the grant agreement. As a result, although the Department's testing of sampled transactions yielded an actual error rate and amount of error at low levels, the results could have been different if the level of testing was extended to the grantee level. The Department will seek OMB's guidance in FY 2006 to determine whether the level of testing for Federal Financial Assistance should be extended to the grantee level. The Department will also consider best practices to follow in FY 2006.

	ACTUAL						PROJECTED								
	First Nine Months FY 2004			Last Quarter of FY 2004 and first Three Quarters of FY 2005			FY 2006			FY 2007			FY 2008		
Program (Dollars in Millions)	Outlays	IP %	IP $	Outlays	IP %	IP $	Outlays	IP %	IP $	Outlays	IP %	IP $	Outlays	IP %	IP $
Year Reviewed: 2005															
Federal Financial Assistance Prgrams															
ECA - Fulbright Program	N/A	N/A	N/A	$ 169	0.00%	$ -	$ 187	0.00%	$ -	$ 196	0.00%	$ -	$ 205	0.00%	$ -
PRM - Refugee Assistance	N/A	N/A	N/A	$ 682	0.00%	$ -	$ 870	0.00%	$ -	$ 1,009	0.00%	$ -	$ 1,039	0.00%	$ -
IO - Contributions to International Organizations and Peacekeeping	N/A	N/A	N/A	$ 1,891	0.00%	$ -	$ 1,948	0.00%	$ -	$ 2,006	0.00%	$ -	$ 2,066	0.00%	$ -
Vendor Payments															
Structures & Equipment	$ 671	3.97%	$ 0.325	$ 485	<1%*	$ 0.235	$ 691	<1%	$ 0.335	$ 712	<1%	$ 0.345	$ 733	<1%	$ 0.355
Year Reviewed: 2004															
Federal Financial Assistance Prgrams															
INL-Narcotics Program	$ 313	0.87%	$ 1.7	$ 114	<1%*	$ 0.574	$ 117	<1%	$ 0.544	$ 121	<1%	$ 0.512	$ 125	<1%	$ 0.477
IIP-U.S. Speaker and Specialist Program	$ 30	81.18%	$ 1.4	$ 41	81.18%	$ 1.897	$ 43	40.00%	$ 1.183	$ 45	2.00%	$ 0.655	$ 47	<1%	$ 0.648
Vendor Payments															
Other Contractual Services	$ 1,534	2%	$ 0.78	$ 3,299	<1%*	$ 0.358	$ 3,398	<1%	$ 0.369	$ 3,500	<1%	$ 0.380	$ 3,605	<1%	$ 0.391

* For programs reviewed in FY 2004, the IP% and IP$ in the last quater of FY 2004 and first three quarters of FY 2005 are projected.

TIER 4: *Identification of Corrective Action taken to reduce the Improper Payments Error Rate*

The potential for the Department making improper payments is low based on the FY 2004 review of high-risk programs and the FY 2005 review of moderate-risk programs. The following is a summary of the improper payments identified in FY 2004 and FY 2005, the cause of the improper payment, and corrective action plans to reduce the estimated rate of improper payments.

Program	Description of Improper Payment	Cause	Steps to Prevent Future Occurrences
Year Reviewed: FY 2005			
Federal Financial Assistance Prgrams			
ECA – Fulbright Program	No improper payments were identified	N/A	N/A
PRM – Refugee Assistance	No improper payments were identified	N/A	N/A
INL – Law Enforcement, Eradication, Aviation Support, & Support to the Military	Test work was started in FY 2005 and will be completed in FY 2006 and reported in the FY 2006 PAR	N/A	N/A
IO – Contributions to International Organizations and Peacekeeping	No improper payments were identified	N/A	N/A
Vendor Payments			
Structures & Equipment	1) Total amount paid was not fully supported on the invoice and/or purchase order; 2) Insufficient supporting documentation was provided for purchase card transactions; 3) Non-compliance with the Prompt Payment Act; 4) Overpayment	These errors appeared to be isolated incidents caused by human error.	The Department will review and enforce its policies related to these improper payments.
Year Reviewed: FY 2004			
Federal Financial Assistance Prgrams			
IIP-U.S. Speaker and Specialist Program	Participants in this program were formerly identified as invitational travelers who should have been required to complete and submit vouchers at the completion of their travel.	The lack of travel vouchers submitted at the completion of travel made most of the travel reimbursement payments improper under IPIA.	The Department issued a revised Grants Policy Directive on Oct. 1, 2005, that reclassifies participants as grantees rather than invitational travelers. This change has been implemented, which will reduce this improper payment issue.
INL Narcotics Program	Federal financial assistance funds should not be used to pay for federal employee travel.	Federal financial assistance funds were used to pay for a federal employee's travel.	The Department will review and enforce its policies related to this improper payment
Vendor Payments			
Other Contractural Services	Insufficient supporting documentation was provided to support the payment	This error appeared to be an isolated incident caused by human error.	The Department will be review and enforce its policies related to this improper payment.

TIER 5: *Audit Recovery Efforts to Recoup Improper Payments*

RECOVERY AUDIT PROGRAM RESULTS

In FY 2004, a recovery audit of vendor payments was initiated in accordance with the Improper Payments Information Act of 2002. This act required agencies to report annually on the extent of erroneous payments and the actions being taken to reduce them. An erroneous payment is any payment that should not have been made or that was made in an incorrect amount (overpayments or underpayments). In the latter half of FY 2004, the Department contracted with a recovery audit firm. Our recovery auditor reviewed all vendor domestic commercial payments from FY 2003 through June of FY 2005 subject to the Prompt Payment Act.

