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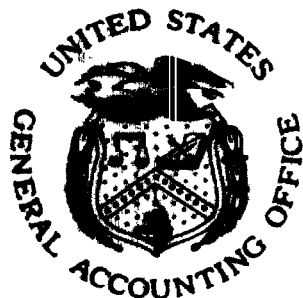
**Report To The Secretary Of State**

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**Department Of State's First-Year  
Implementation Of The Federal Managers'  
Financial Integrity Act**

GAO conducted a review of 22 federal agencies' efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse across the spectrum of federal government operations through annual agency self-assessments of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by the Department of State in its first year of experience with this new act. The report focuses on State's efforts to evaluate internal controls, review accounting systems, and improve the evaluation processes as a result of identified problems.



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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND  
INTERNATIONAL AFFAIRS DIVISION

B-202205

The Honorable George P. Shultz  
The Secretary of State

Dear Mr. Secretary:

This report presents the results of our review of the Department of State's efforts to implement and comply with the Federal Managers' Financial Integrity Act (FIA) of 1982 (31 U.S.C. 3512(b) and (c)), which is aimed at strengthening internal control and accounting systems in federal agencies. (See glossary for definitions of these and other technical terms used in this report.) Our review was part of a governmentwide review conducted to assess the first-year implementation of the act.

FEDERAL MANAGERS' FINANCIAL  
INTEGRITY ACT

Since the Accounting and Auditing Act of 1950 (31 U.S.C. 3512), agency heads have been required to establish and maintain effective internal control systems, and to establish accounting systems that comply with the Comptroller General's requirements.

In 1982, the FIA added a requirement that the head of each executive agency evaluate and report by each December 31st to the President and to the Congress on the adequacy of and weaknesses in their systems of internal administrative and accounting controls, and report separately whether their accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General.

The FIA also required the Office of Management and Budget (OMB) to establish guidelines for evaluating the systems of internal control and the Comptroller General to establish the standards for internal controls. The guidelines were issued in December 1982 and the standards in June 1983. The act did not specifically require that guidelines be established for evaluating whether accounting systems conform to the Comptroller General's principles and standards. In September 1983, however, the Comptroller General suggested steps agencies could take for their first year effort. Also, OMB has been working to develop guidelines for agencies' second year accounting compliance evaluation efforts.

STATE'S FIRST YEAR

We are pleased to report that State has made progress in complying with OMB's guidelines for evaluating and reporting on internal controls. State's first-year effort is impressive considering the scope and complexity of the Department's operations and the intent of the FIA. This effort led to the identification of several material weaknesses in internal control systems, along with plans to fix them. As is often the case in first-year implementation efforts, however, State, like many other agencies, experienced some difficulties and some aspects of the implementation effort could be improved.

Also, State was working to improve its accounting systems before enactment of the FIA and did a good job of reporting the extent to which its major accounting systems comply with the Comptroller General's principles and standards. Here, too, there are some aspects of State's implementation effort which could be improved.

The weaknesses noted in State's process for first-year implementation of the act need to be corrected so that the year-end statement of reasonable assurance on the status of State's internal administrative and accounting controls and the extent to which its accounting systems comply with the Comptroller General's requirements will become more meaningful in State's next annual report to the President and the Congress. A discussion of the results of our review follows. Additional details are included in appendix I along with the objectives, scope, and methodology of our review.

Internal Control Program

The OMB guidelines provide a basic approach to evaluating, improving, and reporting on internal controls. OMB recommends the following process as an efficient, effective way to perform the required evaluations: (1) organizing the internal control evaluation process; (2) segmenting the agency to create an inventory of assessable units, a list of all programs and functions, each of which can be assessed for vulnerability to waste, loss, unauthorized use, or misappropriation; (3) conducting vulnerability assessments in each unit to determine the likelihood that waste, loss, unauthorized use, or misappropriation could occur; (4) reviewing internal controls to see if they are adequate and thus give reasonable protection against waste, loss, unauthorized use, or misappropriation; (5) taking corrective actions to improve internal controls where weaknesses are found; and (6) reporting on the adequacy of internal controls and plans for corrective action.

### Organization

State's internal control directive assigned overall implementation responsibility to the Comptroller and assistance responsibilities to several other officials and groups. Among these were the Director General of the Foreign Service, an internal control committee, and an internal control task force. In addition, the Inspector General (IG) provided some advice during the 1983 implementation effort by commenting on drafts of State's internal control directive and vulnerability assessment guidelines. He also independently reviewed the implementation process and has been asked to evaluate internal controls as part of each inspection he conducts.

We noted that neither the committee nor the task force were active in assisting the Comptroller during the first year. For most of 1983, program guidance and monitoring at the central level was accomplished primarily by the internal control task force chairman. In fact, he was the only staff member assigned to work full-time on the FIA program during most of the year.

We encourage active top level managers' participation in the program and we believe that managers should be held accountable for their internal control responsibilities. In this regard, we noted that the Director General of the Foreign Service was tasked by the Internal Control Directive to establish and issue procedures requiring that internal control responsibility performance be a factor in performance appraisals. This factor, however, is not expected to be in all managers' appraisals until performance agreements are redone in the summer of 1984.

### Segmentation

The assessable units identified when segmenting for the first-year implementation effort did not include all programs and functions of the Department. For example, State did not include the Bureau of Protocol, which operates the Blair House to provide accommodations for visiting dignitaries. The Blair House has a large inventory of government property which could be susceptible to loss. Also, State did not include the Bureau of International Organization Affairs which includes the U.S. Mission to the United Nations. This mission has a staff of over 100 people. The 285 units identified for assessment in 1983 were in only 12 of State's 38 organizational components. Additionally, individual assessable units were developed for only three foreign facilities although State has about 250 foreign posts. We recognize that State plans to identify assessable units for all programs and functions covered by the act in its second-year implementation effort. We believe this will lead to closer compliance of State's implementation effort

with OMB's guidelines, and to a greater realization on the part of many managers of their importance in reducing waste and operational inefficiency.

