UNITED STATES DEPARTMENT OF STATE

AGENCY FINANCIAL REPORT
FISCAL YEAR 2008

TRANSFORMING THE WORLD THROUGH DIPLOMACY

FY 2008 HIGHLIGHTS

(Dollars in Millions)	% Change 2008 over 2007	2008	2007	2006
Balance Sheet Totals as of September 30,				
Total Assets	+15%	$ 52,116	$ 45,234	$ 39,958
Total Liabilities	+8%	21,483	19,894	17,893
Total Net Position	+21%	30,633	25,340	22,065
Results of Operations for the Year Ended September 30,				
Total Net Cost of Operations	+30%	$ 17,741	$ 13,636	$ 12,493
Budgetary Resources for the Year Ended September 30,				
Total Budgetary Resources	+23%	$ 38,825	$ 31,511	$ 26,433
Full-time, permanent employees in the Foreign Service		11,582	11,467	11,397
Full-time, permanent employees in the Civil Service		9,291	8,784	8,189
Full-time, Foreign Service Nationals		9,987	7,802	8,270
Number of Passports Issued		15.9 million	18.4 million	12.1 million
Secretary of State Rice Diplomatic Travels				
Miles traveled		295,565	222,179	247,603
Number of countries visited		46	25	33

ABOUT THIS REPORT

The United States Department of State Agency Financial Report (AFR) for Fiscal Year 2008 provides an overview of the Department's financial performance and results to help Congress, the President and the public assess our stewardship over the financial resources entrusted to us.

The AFR is the first of a series of four reports in the Office of Management and Budget's *Pilot Program for Alternative Approaches to Performance and Accountability Reporting*. For the second year under this voluntary program, the Department has chosen to reconfigure its annual reporting documents and publishing dates to present more streamlined and timely information that clarifies the relationship between performance, budget and financial reporting. The Department believes this approach improves federal reporting and makes information more meaningful and transparent to the public, and provides a more succinct and easily understood analysis of the Department's accountability over its resources. The report provides readers a sense of the Department's highest priorities in the conduct of U.S. foreign policy, and our strengths and challenges in implementing programs that pursue our country's foreign policy agenda.

As part of the four-tiered Pilot Program reporting schedule, the Department provides financial reporting in mid-November, a two-page Budget, Performance and Financial Snapshot of high priority outcomes and financial results in mid-December 2008, a complete performance report in mid-January, and a summary of performance and financial information in a Citizens' Report in mid-January. All four reports will be available online at *www.state.gov/s/d/rm*.

After the new President assumes office, the Department's fiscal year 2010 performance plan will be issued in conjunction with the fiscal year 2010 budget request to Congress, called the Congressional Budget Justification, which will be available at *www.state.gov/s/d/rm*.

ABOUT THE COVER

The cover focuses our attention on a handshake and a smile. Almost universally these serve as an introduction and are an invitation to interact. Secretary Rice is greeting the embassy community in Addis Ababa, Ethiopia. The Secretary attended a meeting there with leaders from the African Great Lakes states (Burundi, the Democratic Republic of the Congo, Rwanda, and Uganda) to discuss issues of regional peace and security on December 5, 2007. *Department Photo/ Roger Warren*

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Message from the Secretary

I am pleased to present the U.S. Department of State's Agency Financial Report for Fiscal Year 2008. The Agency Financial Report provides crucial financial and performance information for Congress and the American people, and highlights our efforts to manage taxpayer dollars responsibly in support of our mission to build democratic and well-governed states that reflect their people's aspirations for freedom, security, and prosperity for all.

In today's world, it is impossible to draw clear lines between our security interests, our development efforts, and our democratic ideals. To meet this challenge, we are more closely aligning the programs of the Department of State and USAID. More than ever before, our organizations work hand-in-hand with each other and with other U.S. Government partners to advance our foreign policy objectives. Our strategic goals, priorities and ideals lie at the core of the Department's and USAID's shared mission and vision that are rooted in partnership, not paternalism – in doing things with other people, not for them.

Our global agenda in public diplomacy, humanitarian assistance, and peace and security is providing the foundation for sustainable economic growth and human development, reinforcing effective democratic governance, and encouraging states to engage responsibly in the international system.

Supporting the President's commitment to enhance the effectiveness of American diplomacy, we have examined staffing and resource needs and taken steps to realign overseas positions to better reflect current and emerging foreign policy priorities. We need to meet the challenges implicit in assigning our diplomats to Iraq, Afghanistan and other dangerous places in the world. I remain dedicated to rebuilding our civilian capacity to engage in diplomacy and to manage programs, including the elimination of shortages of essential skills within our diplomatic corps, particularly in the areas of critical languages and reconstruction and stabilization expertise.

Throughout the year we have worked aggressively to resolve significant management controls issues. We are strengthening controls over access to our Passport Information Electronic Records System to improve prevention, detection and responsiveness. We continue to bolster controls over private security contractors by implementing recommendations of a special panel to improve accountability and control, working closely with our colleagues at the Department of Defense.

We completed a number of New Embassy Compounds overseas in Beijing, Berlin and Baghdad, among others, and our overseas construction program has allowed over 19,000 people to move into more secure facilities. We improved the executive attention and controls over the management of undelivered orders to address this previously reported material weakness. As a result of our efforts, I am pleased to provide an unqualified statement of assurance regarding the Department's management controls. The financial and summary performance data presented herein are complete and reliable in accordance with the guidance from the Office of Management and Budget.

Since 2002, the State Department has submitted to Congress and the American public an annual Performance and Accountability Report. Last year and again this year, the Department is participating in a pilot program under the auspices of the Office of Management and Budget to streamline and clarify the relationships among performance, budget and financial reporting. Additional performance information will be included in the December 2008 Department's Snapshot report and incorporated in the Annual Performance Report and Citizens' Report in January 2009. The Department's Annual Performance Report also will be incorporated into the FY 2010 Congressional Budget Justification, which will be available in the early spring timeframe and posted at *www.state.gov*.

I am proud to represent the Department of State's 30,000 American and Foreign Service National employees at more that 260 posts worldwide. These men and women are doing vital work for the American people, advancing America's values and interests across the globe as they help people everywhere build a better world.

Condoleezza Rice
Secretary of State

November 17, 2008

Distinguished African Americans at the Department of State

African Americans compose 5.6% of the approximately 11,471 members of the U.S. Foreign Service. This percentage falls short of the number of African Americans in the civilian workforce and the general population but represents, over time, efforts to promote diversity through senior-level appointments and recruitment into the career Foreign Service.

The first African American diplomat, Yale graduate Ebenezer Don Carlos Bassett, was appointed by President Ulysses S. Grant as Minister Resident and Consul General in Haiti in 1869. It was not until 1924 when the Rogers Act combined the Consular and Diplomatic Service that James Carter, James Weldon Johnson and William Yerby became the first African Americans to enter the regular career Foreign Service. They were joined by Clifton Wharton who was named Ambassador to Norway in 1961 by President Harry S Truman. After Wharton no other African American entered the Foreign Service for the next 20 years.

In 1949, Edward Dudley was promoted from Minister in Liberia to be the first African American to hold the rank of Ambassador. In that post World War II period, Ralph J. Bunche, after whom the Department's Library is named, went from the Department of State in 1946 to the United Nations where his efforts for peace in Palestine won him the Nobel Peace Prize in 1950. Since then a growing number of African Americans have served as ambassadors including three U.S. Representatives to the United Nations: Andrew Young, Donald F. McHenry and Edward J. Perkins. Others who have made significant contributions to U.S. diplomacy include: Terence Todman, six-time ambassador with appointments beginning in 1969 in Africa, Europe and Latin America and Assistant Secretary for Western Hemisphere Affairs; Ronald D. Palmer, three-time ambassador in Africa and Asia between 1976 and 1986, and; Johnnie Young, four-time ambassador in Africa, the Middle East and Europe between 1989 and 2004. Four African Americans, including Terence Todman, Ruth A. Davis, Johnny Young and George E. Moose, former Assistant Secretary for African Affairs, have been promoted to Career Ambassador, the highest rank in the Foreign Service. Also, four have been appointed Director General of the Foreign Service (DG) including the present DG, Harry K. Thomas and his predecessor, George M. Staples. In December 2007, Barry L. Wells became the first African American Civil Service employee to serve as Ambassador, posted to The Gambia.

African American ambassadors and senior diplomats have not all come from the ranks of the State Department. The former United States Information Agency began an active recruitment effort aimed at African Americans in the latter part of the 1950s and 1960s and attracted numerous officers who achieved ambassadorial rank, including O. Rudolph Aggrey (Senegal, The Gambia and Romania), John E. Reinhardt (Nigeria), Horace G. Dawson, Jr. (Botswana), W. Beverly Carter (Liberia and Tanzania) and Carl T. Rowan (Finland). During this period, the U.S. Agency for International Development and its predecessor organization also hired a number of African Americans who distinguished themselves as senior diplomats, including Samuel C. Adams and John L. Withers (whose son is presently U.S. Ambassador to Albania), Edward J. Perkins, the first African American Ambassador to South Africa and the first African American Director General of the Foreign Service. In 2001 Mattie R. Sharpless of the U.S. Department of Agriculture was named Ambassador to the Central African Republic.

Patricia Roberts Harris was the first of 36 African American women to serve as U.S. ambassador. Her 1965 appointment to Luxemburg was by President Lyndon Johnson who also named Barbara M. Watson as Assistant Secretary of State for Consular Affairs in 1968. Other notable non-career appointments include Carol Moseley-Braun's nomination by President William J. Clinton as Ambassador to New Zealand and President George W. Bush's 2004 naming of Jendayi E. Frazer as the first female Ambassador to South Africa and in 2005 as Assistant Secretary of State for African Affairs. Aurelia Brazeal was the first African American female Foreign Service Officer (FSO) to rise from the entry level to the senior ranks of the Foreign Service. She became Ambassador to Micronesia, Kenya and Ethiopia and Deputy Assistant Secretary for East Asian and Pacific Affairs. In 1992 after a posting as Consul General in Barcelona, Spain, Ruth A. Davis was appointed as Ambassador to the Republic of Benin and the first African American woman to serve as Director of the Foreign Service Institute and Director General of the Foreign Service. Several African American women have had the distinction of being named ambassador to two or more countries including Arlene Render, who served in The Gambia, Cote d'Ivoire and Zambia; Robin R. Sanders, who became Ambassador to Nigeria in 2007 after having served in the Republic of the Congo; and June Carter Perry, Chief of Mission in Madagascar and Sierra Leone.

Efforts made by Secretaries of State Madeleine Albright, Colin L. Powell and Condoleezza Rice to increase diversity in the Department and to attract more minorities to the Foreign Service bode well for augmenting the under-representative number of African Americans in the Service and for achieving a broader geographical distribution of African American Ambassadors throughout the world.