At the end of FY 2005, approximately 40 potential duplicate payments were identified. Of these, four payments totaling approximately $50,000 have been validated as duplicate payments and the Department has sent demand letters to the affected vendors. There are three additional payments, still in the validation process, totaling about $45,000 that are not included in the confirmed duplicate payments presented in the table below.

The Charleston Financial Services Center (CFSC) also sent letters to the Department's vendors requesting account statements. The purpose was to identify vendors with balances owed to the Department. About 4,000 letters were mailed and about 900 vendor statements were received as of September 30, 2005. Additional accounts, totaling approximately $108.7 thousand, were identified by the recovery auditors with potential balances owed to the Department. The CFSC is in the process of validating the balances in the accounts.

U.S. DEPARTMENT OF STATE DEBT RECOVERY PROGRAM

Audit Program	Amount of Payments Subject to Review	Number of Payments Reviewed	Number				Amount (in $000)		
			Potential Duplicates	Actual Duplicates Confirmed	Claims Collected	Outstanding Claims	Duplicate Payments Confirmed	Duplicate Payments Collected	Outstanding Claims
Recovery Auditor	$8.4 Billion	419,688	39	4	—	4	$ 51	$ —	$ 51
Internal CFSC Audit	$22.2 Billion	709,235	284	255	172	83	$ 5,299	$ 5,190	$ 109
Total	$30.6 Billion	1,128,923	323	259	172	87	$ 5,350	$ 5,190	$ 160

To monitor on a routine basis the quality of the Department's payment processes, the CFSC has in place its own debt recovery program and a management structure to monitor for duplicate and erroneous payments. The Financial Oversight and Coordination Office (FOC) and the Office of Claims perform a monthly audit of all payments focusing on identifying potential erroneous and duplicate domestic payments. FOC uses data mining software that identifies potential duplicate and erroneous payments. Once the potential duplicate and erroneous payments are identified, the Office of Claims validates them and the collection process begins. In addition, the Office of Claims has established a debt management support structure, specifically focused on early detection, identification and collection of erroneous and duplicate commercial claims. For FY 2005, there were 284 payments identified as potential duplicate/erroneous payments. Of these, 255 were confirmed duplicate payments totaling approximately $5.3 million as shown in the above table. Of the 255 confirmed duplicate payments, 172 have been collected totaling $5.19 million while 83 remain outstanding totaling $109 thousand.

ACCOUNTABILITY

The Department is committed to reducing erroneous payments issued domestically and overseas. Programs and procedures have been instituted that will strengthen agency management and internal control procedures for prevention, detection and recovery of erroneous payments. The following improvements are being undertaken:

- Issue updated guidance for performing program reviews and risk assessments
- Strengthen policies and procedures with regard to proper documentation requirements for payments
- Provide training to affected staff regarding proper payment requirements and documentation
- Strengthen payment and debt management programs policies and practices that will improve detection, referral and recovery efforts
- Report information on improper payments in the annual *Performance and Accountability Report*

INFORMATION SYSTEMS

Based on the improper payment reviews conducted in FY 2004 and FY 2005, the improper payments identified did not result from the lack of proper information systems. Although the Department is currently in transition to implement a global financial management system by FY 2007, the current financial management system did not have an impact on the level of improper payments identified.

ISSUES

As previously mentioned, one of the challenges the Department faced in FY 2005 was determining to what extent federal financial assistance should be tested to obtain reasonable assurance that improper payments are not occurring at the grantee level. The Department performed limited procedures to test for improper payments that did not involve reviewing payments at the grantee level. However, to supplement the test work performed, the Department relied on monitoring procedures performed at the program offices, the A-133 reports of grantees, and the results of OIG reviews. In FY 2006, the Department will consider establishing procedures in the Bureau of Resource Management to monitor financial transactions. The Department will also seek guidance from OMB in FY 2006 to determine the most feasible way to test federal financial assistance for compliance with the IPIA. The Department will also review best practices to follow in FY 2006.

The Department of State Charleston Financial Service Center.
Department of State Photo

MANAGEMENT OF AUDIT FOLLOW-UP

The information on the Department's follow-up on audit recommendations covers 2005. 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 2005, the Department of State tracked 19 audit reports that were more than one year old and included a total of 60 recommendations in which final action was not taken, which would have brought closure to the reports. These audits contain over $2,070,718 in disallowed costs and funds put to better use. The Department is working to bring closure to the 19 audits and recognizes that the follow-up actions and compliance to the recommendations are essential to improving the effectiveness and efficiency of program operations.

Management Statistical Summary 19 Audits Over One Year Old Requiring Final Action		
Program Area	**Number of Audit Reports**	**Recommendations**
Financial Management	11	44
Information Management	1	6
Security Oversight	–	–
Support Programs	–	–
Property Management and Procurement	2	5
Contracts and Grants	5	5
TOTALS	**19**	**60**

Status of Audits with Recommendations that Funds Be Put to Better Use or Costs be Disallowed

On October 1, 2004, there were no audits with recommendations to put funds to better use. One audit was completed during the year with disallowed costs of $1,800,000. The balance on September 30, 2005 was $1,800,000.

Status of Audits of Disallowed Costs

On October 1, 2004, there was one audit with management decision on which final action had not been taken with a dollar value of disallowed costs totaling $110,851. During the year, two audits were completed that included disallowed costs of $159,867. Therefore, the resulting balance on September 30, 2005 was $270,718.

Funds Put to Better Use and Disallowed Costs in Audit Reports				
	Number of Audit Reports Identifying Amount of Funds Put to BetterUse	**Amount of Funds Put to Better Use**	**Number of Audit Reports Identifying Disallowed Costs**	**Disallowed Costs**
Beginning Balance	—	—	1	$ 110,851
New Audits	1	$ 1,800,000	2	159,867
Implemented Actions	—	—	—	—
Ending Balance	1	$ 1,800,000	3	$ 270,718