### Vulnerability Assessments

Vulnerability assessments were conducted for the 285 assessable units. These are preliminary assessments of the likelihood that waste, loss, unauthorized use, or misappropriation could occur. The assessments include factors such as management's attitude toward internal controls and the inherent risk in a program or function's operations. In performing these assessments, organizational units at State were allowed to follow either of two sets of guidelines State had developed, or any other methodology if results could be reported in conformance with a prescribed format. The criteria in the two sets of guidelines were not fully consistent, however, and this made ranking the assessment results difficult.

Many staff members who performed assessments received no training, the assessments were not adequately documented, and little quality assurance was exercised over the assessment process. Additionally, assessments of automated data processing activities were not adequate. This was because many automated data processing general and application controls were not included as factors in State's assessment guidelines and were not assessed. Examples include controls over systems design, development, maintenance, and physical security. Adequately assessing automated data processing activities is particularly important because State is heavily dependent on automated systems to carry out its mission and administrative functions. For example, the Foreign Affairs Data Processing Center is vital to the Department's overseas networks. A consultant's risk analysis study of the center, conducted several months after the vulnerability assessments, uncovered a number of vulnerabilities not found during the vulnerability assessments.

Your staff is planning to redo the assessments prior to the second annual report and is developing new assessment guidelines, which include detailed documentation requirements, and are to be consistently followed throughout the Department. They also plan to provide close monitoring to ensure the quality of assessments performed in 1984 and to provide training for all managers involved in the process. Additionally, they have developed a plan to assure that automated data processing activities are adequately assessed in 1984.

### Internal Control Reviews

Compared to vulnerability assessments, the internal control review process described in the OMB guidelines and in State's guidelines represents more difficult and time-consuming tasks

for managers. That is because, unlike a vulnerability assessment, an internal control review is a detailed examination (including transaction testing) of a program or function's system of internal controls. These reviews are usually conducted on programs or functions which have been found by vulnerability assessments to be highly or moderately susceptible to waste, loss, unauthorized use, or misappropriation. The purpose of an internal control review is to find out if the internal control system is in compliance with the Comptroller General's standards for internal controls and will thereby reduce the risk of waste, loss, unauthorized use, or misappropriation to an acceptable level.

No internal control reviews were completed at State in 1983. Three were begun, however, in the Bureau of Consular Affairs in late November. One other office stated a need for an internal control review, but decided it could not afford the staff resources to perform one.

State's Comptroller's Office plans to review vulnerability assessment results to determine if more internal control reviews are needed. We believe more internal control reviews are needed to give greater assurance that internal control systems comply with the Comptroller General's standards, and we encourage you to insist that all needed internal control reviews be undertaken.

#### Corrective Actions

Some corrective actions are underway to fix internal control weaknesses identified in State's first-year implementation effort and other corrective actions are planned. Assistant Secretaries of each Bureau, Office Heads, and Chiefs of Mission have been assigned responsibility for assuring planned corrective actions are taken. A system to track and follow up on planned corrective actions was being implemented in May 1984.

We believe that prompt and positive action to correct identified weaknesses is the heart of this program, and we encourage your managers to continue to devote the resources necessary to do so.

#### Reporting

State's first-year report disclosed several material weaknesses in internal control systems and included plans for action to correct them. (See app. II.) Among the material internal control weaknesses reported by the Department were the (1) limitations in the process of checking criteria for passport denial, (2) potential for people to subvert the visa and legal entry process, and (3) inadequate accountability over purchasing and

inventorying equipment for the Department's Security Enhancement Program. The report also included an enclosure which briefly described State's first year internal controls evaluation effort.

### Accounting System Compliance

As mentioned earlier, the act did not specifically require that guidance be developed on the steps an agency should follow to determine and report whether its accounting systems comply with the Comptroller General's requirements. However, on September 29, 1983, the Comptroller General suggested the following actions agencies could take for their first year effort to provide building blocks for future years' implementation efforts: (1) organize the accounting systems evaluation process, (2) develop an inventory or list of accounting systems, (3) identify previously reported deviations from the Comptroller General's requirements, (4) identify any projects underway to enhance accounting systems, (5) rank the systems based on how material the deviations might be, (6) begin reviewing the systems to find out if they comply with the requirements, and (7) plan for the first-year report.

State made progress in the same direction as the Comptroller General's suggested steps during its first-year implementation effort because it was already working to improve its accounting systems. Prior General Accounting Office and Inspector General reports and contractor studies had already identified many significant deviations from the Comptroller General's principles and standards in State's major accounting systems. Many compliance problems were therefore known without performing detailed compliance reviews. Also, State initiated efforts in March 1982 to replace or enhance these accounting systems so that its managers would have the resource-related data needed to carry out their foreign affairs missions.

State's December 1983 report stated that the Department's major accounting systems are not in compliance with the Comptroller General's principles and standards. An example of the type of weaknesses reported is that there is minimal control over billions of dollars in property. (See app. II for list of weaknesses reported.) The report also discussed the system replacements and enhancements that State believes will correct system weaknesses. These ongoing and planned corrective actions will be included in State's tracking and follow-up system.

There are two smaller accounting systems which are not being replaced or enhanced. State officials plan to develop compliance review guidelines, provide any needed training for staff who will conduct the reviews, and review these systems before the second year report is issued. They also plan to



study the major weaknesses in systems for which the scheduled replacement or enhancement will not be implemented for a few years, to determine if any cost-effective corrections can be made before the scheduled system improvements.

CONCLUSIONS

In summary, State has made progress in implementing the FIA, although, there were some weaknesses in its first-year effort. State officials plan to take several actions designed to improve this year's implementation effort, however, and as these improvements are made, the yearend statement of reasonable assurance on the status of State's internal administrative and accounting controls and the extent to which its accounting systems comply with the Comptroller General's requirements will become more meaningful. GAO plans to closely monitor the planned improvements. Because of State's plans, however, we are not making recommendations for program improvement at this time.