— Ambassador Ruth A. Davis
Senior Advisor, Bureau of African Affairs

Management's Discussion and Analysis

Distinguished African Americans at the Department of State

1840 1850 1860 1870 1880 1890 1900

1845 ***First African American appointed to a consular post***
William A. Leidesdorff (1802–1848)
In 1845 William A. Leidesdorff was sent as Vice Consul to Yerba Buena, modern-day San Francisco, where he served until U.S. troops took control of the city in 1846.

1869 ***First African American to receive a diplomatic post***
Ebenezer Don Carlos Bassett, (1833–1908)
Educator and diplomat, Bassett was principal, Institute for Colored Youth, 1857-69. He was U.S. Resident and Consul General Minister to Haiti, 1869-77; appointed by President Grant.

1897 ***First African American appointed envoy extraordinary and minister plenipotentiary***
William Frank Powell, (1848–1920)
First American appointed to the new title of envoy extraordinary and minister plenipotentiary to Haiti (and also chargé d'affaires to the Dominican Republic) by President McKinley.

About the Department

Our Mission and Values

American diplomacy is based on the fundamental beliefs that our freedom is best protected when others are free; our prosperity depends on the prosperity of others; and our security relies on a global effort to defend the rights of all. In this extraordinary moment in history, when the rise of freedom is transforming societies around the world, the United States has an immense responsibility to use its diplomatic influence constructively to advance security, democracy, and prosperity around the globe.

The Department of State is the lead institution for the conduct of American diplomacy and the Secretary of State is the President's principal foreign policy advisor. All foreign affairs activities – U.S. representation abroad, foreign assistance programs, countering international crime, foreign military training programs, services the Department provides to American citizens abroad, and many others – are paid for by the foreign affairs budget, which represents about 1% of the total federal budget, or about 12 cents a day for each American citizen. This small investment is essential to maintaining U.S. leadership abroad, which promotes and protects the interests of American citizens.

OUR MISSION STATEMENT

Advance freedom for the benefit of the American people and the international community by helping to build and sustain a more democratic, secure, and prosperous world composed of well-governed states that respond to the needs of their people, reduce widespread poverty, and act responsibly within the international system.

OUR VALUES

LOYALTY

Commitment to the United States and the American people.

CHARACTER

Maintenance of high ethical standards and integrity.

SERVICE

Excellence in the formulation of policy and management practices with room for creative dissent. Implementation of policy and management practices, regardless of personal views.

ACCOUNTABILITY

Responsibility for achieving United States foreign policy goals while meeting the highest performance standards.

COMMUNITY

Dedication to teamwork, professionalism, and the customer perspective.

DIVERSITY

Commitment to having a workforce that represents the diversity of America.

Our Organization

Congress established the U.S. Department of State in 1789, replacing the Department of Foreign Affairs, which was established in 1781. The Department of State is the lead institution for the conduct of American diplomacy, and promotes and protects the interests of American citizens by:

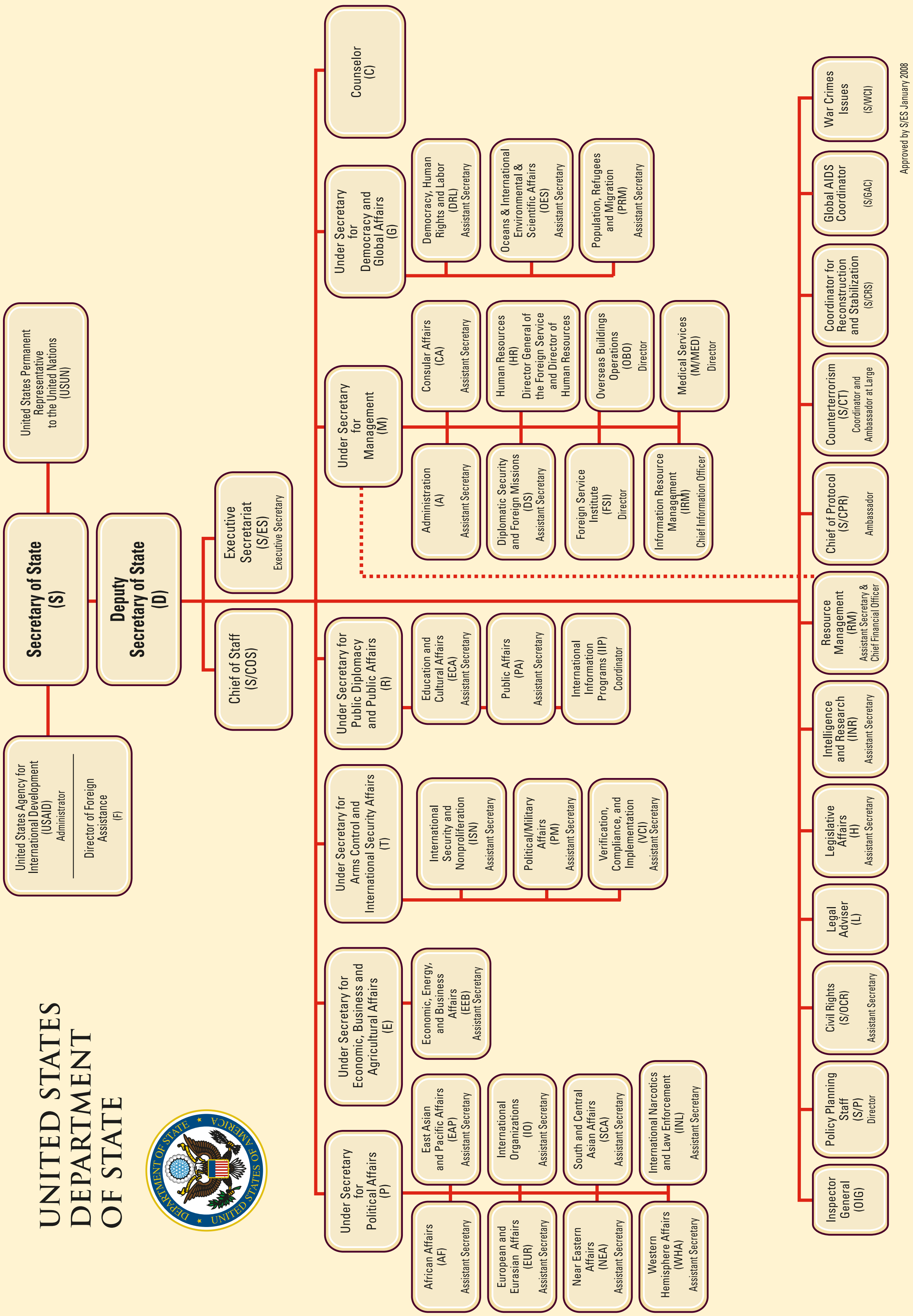
- Promoting peace and stability in regions of vital interest;
- Creating jobs at home by opening markets abroad;
- Helping developing nations establish investment and export opportunities;
- Bringing nations together to address global problems such as cross-border pollution, the spread of communicable diseases, terrorism, nuclear smuggling, and humanitarian crises.

At our headquarters in Washington, D.C., the Department's mission is carried out through six regional bureaus – each of which is responsible for a specific geographic region of the world, the Bureau of International Organization Affairs, and numerous functional and management bureaus. These bureaus provide policy guidance, program management, administrative support, and in-depth expertise in matters such as law enforcement, economics, the environment, intelligence, arms control, human rights, counternarcotics, counterterrorism, public diplomacy, humanitarian assistance, security, nonproliferation, consular services, and other areas. State's organizational chart appears on the following page.

The Department operates more than 260 embassies, consulates, and other posts worldwide. In each Embassy, the Chief of Mission (usually an Ambassador) is responsible for executing U.S. foreign policy goals and coordinating and managing all U.S. Government functions in the host country. The President appoints each Ambassador, who is then confirmed by the Senate. Chiefs of Mission report directly to the President through the Secretary. The U.S. Mission is also the primary U.S. Government point of contact for Americans overseas and foreign nationals of the host country. The Mission serves the needs of Americans traveling, working and studying abroad, and supports Presidential and Congressional delegations visiting the country.

First Lady Laura Bush introduces President George W. Bush prior to speaking on U.S. policy in Africa at the Smithsonian National Museum of African Art in Washington, D.C., February 14, 2008. Bush announced his plan to send U.S. Secretary of State Condoleezza Rice to Kenya to support efforts to end violence and help political reconciliation. *AFP Photo/Saul Loeb*

The Department operates two passport centers, the National Passport Center in Portsmouth, New Hampshire and the Charleston Passport Center in Charleston, South Carolina; two contractor-run passport printing and mailing facilities, the Arkansas Passport Center, in Hot Springs, Arkansas and the Tucson Passport Center in Tucson, Arizona; a passport call center, the National Passport Information Center, in Dover, New Hampshire, a second site in Lansing, Michigan; and 15 passport agencies. In early 2009, the Department expects to open four additional agencies in Dallas, Texas; Detroit, Michigan; Minneapolis, Minnesota; and Tucson, Arizona (which will be co-located with the Tucson Passport Center). The Department of State also operates several other types of office around the world, including two foreign press centers; one reception center; five offices that provide logistics support for overseas operations; 20 security offices; and two financial service centers.


UNITED STATES DEPARTMENT OF STATE
DEPARTMENT OF STATE ★ UNITED STATES OF AMERICA ★
Secretary of State (S)
United States Permanent Representative to the United Nations (USUN)
United States Agency for International Development (USAID) Administrator
Director of Foreign Assistance (F)
Deputy Secretary of State (D)
Executive Secretariat (S/ES) Executive Secretary
Chief of Staff (S/COS)
Counselor (C)
Under Secretary for Democracy and Global Affairs (G)
Democracy, Human Rights and Labor (DRL) Assistant Secretary
Oceans & International Environmental & Scientific Affairs (OES) Assistant Secretary
Population, Refugees and Migration (PRM) Assistant Secretary
Under Secretary for Management (M)
Consular Affairs (CA) Assistant Secretary
Human Resources (HR) Director General of the Foreign Service and Director of Human Resources
Overseas Buildings Operations (OBO) Director
Medical Services (M/MED) Director
Administration (A) Assistant Secretary
Diplomatic Security and Foreign Missions (DS) Assistant Secretary
Foreign Service Institute (FSI) Director
Information Resource Management (IRM) Chief Information Officer
Under Secretary for Public Diplomacy and Public Affairs (R)
Education and Cultural Affairs (ECA) Assistant Secretary
Public Affairs (PA) Assistant Secretary
International Information Programs (IIP) Coordinator
Under Secretary for Arms Control and International Security Affairs (T)
International Security and Nonproliferation (ISN) Assistant Secretary
Political/Military Affairs (PM) Assistant Secretary
Verification, Compliance, and Implementation (VCI) Assistant Secretary
Under Secretary for Economic, Business and Agricultural Affairs (E)
Economic, Energy, and Business Affairs (EEB) Assistant Secretary
Under Secretary for Political Affairs (P)
East Asian and Pacific Affairs (EAP) Assistant Secretary
International Organizations (IO) Assistant Secretary
South and Central Asian Affairs (SCA) Assistant Secretary
International Narcotics and Law Enforcement (INL) Assistant Secretary
African Affairs (AF) Assistant Secretary
European and Eurasian Affairs (EUR) Assistant Secretary
Near Eastern Affairs (NEA) Assistant Secretary
Western Hemisphere Affairs (WHA) Assistant Secretary
War Crimes Issues (S/WCI)
Global AIDS Coordinator (S/GAC)
Coordinator for Reconstruction and Stabilization (S/CRS)
Counterterrorism (S/CT) Coordinator and Ambassador at Large
Chief of Protocol (S/CPR) Ambassador
Resource Management (RM) Assistant Secretary & Chief Financial Officer
Intelligence and Research (INR) Assistant Secretary
Legislative Affairs (H) Assistant Secretary
Legal Adviser (L)
Civil Rights (S/OCR) Assistant Secretary
Policy Planning Staff (S/P) Director
Inspector General (OIG)
Approved by S/ES January 2008