AGENCY COMMENTS

The Department of State agrees with the observations made in this report. Appendix III contains a copy of State's comments.

. . . . .

We are sending copies of this report to the Chairmen of the House and Senate Committees on Appropriations and the Budget, the Senate Committees on Governmental Affairs and Foreign Relations, and the House Committees on Government Operations and Foreign Affairs, and to the Director, OMB.

We appreciate the courtesy and cooperation extended to us during our review.

Sincerely yours,



Frank C. Conahan  
Director



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### ABBREVIATIONS

ADP	Automated Data Processing
FIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
IG	Inspector General
OMB	Office of Management and Budget



OBSERVATIONS ON STATE DEPARTMENT'S  
FIRST-YEAR IMPLEMENTATION OF THE FIA

INTRODUCTION

The Congress, in 1982, enacted the Federal Managers' Financial Integrity Act, 31 U.S.C. 3512(b) and (c), in response to continuing disclosures of waste, loss, unauthorized use, or misappropriation across a wide spectrum of government operations, which were largely attributable to serious weaknesses in agencies' internal controls. The act is designed to strengthen the existing requirement of the Accounting and Auditing Act of 1950, that executive agencies establish and maintain systems of accounting and internal control to provide effective control over and the accountability for all funds, property, and other assets for which the agency is responsible, 31 U.S.C. 3512(a)(3).

We believe that full implementation of the FIA will enable the heads of federal departments and agencies to identify their major internal control and accounting problems and improve controls essential to the development of an effective management control system and a sound financial management structure for their agency. To achieve this, the act requires:

- Each agency to establish and maintain its internal accounting and administrative controls with the standards prescribed by the Comptroller General, so as to reasonably ensure that (1) obligations and costs comply with applicable law; (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are recorded and properly accounted for.
- Each agency to evaluate and report annually on internal control systems. The report is to state whether agency systems of internal control comply with the objectives of internal controls set forth in the act and with the standards prescribed by the Comptroller General. The act also provides for agency reports to identify the material weaknesses involved and describe the plans for corrective action.
- Each agency to prepare a separate report on whether the agency's accounting systems conform to principles, standards and related requirements prescribed by the Comptroller General (section 4 of the act).

- The OMB to issue guidelines for federal departments and agencies to use in evaluating their internal accounting and administrative control systems. These guidelines were issued in December 1982.
- The Comptroller General to prescribe standards for federal agencies' internal accounting and administrative control systems. The Comptroller General issued these standards in June 1983.

The Comptroller General's presentation at the September 29, 1983, meeting of the assistant secretaries for management outlined expectations for agency efforts to report on conforming accounting systems to the Comptroller General's standards (section 4 of the act). Recognizing that not all agencies had begun work to implement section 4, the Comptroller General emphasized the following actions which could be taken to provide building blocks for future years' implementation:

- Organize for completing accounting systems evaluations and issue needed written policies and procedures.
- Inventory accounting systems.
- Identify prior reported system deviations.
- Rank the systems according to the materiality of potential deviations from our accounting principles and standards.
- Initiate reviews of systems.
- Plan for the first year report.

This report on the Department of State is one of 22 reports on the federal agencies' efforts to implement the act.

#### STATE DEPARTMENT'S FIA IMPLEMENTATION PROCESS

State Department's 1983 FIA implementation effort was carried out almost entirely in Washington, D.C. Its implementation process for evaluating and reporting on internal control systems followed the major implementation phases outlined in OMB's guidelines: organizing, segmenting, vulnerability assessments, internal control reviews, taking and following up on planned corrective actions, and reporting.

State's implementation process for evaluating and reporting whether accounting systems comply with the Comptroller General's principles and standards considered the Department's ongoing effort to develop new systems for its major accounting functions. The Inspector General (IG) played a limited role in both processes. Each process and the IG's role are described briefly below.

#### Internal control systems evaluation process

In organizing to implement internal control provisions of the act, State developed an internal control directive which established the program. The directive assigned overall responsibility for the process to the Comptroller. It also assigned responsibilities to other officials and groups. For example, an internal control committee was assigned to assist the Comptroller in managing the process, an internal control task force was assigned to assist the Comptroller in implementing the process, and the Director General of the Foreign Service and Director of Personnel was assigned to establish and issue procedures requiring inclusion of internal control responsibility as a factor in performance appraisals.

Once State's implementation process was organized, the Department was segmented into organizational components for which assessable units could be developed. The purpose of segmenting is to develop an inventory of units which cover all of an agency's programs and administrative functions and which can be assessed for vulnerability to the occurrence of waste, loss, unauthorized use, or misappropriation. Of the 38 organizational components shown on State's January 1982 organization chart, 31 were initially selected for determining assessable units, but ultimately, units to be assessed in 1983 were developed for only 12 components. The 12 components developed 285 assessable units for the first-year implementation effort. An example of a major organizational component not included in State's assessable units is the Bureau of Protocol, which operates the Blair House to provide accommodations for visiting dignitaries. The Blair House has a large inventory of government property which could be susceptible to loss. Another example is the Bureau of International Organization Affairs, which includes the U.S. Mission to the United Nations. This mission has a staff of over 100.

State developed two sets of guidelines for performing vulnerability assessments and allowed the organizational components conducting the assessments to follow either set, or any other methodology if results could be reported in conformance with a prescribed format. The assessments were scheduled for completion by January 31, 1983, but assessments for some of the

285 units were not completed until late September 1983. State reported that the assessments resulted in finding 37 units highly vulnerable and 85 moderately vulnerable to waste, loss, unauthorized use, or misappropriation. The remainder were found to have low vulnerability.