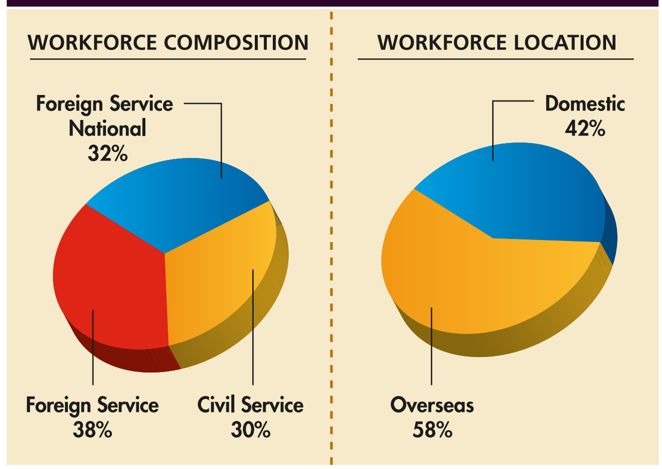
Our People

The Foreign Service and the Civil Service in the Department of State and U.S. missions abroad represent the American people. They work together to achieve the goals and implement the initiatives of American foreign policy. The Foreign Service is a corps of over 11,000 employees. Foreign Service Officers are dedicated to representing America and to responding to the needs of American citizens living and traveling around the world. They are also America's first line of defense in a complex and often dangerous world. A Foreign Service career is a way of life that requires uncommon commitment. It offers unique rewards, opportunities, and sometimes hardships. Members of the Foreign Service can be sent to any embassy, consulate, or other diplomatic mission anywhere in the world, at any time, to serve the diplomatic needs of the United States.

The Department's Civil Service corps, totaling over 9,000 employees, provides continuity and expertise in accomplishing all aspects of the Department's mission. Civil Service officers, most of whom are headquartered in Washington, D.C., are involved in virtually every policy area of the Department – from democracy and human rights to narcotics control, trade, and environmental issues. They are also the domestic counterpart to consular officers abroad, issuing passports and assisting U.S. citizens overseas.

Foreign Service National (host country) employees contribute to advancing the work of the Department overseas. These essential employees contribute local expertise and provide continuity as they work with their American colleagues to perform vital services for U.S. citizens.

FULL-TIME PERMANENT EMPLOYEES
(AS OF SEPTEMBER 30, 2008)

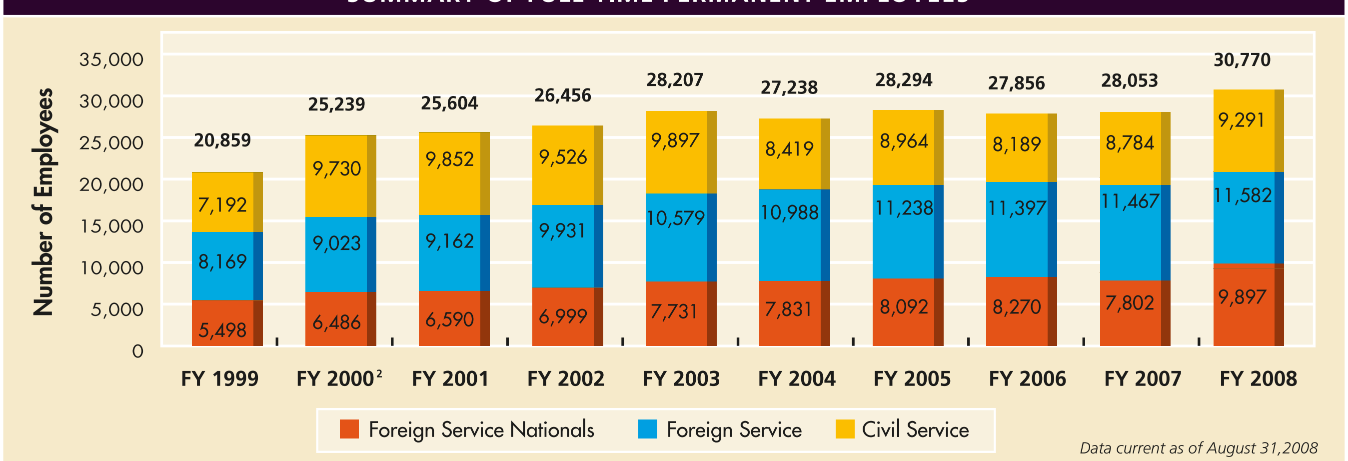


EMPLOYEE COMPOSITION AND NUMBERS

The pie charts above show the distribution of the Department's workforce by employment category, as well as what proportion of the workforce is located overseas.

Since FY 1999, the total number of employees at the Department has increased by 48%, with the greatest increase shown in the Department's Civil Service staff (69%). The Foreign Service staff has increased by 42% over the past decade and the Foreign Service National staff has also increased. This expansion reflects the Department's increased emphasis on security, public diplomacy, counterterrorism, and management reforms.

SUMMARY OF FULL-TIME PERMANENT EMPLOYEES[1]



[1] These numbers do not include FSNs employed under personal service agreements or as personal service contractors.

[2] Reflects integration of employees of the United States Information Agency (USIA) and the Arms Control and Disarmament Agency (ACDA).

Performance Summary and Highlights

How We Manage Performance

The Department of State is committed to using performance management best practices to ensure the most effective U.S. foreign policy outcomes, and to promote greater accountability to our primary stakeholders, the American people. At the Department of State, performance management is a multi-phase process: setting strategic goals and priorities; creating programs; monitoring program activities; collecting data and measuring progress toward achievement of goals; using performance information to influence program and resource allocation decision-making; and communicating results to stakeholders.

These steps are designed to meet the challenges faced by federal agencies which include achieving greater accountability of federal funds, alignment of budget requests with demonstrated results and making informed policy and management decisions based on reported results. The Department's performance management is guided by a Joint Strategic Plan, shared by both the Department of State and the U.S. Agency for International Development that established a Joint Strategic Goal Framework structured around seven strategic goals and key strategic priorities as outlined below.

How We Use Performance Management

The Department of State uses performance management as the basis for both long-term and annual planning processes. Diplomatic missions and Washington-based bureaus engage in annual planning activities that define policy and program goals by country and region, and also by crosscutting global issues such as democracy, economic prosperity, counterterrorism, nonproliferation, health and the environment. The annual process includes senior leadership engagement and culminates with the submission of the President's Budget to Congress. The Department's performance management framework links Department-wide goals to bureau and mission level goals and programs, and their associated performance measures, targets and results as shown in the graphic below.

Performance Management Model

Transparent reporting on stewardship and management of public funds is an integral part of the responsibilities of all federal agencies. In an effort to continuously improve program performance, President George W. Bush issued Executive Order No. 13450, on November 13, 2007, establishing a USG-wide Performance Improvement Council and requiring each federal agency to appoint a Performance Improvement Officer. The full text of the Executive Order can be found at: *www.whitehouse.gov/news/releases/2007/11/20071113-9.html.* Duties of the Performance Improvement Officer include supervising the performance management activities of the agency, development of goals and specific plans, preparation of the agency's strategic and annual plans, and other related activities. At the State Department, implementation of the Executive Order has strengthened the performance management structure and brought new focus to the value and impact of effective performance management.

To streamline Government reporting, the President's Office of Management and Budget (OMB) created a Pilot Program for Alternative Approaches to Performance and Accountability Reporting in 2007. The Department of State elected to participate in this voluntary program and reconfigured its annual reporting documents as detailed below. The Department believes this approach improves the transparency of federal reporting and provides a more succinct and easily understood analysis of the Department's accountability over its resources. All reports provide information that is easily accessible to a diverse set of readers and stakeholders.

In implementing the four-tiered Pilot Program reporting schedule, the Department provides detailed financial reporting in mid-November in this report, a two-page Budget, Performance and Financial Snapshot of high priority outcomes and financial results in mid-December, 2008, a complete performance report in mid-January, 2009, and a summary of performance and financial information for the general audience in a Citizens' Report in mid-January, 2009. All reports will be made available online at *www.state.gov/s/d/rm.*

This structure is designed to improve government reporting and ensure the public and oversight organizations can hold government agencies accountable for the use of public funds. Government programs should deliver tangible, measurable results which attest to the effectiveness of programs and ensure that funding produces maximum results. Congress and the American people should expect nothing less.

Strategic Goals and Results

Secretary Rice meets with Prime Minister Nouri al-Maliki and Foreign Minister Hoshyar Zebari in Bagdad, Iraq, January 2008. *Department of State*

STRATEGIC GOAL 1: ACHIEVING PEACE AND SECURITY

Preserve international peace by preventing regional conflicts and transnational crime, combating terrorism and weapons of mass destruction, and supporting homeland security and security cooperation.

Public Benefit. The United States promotes peace, liberty and prosperity for all people, and ensuring security is central to achieving peace. The U.S. Government directly confronts threats to national and international security from terrorism, weapons proliferation, failed or failing states, and political violence. By enforcing compliance with arms control, nonproliferation, and disarmament agreements through diplomacy, political and economic sanctions, and physical interdiction, we ensure our national security and the security of the global community. In doing so, we strengthen U.S. national security as well as the capability of the U.S. Government and of international partners to prevent or mitigate conflict, stabilize countries in crisis, promote regional stability, protect civilians, and promote the just application of government and law. Our security is best guaranteed when our friends and neighbors are secure, free, prosperous, and at peace.

In the U.S. Government's efforts to protect American citizens and our national interests overseas, our strategic priorities include: fighting transnational crime; countering terrorism; combating weapons of mass destruction; supporting stabilization operations activities and security sector reforms; supporting counternarcotics activities; sponsoring conflict mitigation and reconciliation; and ensuring homeland security.

Key Achievements

- NATO expanded its Training Mission in Iraq to include Air Force/Navy staff officer, border security, and advanced forensics training and handed over significant aspects of its officer and non-commissioned officer academy training to the Iraqi government.
- The Department further developed the U.S.- Poland bilateral security relationship with a ballistic missile defense agreement.

STRATEGIC GOAL 2: GOVERNING JUSTLY AND DEMOCRATICALLY

Advance the growth of democracy and good governance, including civil society, the rule of law, respect for human rights, political competition, and religious freedom.

Public Benefit. The U.S. Government supports just and democratic governance for three distinct and related reasons: as a matter of principle; as a contribution to U.S. national security; and as a cornerstone of our broader development agenda. Governments that accept the twin principles of majority rule and individual rights, respond to the needs of their people, and govern by rule of law, are more likely to conduct themselves responsibly toward other nations.

An ethnic Albanian woman holds a girl who helps her to cast her ballot on the rerun of the parliamentary elections in Saraj, Macedonia. *AP Photo/Boris Grdanoski*

Effective and accountable democratic states are also best able to promote broad-based and sustainable prosperity. The U.S. Government goal is to promote and strengthen effective democracies and assist countries in moving along a continuum toward democratic consolidation. Our programs encompass the strategic priority areas of maintaining rule of law and human rights, good governance, political competition and consensus-building, and civil society.

Key Achievements

- The Department of State continues to advise Turkmenistan on its Law on Religion and assisted in registering two additional religious groups.
- The Department of State partnered with major apparel brands and retailers, investment firms, and non-governmental organizations to eliminate the worst forms of child labor in Uzbekistan's cotton sector.

STRATEGIC GOAL 3: INVESTING IN PEOPLE

Improve health, education, and other social services to help nations create sustainable improvements in the well-being and productivity of their citizens.

Public Benefit. Disease and lack of education destroy lives, ravage societies, destabilize regions, and cheat future generations of prosperity and participation in democracy. By supporting Presidential Initiatives and numerous programs that integrate economic growth with social development we are extending the basic values American citizens hold dear: good health; access to quality education; and protection for vulnerable populations.

The U.S. Government strives to improve child, maternal, and reproductive health, reduce the risk of infectious disease, and increase access to improved drinking water and sanitation services in developing countries. Critical interventions combat HIV/AIDS, tuberculosis, malaria, polio, pneumonia and diarrhea, which are leading causes of illness and death throughout the developing world. Mothers and children are especially vulnerable and are therefore two special target groups for most of these interventions. As an integral part of health programming, U.S. Government programs strengthen local capacity in disease outbreak detection and response, strengthen delivery of health services, essential drugs and commodities, and support advances in health technology.

President Bush poses with children as he visits the Mercy Centre of the Human Development Foundation in Bangkok, Thailand.
AP Photo/Gerald Herbert

Key Achievements

- Through the President's Emergency Plan for AIDS Relief (PEPFAR) program, the Department has aided in the prevention of mother-to-child HIV transmission services for women during nearly 12.7 million pregnancies.
- More than 22.3 million people benefit from malaria prevention measures, including Insecticide-Treated Nets and/or Indoor Residual Spraying.

STRATEGIC GOAL 4: PROMOTING ECONOMIC GROWTH AND PROSPERITY

Strengthen world economic growth and protect the environment, while expanding opportunities for U.S. businesses and ensuring economic and energy security for the nation.

Public Benefit. The U.S. Government goal is to achieve rapid, sustained, and broad-based economic growth for the United States, its trading partners, and developing countries. Global economic growth is a key U.S. foreign policy priority and is essential for the reduction and eventual elimination of extreme poverty, poor health, and inadequate education among developing countries. Countries that offer their citizens hope for increasing prosperity are less prone to extremism, more inclined to favor democracy, more willing to settle disputes peacefully, and more likely to be constructive partners with the United States in the international community.

Secretary of State Condoleezza Rice shakes hands with Colombian Foreign Minister Jaime Bermudez after participating in a signing ceremony on renewable fuels, in Washington, D.C. *AP Photo/Gerald Herbert*

The United States derives enormous benefits from a stable, resilient, and growing world economy and plays a leadership role to promote economic growth and prosperity. Open market policies have lifted standards of living and helped millions of people around the world escape the grip of poverty. These policies have shown themselves time and time again to be the surest path to creating jobs, increasing commerce, and fostering progress.

Key Achievements

- The Department established Open Skies Agreements with Australia, Croatia, and Kenya.
- The Department of State contributed to reducing the median number of days it takes to start a business in African countries to 37 days, 2 days less than last year.

STRATEGIC GOAL 5: PROVIDING HUMANITARIAN ASSISTANCE

Minimize the human costs of displacement, conflicts, and natural disasters to save lives and alleviate suffering.

Public Benefit. The Department of State and USAID are the lead U.S. Government agencies in responding to complex humanitarian emergencies and natural disasters overseas. The United States commitment to humanitarian response demonstrates America's compassion for victims of natural disasters, armed conflict, forced migration, persecution, human rights violations, widespread health and food insecurity, and other threats. The strength of this commitment derives from both our common humanity and our responsibility as a global leader. It requires urgent responses to emergencies; concerted efforts to address hunger and protracted crises; and planning to build capacity to prevent and mitigate the effects of conflict and disasters.

U.S. humanitarian responses to population displacement and human-made disasters complement efforts to promote democracy and human rights. The United States provides substantial resources and guidance through international and nongovernmental organizations for worldwide humanitarian programs, with the objective of saving lives and minimizing suffering in the midst of crises, increasing access to protection, promoting shared responsibility, and coordinating funding and implementation strategies. Our strategic priorities include: providing protection, assistance, and solutions; preventing and mitigating disasters; and promoting orderly and humane means for migration management.

Key Achievements

- The 60,192 refugees resettled in the U.S. represent a 25% increase over FY 2007 refugee admissions levels.
- In FY 2008, 92% of foreign governments increased their efforts to detect, investigate, prosecute and prevent trafficking in persons as well as to protect and assist the victims with Department of State-funded anti-trafficking projects.

A Bangladeshi receives supplies from Hospital Corpsman 1st Class Sam Sanethavong in the wake of a tropical cyclone, in Rangabali, Bangladesh. *AP Photo/U.S. Navy, Sgt. Ezekiel R. Kitandwe*

STRATEGIC GOAL 6: PROMOTING INTERNATIONAL UNDERSTANDING

Foster mutual understanding through a two-way flow of people, ideas, and information to create peaceful and productive relationships between the United States and other countries.

Public Benefit. American values are the foundation of our international engagement. Public perceptions of the U.S. directly affect our ability to achieve our foreign policy and development assistance objectives, making the international exchange of people, ideas and information vital to the security of the United States. Public diplomacy and public affairs functions are premised on the belief that overseas publics who are well-informed about the United States and its policies can positively influence public policy. Accordingly, the Department is expanding the scope of public diplomacy by engaging younger and broader audiences around the world, with particular emphasis on youth and key influencers in the Arab and Muslim worlds. We are tailoring programs and messages to reach these targets, using multiple channels of communication and interaction, both old and new, to expand outreach to overseas audiences, providing aggressive, proactive advocacy of U.S. policies and objectives. We also are seeking to better coordinate interagency public diplomacy activities aimed at developing and communicating USG messages across the globe.

Key Achievements

- Nearly 300 current and former heads of state and government are alumni of the International Visitor Leadership Program (IVLP) and roughly 50% of current world leaders are IVLP alumni.
- In FY 2008, the Department of State engaged more than 24,000 foreign secondary school students, many from under-served communities, in its various programs.

Public Diplomacy Envoy Michelle Kwan works with a young skater at a skating clinic in Buenos Aires, Argentina.
Department of State

STRATEGIC GOAL 7: STRENGTHENING CONSULAR AND MANAGEMENT CAPABILITIES

Assist Americans citizens to travel, conduct business and live abroad securely, and ensure a high quality workforce supported by modern, secure infrastructure and operational capabilities.

Public Benefit. The Department of State commitment to and role in protecting America's homeland, in collaboration with the Department of Homeland Security and other agencies, is reflected in a shared vision that includes: improved technology and efficiency at ports of entry and in visa processing; more secure travel documents for the 21st century; and smarter screening technology for government officials to use at home and abroad. In addition, the Department has the responsibility of protecting and providing a wide range of services for U.S. citizens while they are overseas. Approximately four million Americans reside abroad, and Americans make about 60 million trips outside the United States every year. As the Department continually enhances the integrity of the U.S. passport, it also maintains the highest standards of excellence in customer service.

In strengthening management capabilities, the Department pursues human resource initiatives aimed at building, deploying, and sustaining a knowledgeable, diverse, and high-performing workforce. The Department also develops and maintains programs that enhance the professionalism of that workforce, such as training to foster foreign language proficiency, public diplomacy expertise, and improved leadership and management skills. The Department of State provides and maintains secure, safe, and functional facilities for its employees in the United States, and overseas for both State employees and those of other agencies. Its diplomatic security programs protect both people and national security information. Supporting diplomacy through efficient and effective information technology is another area of management focus, as is the provision of world-class financial services. As more and more new embassy compounds are completed overseas, the Department and USAID are taking advantage of increased opportunities for joint management platforms.

U.S. Ambassador William R. Timken gestures as he stands on the roof of the new embassy building in Berlin, Germany.

AP Photo/Johannes Eisele, Pool

Key Achievements

- 100% of all passport applications were processed within 25 days of receipt and a total of 15.9 million travel documents were issued.
- The Foreign Service Institute increased the number of distance learning students by 37% in order to reach Department of State employees worldwide with greater resource efficiency.

The President's Management Agenda

The President's Management Agenda (PMA) is the President's strategy for improving the management and performance of the federal government, with a focus on delivering results. Each quarter, the Office of Management and Budget (OMB) releases an executive scorecard that rates agencies' overall status and progress on PMA initiatives. Since last year's Agency Financial Report, the Department sustained standards for success for both status and progress in the following three PMA initiatives: Strategic Management of Human Capital, Federal Real Property Asset Management and Right-Sized Overseas Presence. The Department significantly improved its rating in both Competitive Sourcing (now Commercial Services Management) and Performance Improvement. The higher score in Competitive sourcing was based on the successful development of a High Performance Organization plan for IT consolidation. The improvement to green status rating in Performance Improvement was due to integration of performance and budget information in the Congressional Budget Justification. The Department is working to resolve Electronic Government issues. The red status rating for Improved Financial Performance is due to the disclaimer on the Department's FY 2007 audited financial statements. During FY 2008, we were able to reduce to significant deficiencies the management of undelivered orders and accounting for personal property, both of which were identified in the FY 2007 audit as material weaknesses. For FY 2008, we received an audit report with no material weaknesses. In order to restore the green status for Improved Financial Performance, the Department must achieve an unqualified audit opinion.