By mid-November 1983, the 12 components reported to the Comptroller's Office the corrective actions planned as a result of vulnerability assessments. Most planned actions involved increased training or making program changes to correct control weaknesses. Two components stated a need for internal control reviews, but one later decided it did not have the staff to perform a review.

After vulnerability assessments are performed to determine how susceptible a program or function is to waste, loss, unauthorized use, or misappropriation, internal control reviews can be performed beginning with those programs/functions determined to be highly or moderately vulnerable. An internal control review is a thorough evaluation of a system of internal controls (including transaction testing) to find out if cost effective controls are in place and working so the risk of waste, loss, unauthorized use, or misappropriation will be reduced to an acceptable level. State developed guidelines for performing internal control reviews, trained reviewers in the component requesting the reviews, and began three reviews on November 28, 1983. These reviews are to cover nine assessable units in the Bureau of Consular Affairs which were rated highly vulnerable and 14 that were rated moderately vulnerable. They are expected to be completed by June 30, 1984.

State is implementing a tracking and follow-up system. It will be used to track progress in making any corrections to internal control systems which are determined necessary following completion of the internal control reviews. It will also track the corrective actions planned during State's first-year implementation effort. The system is expected to be fully operational by the end of June 1984.

State used vulnerability assessment results, GAO and State IG reports, and the knowledge of some of its experienced officials to determine the material internal control weaknesses to be included in its December 1983 report to the President and to the Congress. Among the material internal control weaknesses identified by the State Department are the (1) potential for individuals to subvert the visa and legal entry process; (2) limitations in the process of checking criteria for passport denial; (3) basis for costing and billing of administrative support to agencies serviced in other countries; and (4) inadequate accountability over the purchasing, inventorying, and shipping of equipment for the Department's Security Enhancement Program.



The report also included corrective actions the Department plans to take to overcome the reported weaknesses.

#### Accounting systems compliance evaluation process

State began evaluating its major accounting systems in 1980 before passage of the Federal Managers' Financial Integrity Act and found, as have past evaluations by GAO and State IG, that the systems have major weaknesses and do not fully comply with the Comptroller General's accounting principles and standards. To improve this situation, State initiated efforts in March 1982 to improve the effectiveness of financial management functions that provide its managers with the resource-related data needed to carry out their foreign affairs missions. State plans to replace or enhance four of its six accounting systems over the next four years at an estimated cost of \$37 million. An important by-product of this effort will be to bring the major accounting systems into compliance with the Comptroller General's accounting principles and standards.

State's first-year implementation effort for accounting compliance provisions of the act began with the Comptroller being verbally assigned implementation responsibility. Accounting compliance evaluation guidelines were not developed, staff was not trained, and compliance evaluations were not performed because State saw little reason to evaluate systems it planned to replace. Instead, it developed an inventory of accounting systems and worked to develop a list of weaknesses in its major systems. To develop the list of weaknesses, State officials reviewed contractor studies of the systems, as well as GAO and IG audit reports. They also interviewed senior managers knowledgeable of the systems, and developed checklists of GAO's requirements to compare with system features. The systems were later ranked, based on the seriousness of deviations from the Comptroller General's accounting principles and standards.

State's first-year report to the President and to the Congress on accounting systems compliance discussed the Department's efforts to identify accounting systems problems. It also stated that State's accounting systems did not meet the Comptroller General's principles and standards, disclosed material weaknesses in the systems, and presented the corrective actions which had been taken or are planned. Among the major accounting weaknesses identified by the State Department are

- accounting control over billions of dollars in property is minimal;
- a system of general ledger and subsidiary accounts is not maintained and full accrual accounting is not used;

--financial information is not timely. Existing financial reports are limited and fail to provide needed information; and

--separate payrolls exist which lack standardization.

#### Inspector General's role

State's IG provided some advice to the Comptroller's Office on the internal control systems evaluation effort. He also independently reviewed the first-year internal controls evaluation implementation effort and performed limited review work to assess the quality of State's first year accounting compliance report. Additionally, the IG has been asked to evaluate internal controls as part of each inspection he conducts.

#### IMPROVEMENTS NEEDED IN STATE'S INTERNAL CONTROL EVALUATION PROCESS

The State Department has made progress in implementing the internal controls evaluation process. As noted, however, there were some weaknesses in State's first year effort. These weaknesses need to be corrected so that the statement of reasonable assurance on the status of State's internal controls will become more meaningful in State's next annual statement to the President and the Congress. Two areas of particularly significant weakness in State's first-year effort are discussed below.

#### More specific guidance and training are needed to improve the evaluation effort

Although State did not complete any internal control reviews in 1983, vulnerability assessments were performed for the 285 assessable units developed. However, our review found that assessable units might not be rated consistently because State had two sets of guidelines. As a result, a rating of "moderately vulnerable" under one set of guidelines might not mean moderately vulnerable under the other set of guidelines. Thus, it is uncertain whether comparable rankings of assessable units were valid. Also, many assessments were inadequately documented and State's assessment guidelines were inadequate in some respects. Further, many of the managers who performed these assessments received no training. We believe that in addition to the close monitoring State plans to ensure quality during the 1984 assessment process, better guidance and training will also be needed to ensure consistency. This is especially so since State plans to assess all programs and functions throughout the Department which will add a significantly larger number of assessments to be performed.

After developing two sets of vulnerability assessment guidelines for the first-year implementation effort, State allowed agency components to use either set or any other methodology as long as assessment results could be reported in conformance with a prescribed format. Agency components exercised this flexibility, although they did not all report assessment results in the prescribed format. Additionally, this programmed inconsistency into the assessment process from the beginning because the two sets of guidelines were not fully consistent which made ranking the assessments difficult. We noted that seven agency components used one set of guidelines, two used the other set, one used one set for some assessments and the other set for other assessments, one, the Bureau of Personnel, used one set for some assessments and neither for others, and one, the Bureau of International Narcotics Matters, did not fully follow either set.