A summary of the Department's FY 2008 Fourth Quarter Scorecard is provided below. For more information on the PMA and the executive scorecard, please visit *www.whitehouse.gov/results.*

PMA Initiative	Description	Status	Progress	Change from 2007
Strategic Management of Human Capital	Build, sustain, and deploy effectively a skilled, knowledgeable, diverse and high-performing workforce aligned with mission objectives and goals.	🟢	🟢	no change
Improved Financial Performance	World-class financial services that support strategic decision-making, mission performance, and improved accountability to the American people.	🔴	🟡	↓ down
Commercial Services Management (Formerly Competitive Sourcing)	Achieve efficient, effective competition between public and private sources and establish infrastructure to support competitions.	🟢	🟢	↑ up
Performance Improvement	Improve the performance and management of the federal government by linking performance to budget decisions and improve performance tracking and management. The ultimate goal is better control of resources and greater accountability over results.	🟢	🟢	↑ up
Expanded Electronic Government	Expand the federal government's use of electronic technologies (such as e-procurements, e-grants, and e-regulation) so that Americans can receive high-quality government service.	🟡	🟢	↓ down
Federal Real Property Asset Management	To promote the efficient and economical use of America's real property assets.	🟢	🟢	no change
Right-Sized Overseas Presence (OMB Lead)	Reconfigure U.S. Government overseas staff allocation to the minimum necessary to meet U.S. foreign policy goals.	🟢	🟢	no change

🟢 **Green** for success, 🟡 **Yellow** for mixed results, and 🔴 **Red** for unsatisfactory.

Program Assessment Rating Tool (PART) Status

The Office of Management and Budget's (OMB) Program Assessment Rating Tool (PART) is used by agencies across the Federal government to assess program performance and to drive a sustained focus on program results. A key component of the President's Management Agenda, PART assessments review overall program effectiveness, from how well a program is designed to how well it is implemented and what results it achieves. PART results are used to improve program management and to ensure the most effective and efficient use of taxpayer dollars.

Since 2002, the Department and OMB have used PART to review a total of fifty-one programs covering State Operations and Foreign Assistance. The chart below lists the fifty-one programs assessed between 2002 and 2008 and their PART scores and ratings. For additional information on PART and these assessments, please visit *http://www.expectmore.gov.*

Program Name	Score and Rating
Contributions to International Atomic Energy Agency	98% Effective
Educational & Cultural Exchanges, Global	97% Effective
Capital Security Construction	97% Effective
Migration & Refugee Assistance-Protection	96% Effective
UN High Commissioner for Refugees	96% Effective
South Asia Military Assistance	93% Effective
Humanitarian Demining	93% Effective
Migration & Refugee Assistance-Other	93% Effective
International Boundary & Water Commission	92% Effective
Visa & Consular Services	92% Effective
Worldwide Security Upgrades	92% Effective
Humanitarian Migrants to Israel	91% Effective
Contribution to UN Development Program	91% Effective
Contribution to UNICEF & Other Programs	91% Effective
Global Peace Operations Initiative	91% Effective
Security Assistance for Western Hemisphere	90% Effective
Export Control Assistance	90% Effective
Nonproliferation & Disarmament Fund	89% Effective
Foreign Service Institute	88% Effective
Support for East European Democracy/FSA	88% Effective
U.S. Embassy Compound Security	87% Effective
International Peacekeeping Activities	86% Effective
Refugee Admissions to the U.S.	86% Effective
Non-Security Embassy Construction	86% Effective
Terrorist Interdiction Program	85% Effective
Anti-Terrorism Assistance	85% Effective
Organization for Security and Coorperation in Europe	83% Moderately Effective
Contributions to International Organizations	82% Moderately Effective
Military Assistance to NATO & NATO Aspirant Nations	82% Moderately Effective

Program Name	Score and Rating
Assistance to Refugees	82% Moderately Effective
Assistance to Transforming Countries	80% Moderately Effective
Security Assistance to Sub-Saharan Africa	77% Moderately Effective
Global Threat Reduction	76% Moderately Effective
Assistance to Developing Countries	75% Moderately Effective
Assistance to Rebuilding Countries	73% Moderately Effective
President's Emergency Plan for AIDS Relief (PEPFAR)-Focus Countries	73% Moderately Effective
Protection of Foreign Missions and Officials	72% Moderately Effective
Economic Support Fund-Western Hemisphere	71% Moderately Effective
Security Assistance for Near East Asia	69% Adequate
Economic Support Fund-Africa	67% Adequate
Human Rights and Democracy Fund	66% Adequate
PEPFAR-Global Fund	65% Adequate
Interagency Cooperative Administrative Support Services	65% Adequate
Contributions to International Fisheries Commissions	59% Adequate
Public Diplomacy	59% Adequate
PEPFAR-Other Bilateral Programs	58% Adequate
International Narcotics Control & Law Enforcement (INCLE), Africa/Asia	53% Adequate
INCLE, WHA	53% Adequate
Andean Counterdrug Initiative	52% Adequate
International Information Programs	50% Adequate
INCLE, South Asia	50% Adequate

Legend

- **Effective** (85-100%)
- **Moderately Effective** (70-84%)
- **Adequate** (50-69%)

State Operations PARTs
Foreign Assistance PARTs (bolded)

Summary Analysis of Financial Condition

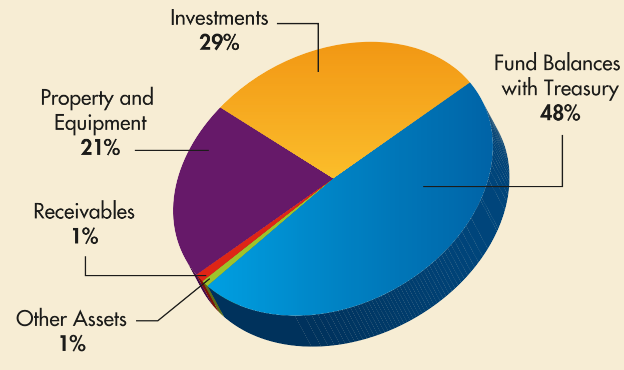
Overview of Financial Position

Assets. The Department's total assets were $52 billion at September 30, 2008, an increase of 15 percent over the 2007 total of $45 billion. Fund balances with Treasury were up $5.4 billion primarily due to an increase in appropriations received but not yet obligated. Investments were up $479 million because contributions and appropriations received to support the Foreign Service Retirement and Disability Fund were greater than benefit payments; the excess is required to be invested for future benefit payments. Property and equipment increased $879 million due to continued emphasis on the construction of new embassies and necessary security upgrades at existing embassies.

Fund Balances, Investments and Property and Equipment comprise 98 percent of total assets for 2008 and 2007. Investments consist almost entirely of U.S. government securities held in the Foreign Service Retirement and disability Fund; government agencies are, for the most part, precluded from making any other type of investment.

Many Heritage Assets, including art, historic American furnishings, rare books and cultural objects, are not reflected in assets on the Department's Balance Sheet. Federal accounting standards attempt to match costs to accomplishments in operating performance, and have deemed that the allocation of historical cost through depreciation of a national treasure or other priceless item intended to be preserved forever as part of our American heritage would not contribute to performance cost measurement. Standards require only the maintenance cost of these heritage assets be expensed, since it is part of the government's role to maintain them forever in good condition. All of the embassies and other properties on the Secretary of State's Register of Culturally Significant Property, however, do appear as assets on the Balance Sheet, since they are used in the day-to-day operations of the Department. See the Required Supplementary Information here as well as the report at *www.state.gov/documents/organization/66242.pdf* for further details.

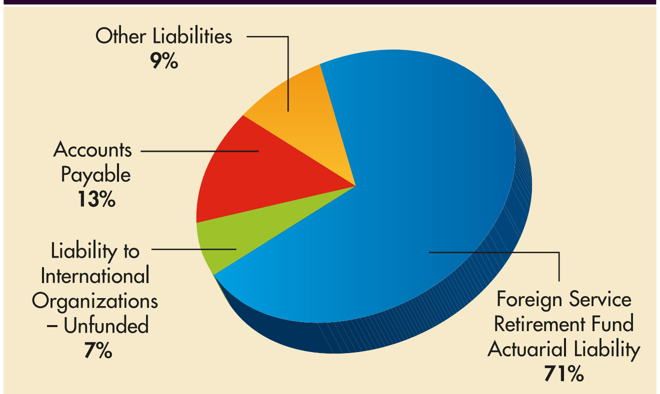
Assets by Type



(Dollars in Millions) **As of September 30**	**2008**	**2007**
Fund Balances with Treasury	$ 25,151	$ 19,779
Investments, Net	14,891	14,412
Property and Equipment, Net	11,077	10,198
Receivables, Net	671	620
Other Assets	326	225
Total Assets	$ 52,116	$ 45,234

Liabilities. The Department's total liabilities were up eight percent between 2008 and 2007, to $21 billion from $20 billion. The liability for future benefits payments to retired foreign service officers shown as the Foreign Service Retirement Actuarial Liability, 71 percent of the total, was up $410 million (three percent) due to increasing participation in the benefit plan. Cost assumptions did not change. The remainder of the increase in liabilities was due to increases in funded accounts payable, up $928 million, 48 percent, in 2008 compared to 2007. Accounts payable for liabilities to International Organizations are 40 percent of the total accounts payable, and they were up 44 percent, due to increases in dues assessments and timing of payments.

Liabilities by Type



(Dollars in Millions) As of September 30	2008	2007
Foreign Service Retirement Actuarial Liability	$ 15,139	$ 14,729
Liability to International Organizations	1,507	1,477
Accounts Payable	2,878	1,950
Other Liabilities	1,959	1,738
Total Liabilities	$ 21,483	$ 19,894

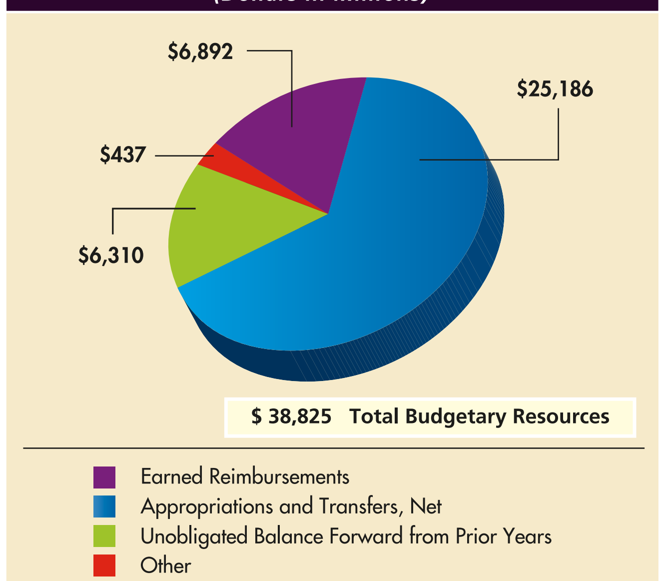
Ending Net Position. The Department's net position, comprised of both unexpended appropriations and the cumulative results of operations, increased 21 percent between 2007 and 2008. Unexpended appropriations was up $3.5 billion, primarily due to appropriations still available in the new Global Health and Child Survival fund. Cumulative Results of Operations was up $1.9 billion, primarily due to resources used to purchase property and equipment, $1.8 billion, which are capitalized on the Balance Sheet rather than presented in Net Cost as expenses.

Results of Operations

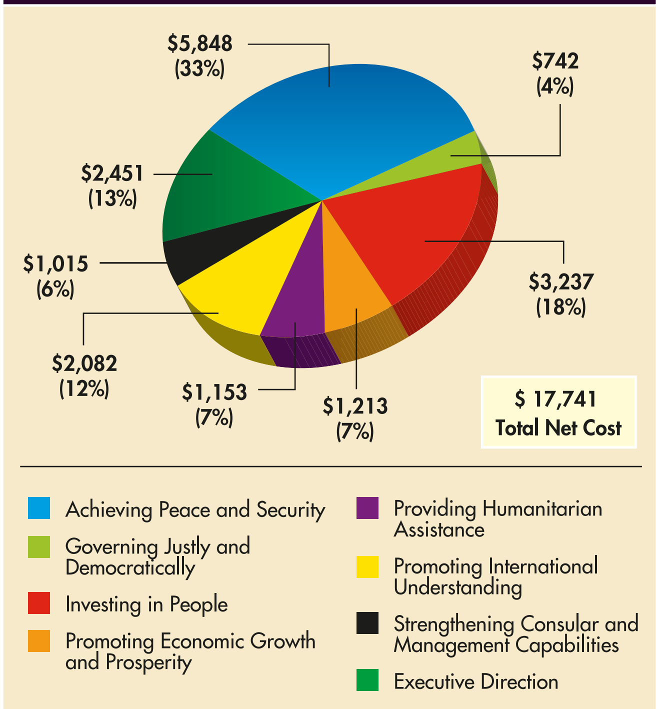
The following two charts illustrate the sources of funds received by the Department in 2008 and the results of operations by net program costs reported on the Statement of Net Cost.

The Combined Statement of Budgetary Resources details what budgetary resources were available to the Department for the year and the status of those resources at year-end. Total Budgetary Resources were up $7.3 billion, 23 percent, in 2008 over 2007. Most of that increase, $5.7 billion, came from increased budget authority from appropriations and spending authority from offsetting collections granted by Congress and authorized by the Office of Management and Budget (OMB). Appropriations and offsetting collections comprised 83% of year-end resources. The remainder was transfers, recoveries of prior-year unpaid obligations, and unobligated balances brought forward. The Department obligated $30.7 billion of the $38.8 billion total resources in 2008, an increase of $5.5 billion, 22 percent, over 2007. Percent of total resources obligated remained stable at 79 percent in 2008 versus 81 percent in 2007.

Sources of Funds
(Dollars in Millions)



Net Cost by Strategic Goal
(Dollars in Millions)



The Consolidated Statement of Net Cost presents the Department's costs by strategic goal. These strategic goals were determined by the Department's current State-USAID Joint Strategic Plan for 2007 – 2012 established pursuant to the Government Performance and Results Act of 1993. Cost by goal is net of earned revenue by goal. Revenue to the Department from other federal agencies must be established and billed based upon actual costs only, without profit, per statute. Revenue from the public, in the form of fees for service, such as visa issuance, is also to be cost-recovery only, without profit, at the Department. Therefore, the net cost per goal measures actual cost to the American taxpayer after fees and agreements with other federal agencies that should net to zero. Note 15 to the financial statements presents further breakdown of costs by responsibility segments, per under-secretary.

Total net cost of $17.7 billion is an increase of 30 percent or $4.1 billion over 2007. The two goals of Achieving Peace and Security and Investing in People, along with an increase in costs for security account for most of this increase. As seen in the Net Cost by Strategic Goal chart above, the goal of Achieving Peace and Security is the largest representing 33 percent of 2008 net costs. Net costs for this goal increased $1 billion in 2008, primarily due to an increase of $652 million for International Organizations (IO). Our IO costs include annual assessments for peacekeeping missions and assessments from the United Nations. Our second largest goal, Investing in People, accounted for $936 million of the net costs increase. This was primarily the result of initiatives this year with the new fund established for Global Health and Child Survival. Support costs for Diplomatic Security and Diplomatic Readiness functions are distributed to all strategic goals and accounted for $1.6 billion of the increase in net costs. Additionally, passport and visa issuance included in the goal of Strengthening Consular and Management Capabilities received increased focus in 2008 contributing to $465 million of the net costs increase attributable to this goal.

Budgetary Position

The FY 2008 budget for the Department of State totaled $12.8 billion. It included State Operations appropriations for Administration of Foreign Affairs ($9.1 billion), contributions to international organizations and international peacekeeping activities ($3.5 billion), international commissions ($155 million), and related programs ($36 million). These amounts do not include foreign assistance funding, which was provided through Foreign Operations appropriations.

The Department's FY 2008 budget was funded by the *FY 2008 Omnibus Appropriations Act under Division J – Department of State, Foreign Operations, and Related Programs Appropriation Act.* The budget also included supplemental funding provided through the Supplemental Appropriations Act, 2008. Supplemental funding was required primarily to address the extraordinary costs for security and operations of the U.S. Missions in Iraq and Afghanistan, as well as the U.S. share of costs for United Nations peacekeeping missions.

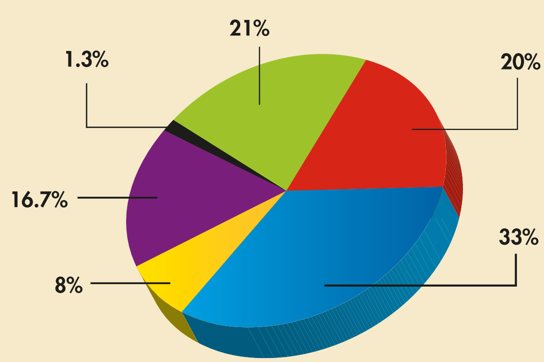
In addition to appropriated funds, the Department continued to rely on revenue from user fees – Machine Readable Visa fees, Enhanced Border Security Program fees, the Western Hemisphere Travel Surcharge, and other fees – for the Border

Security Program. The revenue from these fees supported program requirements to protect American citizens and safeguard the nation's borders. FY 2008 requirements included consular workloads in connection with renewals of Border Crossing Cards and passport demand associated with implementation of the Western Hemisphere Travel Initiative.

Appropriations for Administration of Foreign Affairs constitute the Department's core funding. They support the people and programs required to carry out U.S. foreign policy and advance U.S. national security, political, and economic interests at more than 260 posts in over 180 countries around the world. They also build, maintain, and secure the infrastructure of the American diplomatic platform, from which most U.S. Government agencies operate overseas.

For FY 2008, the Department's principal operating appropriation – Diplomatic and Consular Programs (D&CP) – was funded at $6.8 billion. Total D&CP funding included $1.7 billion to support operations of the U.S. Mission in Iraq, $1.2 billion for the Worldwide Security Protection program to strengthen security for diplomatic personnel and facilities under threat from terrorism, and

The Federal Government Dollar – Outlays in 2008



Social Security – 21%
National Defense – 20%
Medicaid, Health Other Entitlement's – 33%
Net Interest – 8%
International Affairs – 1.3%
All Other Functions – 16.7%

Source: FY 2009 Mid-Session Review, Budget of the U.S. Government, Estimates for FY 2008

$361 million for vigorous public diplomacy to counter extremist misinformation and secure support for U.S. policies abroad. The funding also included resources to further the Government-wide reforms of the President's Management Agenda and agency-specific initiatives on rightsizing the U.S. Government's overseas presence and Federal real property asset management.

The Department's IT Central Fund for FY 2008 investments in information technology totaled $347 million. The Fund total included $60 million from the Capital Investment Fund (CIF) appropriation and $287 million in revenue from Expedited Passport fees. Investment priorities included modernization of the Department's global IT infrastructure to assure reliable access to foreign affairs applications and information and projects to facilitate collaboration and data sharing internally and with other agencies. IT investments also supported E-Government initiatives of the President's Management Agenda.

The Embassy Security, Construction, and Maintenance (ESCM) appropriation was funded at $1.5 billion. This funding helped provide U.S. missions overseas with secure, safe, and functional facilities. The funding also supported management of the Department's real estate portfolio, which exceeds $14 billion in value and includes over 15,000 properties. The ESCM funding included $747 million to support capital security construction and compound security projects. Under the Capital Security Cost Sharing program, all agencies with overseas staff under Chief of Mission authority contributed $361 million to the construction costs of new diplomatic facilities.

The Educational and Cultural Exchange Programs (ECE) appropriation was funded at $501 million. Aligned with public diplomacy efforts, these strategic activities engaged foreign audiences to develop mutual understanding and build foundations for international cooperation. The funding included $286 million for academic programs of proven value, such as the J. William Fulbright Scholarship Program and English language teaching. It also included $164 million for professional and cultural exchanges, notably the International Visitor Leadership Program and Citizen Exchange Program.

For FY 2009, the Department's budget request (at this date still pending before the Congress) totals $11.5 billion. It includes resources to address ongoing national security and foreign policy priorities, particularly supporting the global war on terror and advancing transformational diplomacy. The request for D&CP is $5.4 billion, including $1.2 billion for Worldwide Security Protection to meet new demands in all regions. The request provides $71 million for CIF for further investments in IT infrastructure and collaborative tools. The request for ESCM totals $1.8 billion, including $948 million for design and/or construction of secure facilities, additional site acquisitions, and compound security projects. Further, the request provides $522 million for ECE to strengthen the exchanges component of public diplomacy, expand the National Security Language Initiative, and bring key influencers to America.

The Department has received FY 2009 bridge supplemental funding for State Operations totaling $1 billion. This funding was provided to support operational requirements in Iraq, Afghanistan, and Pakistan as well as new security requirements and overseas construction. Additionally, supplemental funds were appropriated for Contributions to International Organizations and for U.N. Peacekeeping Missions.

Limitation of Financial Statements

Management prepares the accompanying financial statements to report the financial position and results of operations for the Department of State pursuant to the requirements of Chapter 31 of the U.S. Code Section 3515(b). While these statements have been prepared from the books and records of the Department in accordance with OMB Circular A-136, *Financial Reporting Requirements,* and other applicable authority, these statements are in addition to the financial reports, prepared from the same books and records, used to monitor and control the budgetary resources. These statements should be read with the understanding that they are for a component of the U.S. government, a sovereign entity.

Members of a pantomime theater perform at the 17th International AIDS Conference in Mexico City in August 2008. Speaking at the Conference was Ambassador Mark R. Dybul, the U.S. Global AIDS Coordinator. His mission is to lead implementation of the U.S. President's Emergency Plan for AIDS Relief (PEPFAR). PEPFAR is the largest commitment ever by a single nation toward an international health initiative — a comprehensive approach to combating HIV/AIDS around the world. PEPFAR employs the most diverse prevention, treatment and care strategy in the world.