State's assessment guidelines contained different forms which were required to be filled out when performing an assessment. The agency components that followed one of the guidelines, however, did not fill out all the required forms. Also, some of the forms submitted to the Comptroller's Office were only partially filled out and/or were not signed by the assessment performer or the reviewer. One official said he had never seen the assessment form on which his name was typed as activity manager. In the Bureau of Personnel, some forms were not signed by anyone and there were no forms for other assessments, the results of which were reported in memorandum form. Additionally, the bureau, which chose not to fully follow either set of guidelines, developed its own assessment forms.

Backup documentation for assessment results was not available in some instances, although both sets of guidelines briefly mentioned some types of backup documentation. For example, the internal control manager in the Bureau of Inter-American Affairs said the assessment documentation was discarded because of a shortage of file cabinets. Officials responsible for automated data processing (ADP) in the Bureau of Administration discarded all backup documentation after assessments were completed. There was no backup documentation for the assessment performed at the Paris Regional Administrative Management Center. This makes it very difficult for the Comptroller's Office or anyone else to evaluate the quality of the assessments.

Both of State's vulnerability assessment guidelines were, in some respects, inconsistent with OMB's guidelines, which was to be expected since both were written before OMB issued its guidelines. For example, one set of guidelines did not (1) consider policies and procedures as a factor in assessing a program or function's vulnerability, (2) contain quality assurance

procedures, and (3) provide for an assessment of compliance with standards of internal control. Moreover, the other set of guidelines did not provide for an assessment of compliance with standards of internal control and its quality assurance procedure did not provide for testing the assessments or for coordinating with applicable reviews by the Inspector General. Further, State's guidelines did not adequately provide for assessing ADP general or application controls because they did not include, as assessment factors, many important ADP control points. For example, controls over systems design, development, maintenance, physical security, and disaster recovery were not included as assessment factors. State ADP officials in the Bureau of Administration said that they did not expand on State's assessment guidelines when assessing ADP vulnerability and agreed that the guidelines and assessments were inadequate.

We found that training provided to State Department personnel, who performed the vulnerability assessments, was insufficient to a large extent. At least 50 percent of the people who performed assessments received no training. Some assessment performers expressed difficulty in relating the assessment process to operations in their own unit.

State officials recognize that the vulnerability assessment guidance and training need to be improved. They plan to issue one set of guidelines for the 1984 assessments which is to include detailed documentation requirements and be required for use throughout the Department. They also plan to provide training in 1984 for all managers asked to perform assessments. Therefore, we are not making recommendations on these matters, but we do plan to closely monitor State's second year implementation effort.

#### Need to adequately assess ADP controls

State is heavily dependent upon automated systems to carry out its mission and administrative functions. For example, the Foreign Affairs Data Processing Center is vital to the mission of the State Department. Much of the data handled by the center is classified, and the computer systems are essential to overseas networks and critical applications. State has budgeted \$24.7 million to spend on ADP for fiscal year 1984.

As noted earlier, State ADP officials recognize that State's vulnerability assessments did not adequately assess ADP controls. The prime reasons were that State's guidance did not include certain important ADP controls as assessment factors or provide details on how to assess ADP vulnerability, and assessment performers limited their consideration of ADP controls to factors included in the guidance. Additionally, it should

be pointed out that State's vulnerability assessment training did not include details on how to assess ADP vulnerability and three of the six ADP assessment performers in the Bureau of Administration received no training. Further, backup documentation which might have shown the factors considered in assessing ADP controls were discarded.

By not adequately assessing ADP controls, State may not identify as vulnerable or schedule internal control reviews for programs or functions where internal control systems may have material weaknesses. For example, a consultant's risk analysis study of State's Foreign Affairs Data Processing Center, performed several months after the vulnerability assessments were completed, uncovered several risks that were not mentioned in the assessments. Based on this analysis, the center was found to be vulnerable to (1) willful damage by malicious intruders, (2) accidental damage from environmental factors, and (3) extended periods of inoperability because of electrical and mechanical problems.

In commenting on a draft of this report, which had proposed a recommendation that the Secretary of State ensure that ADP general and application controls are adequately assessed in 1984, State officials agreed that ADP controls need to be adequately assessed. Further, they have developed a plan which they believe will result in a more adequate assessment in 1984. Therefore, we have removed the recommendation which had been proposed in the draft report.

#### ACCOUNTING SYSTEM COMPLIANCE

Section 4 of the FIA requires that each agency report whether their accounting systems conform to the accounting requirements prescribed by the Comptroller General. By the end of the first year's implementation effort, State had prepared a report to the President and the Congress stating that its accounting systems do not comply with the Comptroller General's requirements, but that corrective actions are being taken. State had also performed most of the actions suggested by the Comptroller General in a speech to agency Assistant Secretaries on September 29, 1983. In his speech concerning agency efforts to implement section 4, the Comptroller General said that the tasks of reviewing accounting systems compliance with the GAO requirements and correcting the significant deviations are important, and will require a substantial sustained effort by each agency. He suggested several constructive actions that agencies could take during the first year of the act to provide building blocks for future years' implementation of section 4. The actions completed by State through the end of the first year have already been discussed in this report. As a result of

these actions, State completed most of the Comptroller General's suggestions and has a good foundation from which to expand its efforts during the second year.

During 1984, State officials say they plan to prepare written guidance and procedures that will assign responsibilities for the accounting compliance evaluation implementation. They say the guidance will also explain the need for and the purpose of compliance evaluations, how they are to be performed, and assign responsibility for quality review. Additionally, they say that, after choosing officials to perform the compliance evaluations in 1984, they will conduct training as needed. State plans to conduct compliance evaluations in 1984 on the two systems not scheduled for replacement or enhancement--the International Boundary and Water Commission accounting systems.

In addition to the above actions, State officials say they will consider making cost-beneficial improvements to accounting systems being replaced or enhanced. These actions will be interim measures taken to improve internal control in the systems to prevent waste, loss, unauthorized use, or misappropriation of funds. State officials said they are considering actions to improve cashier operations, to increase the number of account reconciliations, and to increase the number of surprise cash audits. In deciding if the benefits to be obtained will outweigh the costs to make the corrections, the officials said they will consider such factors as the (1) significance of the weakness, (2) dollar volume accounted for, (3) use of the system, and (4) date the system revision or replacement is to be implemented.

Because of State's plans, we are not making recommendations concerning the accounting systems compliance effort at this time. We do plan, however, to closely monitor State's second-year implementation effort.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our review was to evaluate State's process for implementing the Federal Managers' Financial Integrity Act and its first annual reports on the status of internal control and accounting systems. Our review was conducted in Washington, D.C., except for a small amount of work performed at State's Regional Administrative Management Center in Paris, France. Our review included

- interviewing key officials responsible for directing and implementing State's first-year effort;

- reviewing relevant legislation; OMB's implementation guidelines; and State's directive, guidelines, year-end reports, and other documentation relevant to the first-year effort;
- reviewing documentation prepared by OMB's review of State's implementation effort;
- examining documentation submitted to State's Comptroller's Office for all 285 vulnerability assessments performed;
- interviewing over 170 managers who were involved in the vulnerability assessment process; and
- examining plans for corrective actions submitted by the 12 State Department components which performed the assessments.

Because our first-year review was limited to an evaluation of the implementation process, we did not attempt to independently determine the status of State's internal control system or the extent to which their accounting systems comply with the Comptroller General's accounting principles and standards. Our work was conducted in accordance with generally accepted government auditing standards.

INTERNAL CONTROL WEAKNESSES AND WEAKNESSES IN  
ACCOUNTING SYSTEMS REPORTED TO THE PRESIDENT AND  
THE CONGRESS IN THE DEPARTMENT OF STATE'S  
DECEMBER 1983 FIA STATEMENT

The Department of State's December 1983 FIA statement reported four department-wide and five organization or program specific areas which contain material weaknesses in internal controls. The accounting compliance portion of the statement reported material weaknesses in the Department's four major accounting systems. The statement also listed the actions taken, actions underway, and actions planned to correct the material weaknesses reported. Excerpts from the statement showing the areas of material weaknesses reported follow.

INTERNAL CONTROL

Department-wide material weaknesses

- The Departmental Accounting System has not been approved by the Comptroller General. The system does have fund controls. However, it is weak overall, and does not meet the principles, standards, and related requirements of the Comptroller General.
- Certain personnel in the administrative and program management functions lack sufficient competency because of inadequate training. The development of sufficient numbers of personnel with foreign language proficiency is also affected by the lack of training availability and resources.
- The Foreign Affairs Manual portions on "Financial Management" require major updating to reflect regulatory and procedural changes.
- A Departmental personal property management program must be developed for use at posts throughout the world. Management controls in the major functions encompassed by personal property management activities are generally inadequate.

Organization or program specific  
material weaknesses

- The system utilized for the costing and billing of administrative support to serviced agencies is based upon past usage, thus resulting in variances with current actual service consumption.



- The visa issuance function is a target for fraud and abuse by individuals who seek to subvert the visa and legal entry process.
- Limitations in the process of checking criteria for passport denial result in the potential issuance of passports to some individuals who should have been denied.
- There is inadequate accountability of the purchasing, inventorying, and shipping of equipment for the Department's Security Enhancement Program.
- Control of funds overseas in disbursing, currency purchasing, and cashiering needs closer monitoring and management supervision.

### ACCOUNTING SYSTEM COMPLIANCE

#### Departmental accounting system

This system has not been approved by the Comptroller General. The system does have fund controls. However, overall it is weak and does not meet the principles, standards, and related requirements of the Comptroller General.

- The system does not provide readily or automatically for the preparation of all needed financial reports. Existing financial reports are not timely and fail to provide needed management and fiscal information. Additionally, data requires further manual manipulation before it is usable by management. Research into resource issues is frequently inhibited because of the lack of adequate available data.
- The Department is not able to maintain a system of general ledger and subsidiary accounts. Accordingly, the data reported on financial statements are derived laboriously and based on questionable records of resources and operations.
- The full accrual basis of accounting is not used. Therefore, the system does not recognize all significant and accountable aspects of financial transactions, events, or allocations, as they occur. The Department's attempt to periodically convert data to the accrual basis is a labor intensive process, cumbersome, untimely, and results in data which are questionable.
- Significant elements of cost incurred are not systematically measured, assembled, or reported.

Therefore, management does not have adequate cost information to assure efficient use of resources in carrying out operations.

- There is no adequate system of records and related procedures to provide a proper accounting over billions of dollars invested in property. Accordingly, property records are incomplete and unreliable, inhibiting effective management of property.
- The system does not provide reliable financial data needed in determining and supporting hundreds of millions of dollars to be reimbursed from other government agencies resulting in questionable and often disputed billings.
- Training of certain administrative personnel is inadequate for the responsibilities, duties, and functions assigned to them.
- Many policies and procedures for carrying out financial operations do not conform to applicable laws, external regulations, or current management policies, resulting in a lack of appropriate guidance for the Department's worldwide budget and fiscal operations.

### Payroll system

The payroll system is composed of two parts. One part relates to American employees, the other to Foreign Service Nationals.

In September 1977, the Comptroller General approved the design of that portion of the system which operates in Washington and performs the payrolling for all employees located in the United States and South America. The systems for payrolling of employees located in other parts of the world have not been approved.

### American employees

The payroll systems are not integrated, resulting in employees transferring between payrolling offices being incorrectly paid, receiving separate W-2's, and having difficulty in obtaining data regarding leave history.

In addition, the Washington based system does not include the necessary up-front controls to assure that payroll data is correctly processed, all data is considered in the processing, and the results of processing are accurate.