The success of the Emergency Plan is firmly rooted in partnerships between the American people and the people of the countries in which we are privileged to serve — governments, non-governmental organizations including faith- and community-based organizations, and the private sector. Under PEPFAR, the U.S. Government has committed $18.8 billion to the fight against global HIV/AIDS.

AFP Photo/Ronaldo Schemidt

The Department also issues financial statements for its Foreign Service Retirement and Disability Fund, the International Cooperative Administrative Support Services Fund that operates embassies, and the International Boundary and Water Commission. These complete, separately-issued financial reports are available annually from the Department's Bureau of Resource Management, Office of Financial Policy, Reporting and Analysis, at 2401 E Street NW, Room 1500, Washington DC 20037. Telephone (202) 261-8620.

Internal Controls, Financial Management Systems and Compliance with Laws and Regulations

Management Assurances

The Department's Management Control policy is comprehensive and requires all Department managers to establish cost-effective systems of management controls to ensure U.S. Government activities are managed effectively, efficiently, economically, and with integrity. All levels of management are responsible for ensuring adequate controls over all Department operations.

Federal Managers' Financial Integrity Act

The Department of State's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). The Department conducted its assessment of the effectiveness of internal control over the efficiency and effectiveness of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, the Department can provide reasonable assurance that its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations and financial management systems met the objectives of FMFIA as of September 30, 2008.

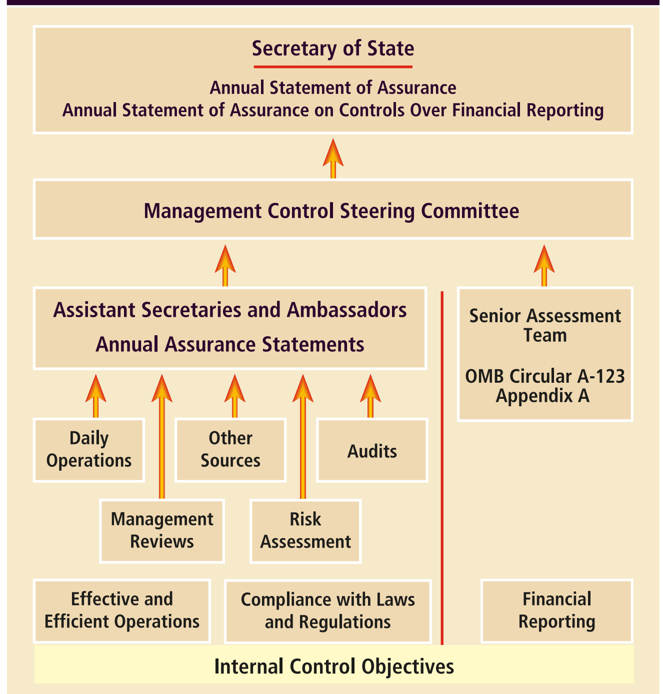
In addition, management is also responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The Department conducted its assessment of the effectiveness of internal control over financial reporting in accordance with Appendix A of OMB Circular A-123. Based on the results of this assessment, the Department can provide reasonable assurance that its internal control over financial reporting as of June 30, 2008 was operating effectively and no material weaknesses were found in the design or operation of the internal control over financial reporting. Further, subsequent testing through September 30, 2008 did not identify any reportable changes to our assessment of internal control over financial reporting.

Because of its inherent limitations, internal control over financial reporting, no matter how well designed, cannot provide absolute assurance of achieving financial reporting objectives and may not prevent or detect misstatements. Therefore, even if the internal control over financial reporting is determined to be effective, it can provide only reasonable assurance with respect to financial statement preparation and presentation. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Condoleezza Rice
Secretary of State
November 17, 2008

Departmental Governance

FMFIA Annual Assurance Process



MANAGEMENT CONTROL PROGRAM

The Federal Managers' Financial Integrity Act (FMFIA) requires agencies to establish internal control and financial systems that provide reasonable assurance that the following objectives are achieved:

- Effectiveness and efficiency of operations,
- Compliance with applicable laws and regulations, and
- Reliability of financial reporting.

It also requires that the head of the agency, based on an evaluation, provide an annual Statement of Assurance on whether the agency has met this requirement. OMB Circular A-123, *Management's Responsibility for Internal Control*, implements the FMFIA and defines management's responsibility for internal control in Federal agencies.

In 2004, Appendix A of Circular A-123 was added to improve governance and accountability for internal control over financial reporting in Federal entities similar to the internal control requirements for publicly-traded companies contained in the Sarbanes-Oxley Act of 2002. The Circular A-123 requires that the agency head provide a separate assurance statement on the effectiveness of internal control over financial reporting (ICOFR), which is an addition to and also a component of the overall FMFIA assurance statement.

The Secretary of State's 2008 Annual Assurance Statement for FMFIA and ICOFR is provided on the preceding page. We have also provided a Summary of Financial Statement Audits and Management Assurances as required by OMB Circular A-136 later in this report's section called Other Accompanying Information.

The Department's Management Control Steering Committee (MCSC) oversees the Department's management control program. The MCSC is chaired by the Chief Financial Officer, and is composed of eleven other Assistant Secretaries [including the Chief Information Officer and the Inspector General (non-voting)], the Deputy Chief Financial Officer, the Deputy Legal Adviser, the Deputy Assistant Secretary for Global Financial Services, and the Director for the Office of Overseas Buildings Operations. Individual assurance statements from Ambassadors assigned overseas and Assistant Secretaries in Washington, D.C. serve as the primary basis for the Department's FMFIA assurance issued by the Secretary. The assurance statements are based on information gathered from various sources including the managers' personal knowledge of day-to-day operations and existing controls, management program reviews, and other management-initiated evaluations. In addition, the Office of Inspector General and the Government Accountability Office conduct reviews, audits, inspections, and investigations that are considered by management.

The Senior Assessment Team (SAT) provided oversight during 2008 for the internal control program in place to meet Appendix A requirements. The SAT reports to the MCSC and is comprised of 15 senior executives from bureaus that have significant responsibilities relative to the Department's financial resources, processes, and reporting.

It is the Department's policy that any organization with a material weakness or significant deficiency must prepare and implement a corrective action plan to fix the weakness. The plan, combined with the individual assurance statements and Appendix A assessments, provide the framework for monitoring and improving the Department's management controls on a continuous basis.

The Department's management controls program is designed to ensure full compliance with the goals, objectives, and requirements of the FMFIA and various Federal regulations. To that end, the Department has dedicated considerable resources to administer a successful management control program. The Department worked closely with the Independent Auditor to address the reported material weakness related to the management of unliquidated obligations. As a result of the improvements made, the SAT and MCSC voted to downgrade this item to a significant deficiency. During fiscal year 2008, the Office of Management Controls initiated efforts to integrate the work performed in meeting requirements of Appendix A, and Appendix C regarding the Improper Payments Information Act, with the FMFIA program. The Department employs a risk-based approach in evaluating internal controls over financial reporting on a multi-year rotating basis, which has proven to be efficient. The Department is working to expand the use of risk-based assessments in an integrated approach to the entire FMFIA program.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires that agencies' financial management systems provide reliable financial data in accordance with generally accepted accounting principles and standards. Under FFMIA, financial management systems must substantially comply with three requirements — Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger (SGL).

To assess conformance with FFMIA, the Department uses FFMIA implementation guidance issued by OMB (January 2001 Memorandum to Executive Department Heads, Chief Financial Officers, and Inspectors General), results of OIG and GAO audit reports, annual financial statement audits, the Department's annual Federal Information Security Management Act (FISMA) Report, and other relevant information. The Department's assessment also relies a great deal upon evaluations and assurances under the FMFIA including assessments performed to meet the requirements of OMB Circular A-123 Appendix A. Particular importance is given to any reported material weakness and material non-conformance identified during these internal control assessments.

The Department has made it a priority to meet the objectives of the FFMIA. Based on assessment results, along with information contained in the Department's FY 2008 FISMA Report and evaluations and assurances provided under FMFIA, the Department affirmed its determination of substantial compliance with FFMIA in its FY 2008 Management Representation Letter provided to the Independent Auditor. Further reinforcing FFMIA substantial compliance, the Department's Management Control Steering Committee voted to classify the Department's Financial and Accounting Systems as a financial system deficiency (versus significant or material non-conformance).

During the prior fiscal year the Department completed a major upgrade of its core financial management system, the Central Financial Management System (CFMS) to the Global Financial Management System (GFMS). GFMS establishes a common, uniform platform based on a commercial off-the-shelf (COTS) financial system. The COTS product has been tested and certified through the CFO Council software certification process as meeting Office of Federal Financial Management financial system requirements.

Federal Information Security Management Act

The Department of State 2008 Federal Information Security Management Act (FISMA) and Privacy Management Report presented continued improvement in IT security within the Department, as well as a framework for 2009 efforts. The Department is dedicated to protecting information and information systems with a comprehensive Information Security Program integrating operational security and information assurance programs monitored by performance metrics that are continually improving.

Since last year, the Department has taken significant steps to improve management controls, including conducting a comprehensive data call of all its domestic bureaus and overseas posts in an effort to accurately identify its FISMA reportable inventory. The Department exercised a focused effort and markedly improved its Plan of Action and Milestones (POA&M) process since last year's FISMA review, developing databases to manage the POA&M process and posting a toolkit on its website that assisted system owners with certification and accreditation (C&A) requirements to better manage the POA&M process. The Department's C&A process and quality also improved overall, as well as in addressing privacy responsibilities. During 2008 the Privacy Protection Governance Board continued to meet under the Chairmanship of the Assistant Secretary for Administration, who is the designated Senior Agency Official for Privacy, and the Department finalized its Personally Identifiable Information Breach Response Policy.

The Department documented its agency-wide requirements for configuration management within policy established by the Bureaus of Diplomatic Security and Information Resource Management. Further, the Department implemented several new initiatives during FY 2008 to improve its incident reporting services and analyses. Finally, the Department made significant progress in providing security awareness to employees, and established a plan to ensure that non-system overseas employees receive security training as well.

In FY 2008, the Department achieved measurable progress throughout the agency-wide information security program. These accomplishments are key indicators the Department gained forward momentum for FY 2009 focusing attention on security concerns and designed processes and procedures to sustain that momentum. The Department begins FY 2009 with renewed confidence that the constant security challenges facing any global enterprise will be considered, identified, and resolved in a timely and comprehensive manner and substantial progress on all the initiatives started in FY 2008 will be maintained.