### Foreign Service National employees

Payroll is processed by three systems which differ from each other in design and operation. These systems are between 8 and 15 years old, have been continuously modified and are difficult to maintain. In addition, there is a need to develop system modules to support the unique features of the compensation plans of employees in 140 countries.

### Working Capital Fund system

This system was approved by the Comptroller General in May 1965. The system in operation is labor intensive and does not produce prompt financial reports needed by cost center managers to monitor their operations. Also, it does not account for certain costs resulting in an understatement of current expenses, and lacks an adequate system of records and related procedures to provide a proper accounting for the investment in property.

### Foreign Service Retirement and Disability Fund system

This system was approved by the Comptroller General in July 1970. Since that time certain operations have been revised and automated. However, many manual and automated data processing procedures have not been documented or are poorly documented, resulting in the lack of an effective system of communication to employees who must operate the system. Other deficiencies in the current system are (1) procedures to prevent overpayments to reemployed annuitants need to be improved, (2) the accrual basis is not used to record and report revenue, (3) general ledger and subsidiary accounts are not established and maintained for receivables from annuitants, (4) the reporting deadline established by law has not been met, and (5) segregation of functions and audit coverage is not adequate.



DEPARTMENT OF STATE  
*Comptroller*  
Washington DC 20520

March 20, 1984

Mr. Frank C. Conahan  
Director  
National Security and  
International Affairs Division  
U. S. General Accounting Office  
Washington, D.C. 20548

Dear Frank:

I have reviewed GAO's Draft Report: "The Department of State's First Year Implementation of the Federal Managers' Financial Integrity Act", and I want to compliment your staff on the thorough and objective presentation of the Department's first year implementation of the Act. I concur in the observations cited in the Report.

In 1984 we plan a fully comprehensive review of all Departmental operations, domestic and abroad. With additional positions devoted to the central internal control staff, we will enhance our roles of coordination, training, technical assistance and quality assurance.

I would like to take this opportunity to commend the GAO team that has worked with the State Department. I especially want to acknowledge the efforts of Mr. Earl Morrison. The highly professional manner with which he directed the review and his positive approach in communicating his observations contributed significantly to our motivation to enhance our program in 1984.

Please be assured of the cooperation of my own staff and Department officers as we continue to work together to improve internal controls in the State Department.

Sincerely,

A handwritten signature in cursive script that reads "Rogers".

Roger B. Feldman

## GLOSSARY

The following definitions were developed by GAO for our review of the implementation of the Federal Managers' Financial Integrity Act.

### Accounting System

The total structure of the methods and procedures used to record, classify, and report information on the financial position and operations of a governmental unit or any of its funds, or organizational components. An accounting system should assist in the financial management functions of budget formulation and execution, proprietary accounting and financial reporting.

### Administrative Function

An activity in an agency which is carried out to support the accomplishment of an agency's programs, missions, or objectives. These activities may include ADP, travel, or consulting services. However, there is no uniform definition of administrative functions; each agency's may be unique.

### ADP Application Controls

Controls that are unique to each software application system. Application controls are intended to assure the quality of data origination, input, processing, and output.

### ADP General Controls

Controls that apply to the overall management of the ADP function in an agency. General ADP controls have a direct effect on the quality of service rendered to ADP users and cover the processing of all ADP application systems. These controls affect most ADP hardware and application software systems, and include

- organizational controls for the ADP unit;
- system design, development, and modification controls;
- data center management controls;
- data center security controls;
- system software controls; and
- hardware controls.

These controls should be evaluated by ADP managers as part of an analysis of the general control environment.

### Agency Component

A major organization, program, or functional subdivision of an agency having one or more separate systems of internal control, and a specific, responsible manager.

### Assessable Unit

A program or administrative function or subdivision thereof, which is to be the subject of a vulnerability assessment. An agency should identify its assessable units in such a way as to (1) include the entire agency and (2) facilitate meaningful vulnerability assessments. All agency programs or administrative functions must be assessed, with the exception of those involved in the performance of policymaking or statutory formulation.

### Audit Resolution

Begins when auditors report their findings to management and completed only after management takes action. Management must either correct identified deficiencies, produce improvements, or demonstrate that findings are invalid. "Audit Resolution" is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

### Control Objective

A desired goal or condition for a specific event cycle, system, or subsystem. An agency's control objectives should be developed for each agency activity and should address the three objectives in the Federal Managers' Financial Integrity Act. An example of a control objective may be "Paychecks should be issued to all, and only, entitled persons." "Control Objectives" are one of the Comptroller General's Standards for Internal Controls in the Federal Government.

### Control Technique

Any mechanism relied on to efficiently and effectively accomplish a control objective. These mechanisms, if operating as intended, help prevent fraud, waste, abuse, or mismanagement. An example of a control technique might be the comparison of automated personnel and payroll master files prior to computing and issuing paychecks. "Control Techniques" are one of the Comptroller General's Standards for Internal Controls in the Federal Government.

### Documentation

That information which would allow an independent reviewer to reach the same conclusions as the original reviewer regarding an agency's internal controls; and the methods used, personnel involved, and conclusions reached in conducting its internal control evaluation, improvement, and reporting process. This information should be current and be available for review. "Documentation" of internal controls is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

### Event Cycle

A grouping of similar activities. An entity's activities can be grouped into a discrete number of cycles. These groupings are based on what is accomplished, and therefore facilitate the identification of cycle objectives. For example, most agencies will have a disbursement cycle which will include all events contributing to the objective of providing reasonable assurance that all payments are legal, proper, accurate, and timely.

### General Control Environment

Those environmental factors that can influence the effectiveness of internal controls over program and administrative functions. An evaluation of the general control environment is the first step in the vulnerability assessment process required by OMB's Guidelines.

This evaluation may be performed for the component as a whole, or individually for each program and administrative function within the component. The determining factors would be the size, nature, and degree of centralization of the programs and functions conducted within the agency component.

### Inherent Risk

The inherent potential for waste, loss, unauthorized use, or misappropriation due to the nature of an activity itself. An analysis of each assessable unit's inherent risk is the second step in the vulnerability assessment process required by OMB's Guidelines. OMB's Guidelines suggest that the matters to be considered in the analysis should include, but need not be limited to, the following: purpose and characteristics, budget level, impact outside the agency, age and life expectancy, degree of centralization, special concerns, prior reviews, and management responsiveness.

## Internal Controls

The plan of organization and all coordinate methods and measures adopted by an agency to provide reasonable assurance that the three objectives of the Federal Managers' Financial Integrity Act of 1982 are achieved. Internal controls should be established in accordance with the Comptroller General's Internal Control Standards. Typically, an internal control represents the combination of a control objective, along with a control technique (or set of techniques) which are being relied on to achieve that control objective.

## Internal Control Review

A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner. OMB's Guidelines recommend six steps for an internal control review: (1) identification of the event cycle, (2) analysis of the general control environment, (3) documentation of the event cycle, (4) evaluation of internal controls within the cycle, (5) testing of the internal controls, and (6) reporting the results. Internal control reviews should normally be conducted for those areas rated as highly vulnerable in the vulnerability assessment process, where corrective action is not readily apparent. An agency should allocate resources for these detailed reviews of internal control based on vulnerability; those most vulnerable should be reviewed first.

## Internal Control Standards

In 1983, the Comptroller General issued a set of Standards For Internal Controls In The Federal Government. The Federal Managers' Financial Integrity Act of 1982 requires each executive agency to establish internal accounting and administrative controls in accordance with these standards. There are five general standards, six specific standards, and one audit resolution standard. The five general standards are: (1) reasonable assurance, (2) supportive attitude, (3) competent personnel, (4) control objectives, and (5) control techniques. The six specific standards are: (1) documentation, (2) recording of transactions and events, (3) execution of transactions and events, (4) separation of duties, (5) supervision, and (6) access to and accountability for resources.



## OMB Guidelines

The document issued by the Office of Management and Budget in December 1982, Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government. An evaluation conducted in accordance with these guidelines is to provide a basis for an agency's annual statement required by the act.

## Preliminary Evaluation of Safeguards

A judgment regarding the existence and adequacy of internal control over an assessable unit. This evaluation is the third step in the vulnerability assessment process required by the OMB Guidelines. The evaluation is preliminary in that a more in-depth review of internal controls is the focus of the internal control review phase. The preliminary evaluation of controls required here should be based largely on the evaluator's working knowledge of the existence and functioning of internal controls in the subject assessable unit.

## Program

Generally, an organized set of activities directed toward a common purpose or goal, and undertaken or proposed by an agency in order to carry out its responsibilities. In practice, however, the term "program" has many meanings. It is used to describe the agency's mission, functions, activities, services, projects, and processes.

## Quality Assurance

The process(es) or system(s) of an agency which provide reasonable assurance that the internal control evaluation, improvement, and reporting process established in accordance with the OMB Guidelines is carried out in a consistent, accurate, and reliable manner. These processes or systems will form part of the basis for the annual assurance letters, and statement to the President and the Congress. An agency's quality assurance has several essential elements, including appropriate documentation for the internal control evaluation process, appropriate IG role in the process, adequacy of resources and overall organization of the process, appropriate training for managers with internal control responsibilities, and assuring that actions taken will correct weaknesses permitting fraud, waste, or mismanagement.

### Reasonable Assurance

Internal control systems should provide reasonable, but not absolute, assurance that the objectives of the system will be accomplished. This concept recognizes that the cost of internal control should not exceed the benefit expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of internal controls. Errors or irregularities may occur and not be detected because of inherent limitations in any internal control, including those resulting from resource constraints, or congressional restrictions. "Reasonable Assurance" is one of the Comptroller General's Standards for Internal Control in the Federal Government.

### Segmentation

The process by which an agency identifies its assessable units; i.e., its programs and administrative functions. The inventory of assessable units developed as a result of this process must be appropriately detailed so as to provide a basis for the conduct of meaningful vulnerability assessments. The OMB Guidelines provide that all the agency activities, except those concerned with policymaking, should be included in the inventory.

There is no single best method to segment an agency, particularly in light of variations in agency organization structure and responsibilities.

### Specific Risk

A judgment regarding the likelihood and magnitude of error or irregularity in the event cycle being evaluated. These judgments represent an essential element of the fourth step recommended by OMB in its Guidelines for an internal control review: "Evaluation of the internal controls within the event cycle." The judgment regarding specific risk is based on a comparison of control objectives with related control techniques. Based on this evaluation, the amount and type of control testing, OMB's fifth step in an internal control review, will be determined.

### Testing

The examination of available evidence to determine whether internal controls are functioning as intended. Testing is the fifth step recommended in OMB's Guidelines for the performance of an internal control review.

The nature of the controls, the significance of the cycle, importance of control objective, the nature of the specific risks, possible compensating controls, testing resources, and timing must all be considered in developing appropriate tests. Generally, testing can be categorized as either "compliance" or "substantive." Compliance testing is generally used when the judgment regarding specific risk has given reason to rely on a control technique. It is designed to verify if one or more internal control techniques are operating. The other category of testing, "substantive" testing, is used when the specific risk is sufficiently great that the control cannot be relied on. A substantive test is designed not to verify the operation of a control technique but rather to verify the results of the process to which the control was applied.

#### Vulnerability Assessment

A biennial review of the susceptibility of an assessable unit to the occurrence of waste, loss, unauthorized use, or misappropriation. OMB's Guidelines prescribe three basic steps for the conduct of vulnerability assessment: (1) analyze the general control environment, (2) analyze the inherent risk, and (3) perform a preliminary evaluation of existing safeguards.

The primary purpose of vulnerability assessments is to determine if and in what sequence resources should be allocated for the performance of internal control reviews.



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