Jordanian deminers observe land mine destruction at the Jordan – Syrian border in August 2008. Women and children bear the brunt of these devices. The U.S. continues to contribute tens of millions of dollars annually to help rid the world of the "hidden killers" that remain from past conflicts, the overwhelming preponderance of which have been manufactured and employed by other countries and foreign combatants. The United States remains the world's top contributor to humanitarian mine action, having spent well over $1.2 billion since 1993. In FY 2006, the United States dedicated $76 million to mine action, and in FY 2007, the U.S. spent $82 million more.

The Office of Weapons Removal and Abatement in the U.S. Department of State's Bureau of Political-Military Affairs has released the Seventh Edition of "To Walk the Earth in Safety," summarizing the 2006-2007 accomplishments of the U.S. Humanitarian Mine Action Program, the world's largest such operation. Milestones in 2007 include the reduction in annual reported casualties from landmines and explosive remnants of war worldwide to 5,751, down from about 26,000 just four years before. The interagency U.S. Humanitarian Mine Action Program is the largest and one of the world's oldest such programs. It is comprised of the Department of State, the Department of Defense, the U.S. Agency for International Development's Leahy War Victims Fund, and the Centers for Disease Control and Prevention.

AFP Photo/Awad Awad

Department of State History

Why is it called the Department of State?

On September 15, 1789, Congress passed "An Act to provide for the safekeeping of the Acts, Records, and Seal of the United States, and for other purposes." This law changed the name of the Department of Foreign Affairs to the Department of State because certain domestic duties were assigned to the agency.

These included:

- Receipt, publication, distribution, and preservation of the laws of the United States;
- Preparation, sealing, and recording of the commissions of Presidential appointees;
- Preparation and authentication of copies of records and authentication of copies under the Department's seal;
- Custody of the Great Seal of the United States;
- Custody of the records of the former Secretary of the Continental Congress, except for those of the Treasury and War Departments.

Other domestic duties that the Department was responsible for at various times included issuance of patents on inventions, publication of the census returns, management of the mint, control of copyrights, and regulation of immigration. Most domestic functions have been transferred to other agencies. Those that remain in the Department are: preparation and authentication of copies of records and authentication of copies under the Department's seal, storage and use of the Great Seal, performance of protocol functions for the White House, drafting of certain Presidential proclamations, and replies to public inquiries.

Who was the first U.S. Diplomat?

Benjamin Franklin was the first U.S. diplomat. He was appointed on September 26, 1776 as part of a commission charged with gaining French support for American independence. He was appointed Minister to France on September 14, 1778 and presented his credentials on March 23, 1779, becoming the first American diplomat to be received by a foreign government. Franklin was one of three Commissioners who negotiated the peace treaty with Great Britain, and continued to serve in France until May 17, 1785.

When was the first U.S. treaty signed?

The first U.S. treaty was the Treaty of Amity and Commerce with France that was signed in Paris on February 6, 1778.

What is the oldest diplomatic property owned by the United States?

The oldest diplomatic property owned by the United States is the U.S. Legation building in Tangier. The Sultan of Morocco made a gift of the building in 1821. It served as the U.S. Consulate and Legation until 1956. It is currently preserved as a museum and study center.

Financial Section

Distinguished African Americans at the Department of State

1920 1925 1930 1935 1940 1945 1950

1925 ***Among the first African Americans to join the Foreign Service***
Clifton R. Wharton (1899–1990)
First African American Foreign Service Officer to become chief of a diplomatic mission in Europe when he was appointed Minister to Romania on February 5, 1958. He served in Romania until October 21, 1960. He then served as Ambassador to Norway from April 18, 1961 to September 4, 1964.

1949 ***First African American Ambassador***
Edward R. Dudley
Edward R. Dudley was appointed Minister to Liberia in 1948 and promoted to Ambassador to Liberia in 1949.

1950 ***First African American woman United Nations Official***
Edith S. Sampson, (1901–1979)
First African American woman to be named an official representative to the United Nations from 1950-1953.

Message from the Chief Financial Officer

The scale and complexity of the Department's mission has grown exponentially since 9/11. Operating in this environment of expanding mission requirements and budget deficits, the pressure to operate efficiently and reduce costs has never been greater. As a result, the demand for effective financial management and internal controls has never been greater. The hallmark of top financial operations is their ability to not only provide accurate and timely financial data but also to use that data and expertise to provide high-value financial advice to the key decision-makers.

The Agency Financial Report (AFR) for FY 2008 is a cornerstone of our efforts to disclose the Department's financial status, successes, and shortcomings. It is a comprehensive review of the Department's activities against the backdrop of the global challenges presented by a complex world. In the FY 2008 AFR, as in past years, what is apparent and should be inspirational to all Americans is the inextricable link between the Department's accomplishments and the unwavering commitment of our employees serving around the world, in challenging as well as tranquil situations, dedicated to our mission and our nation.

As we transition to a new administration, I would like to thank the Bureau of Resource Management (RM) staff for the work they contribute to help the entire Department. Their steadfast efforts have allowed us to plan for and garner vitally needed resources; budget, steward and account for our funds on behalf of America's taxpayers; and assist posts in the field as they conduct our nation's diplomatic affairs.

In addition, their efforts have led to the achievement of many financial management successes. These include: the streamlining and consolidation of our global financial systems and operations; the installation of Direct Connect at every post that has the necessary connectivity; the improvement in managerial cost accounting information; Interagency Cooperative Administrative Support System (ICASS) support to Posts by simplifying and standardizing of ICASS mechanisms; the establishment of a robust Global Partnership Center in RM, fully supporting the Department's Transformational Diplomacy agenda; a more complete integration of strategic and performance planning with budgeting, that better and more comprehensively links funding to the Department's strategic goals and results; and the standardization of the budget process.

Bradford R. Higgins

Our financial management staff continues to strive for perfection in its pursuit of world-class financial management support for this Department. In addition, the Department has demonstrated innovation and leadership in performance management by improving performance systems and coordinating strategic planning with other foreign affairs agencies.

Few agencies or corporations have the level of complexity and challenges that the Department faces daily as we operate in over 260 locations in 172 countries, often in hostile environments, while conducting business in 150 currencies where an even larger number of languages are spoken. Regardless, the Department makes every effort to achieve the highest standard of financial reporting as required by OMB (45 days versus 60 days in the corporate world). Unfortunately, since the start of accelerated reporting five years ago, given the extensiveness and complexity of our financial operations, it has been a challenge for the Department to complete its audit and meet OMB's 45-day filing deadline. It will continue to be a challenge as each year brings new challenges such as accounting for contractor-held property in Iraq and Afghanistan and allocations to other agencies for programs such as HIV/AIDS. While I am pleased that we were able to submit our FY 2008 financial report to OMB on time, I am disappointed that we were unable to provide sufficient evidential matter for the Independent Auditor to complete the audit and express an opinion by the November 17, 2008 deadline. Since then, with the cooperation of the Independent Auditor and OIG, our efforts continued, and the Department satisfied the Independent Auditor about the amounts presented in the financial statements and footnotes. Therefore, on December 12, 2008, we have received an unqualified ("clean") opinion on the financial statements, as of and for the year ended September 30, 2008.

I am pleased to report the Department maintains a robust system of internal controls overseen by senior leadership and administered by RM. During the past year, the Department worked closely with the Independent Auditor to address the material weaknesses reported for FY 2007 related to the management of undelivered orders and accounting for personal property. As a result of improvements made, these areas were downgraded and the Department ended the year with no material weaknesses in internal control. Accordingly, for FY 2008, the Secretary was able to provide an overall unqualified statement of assurance for FMFIA, and an unqualified statement of assurance for internal controls over financial reporting.

I have had the honor and privilege to be able to serve our Country, President, and the Secretary as Assistant Secretary and during my assignment in Iraq. In closing, I would like to also express my sincere appreciation to the thousands of Department financial professionals around the globe who plan, budget, allocate, obligate, disburse, and account for billions of dollars in annual resources. Despite our worldwide geographic dispersion, the Department operates as one team distinguished by its dedication to strong ethics and corporate governance. These men and women have built a foundation of solid financial management and reporting; our mission going forward will be to provide a high level of financial advisory expertise to the Secretary and the Bureaus, and to ensure that the Department obtains maximum results from its funding. Accountability to the citizens of the United States, the President, Congress, and our employees, as well as other customers and constituents remains our paramount priority.

Bradford R. Higgins
Assistant Secretary for Resource Management
and Chief Financial Officer
December 12, 2008

United States Department of State
and the Broadcasting Board of Governors

Office of Inspector General

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INFORMATION MEMO TO THE SECRETARY

FROM: OIG – Harold W. Geisel, Acting

SUBJECT: Independent Auditor's Report on the U.S. Department of State's 2008 and 2007 Financial Statements (AUD/FM-09-02A)

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of Leonard G. Birnbaum and Company, LLP (LGB), to audit the financial statements of the Department of State as of September 30, 2008 and 2007, and for the years then ended. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards; Office of Management and Budget (OMB) audit guidance; and the *Financial Audit Manual*, issued by the Government Accountability Office and the President's Council on Integrity and Efficiency.

In a report dated November 17, 2008, LGB stated that because the Department was unable to respond to requests for evidential material in a timely manner and LGB was not able to perform other auditing procedures to satisfy itself as to the accuracy of the 2008 financial statements in time to meet the November 17, 2008, deadline imposed by OMB for issuing the report, the scope of its work was not sufficient to enable it to express, and it did not express, an opinion on the financial statements as of, and for the year ended, September 30, 2008.

The Department has since provided LGB with sufficient evidential material to support the amounts reported on the financial statements as of, and for the year ended, September 30, 2008. LGB has satisfied itself that the amounts presented in the Department's 2008 financial statements are presented fairly in all material respects in conformity with accounting principles generally accepted in the United States of America. Accordingly, the present opinion on the Department's 2008 financial statements is different from the disclaimer of opinion identified in the previous report dated November 17, 2008, and that report should not be relied upon.

LGB found the following:

- certain deficiencies in the Department's internal control that LGB considered to be significant deficiencies,

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- instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management system, and
- that the Department's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).

LGB is responsible for the auditor's report dated December 12, 2008, attached to this memorandum, and the conclusions expressed in the report. OIG does not express an opinion on the Department's financial statements or conclusions on internal control and compliance with laws and regulations, including whether the Department's financial management systems complied with FFMIA.

Comments from the Bureau of Resource Management are included in the attached report in Appendix A.

OIG appreciates the cooperation extended to it and LGB by Department managers and staff during the conduct of this audit.

Attachment: As stated.

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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, and Combined Statements of Budgetary Resources (annual financial statements) as of, and for the years ended, September 30, 2008 and 2007. We have considered internal control over financial reporting as of, and during the year ended, September 30, 2008, and we have tested compliance with selected laws and regulations.

In our report dated November 17, 2008, we stated that because the Department was unable to respond to requests for evidential material in a timely manner and we were not able to perform other auditing procedures to satisfy ourselves as to the accuracy of the 2008 financial statements in time to meet the November 17, 2008, deadline imposed by the Office of Management and Budget (OMB) for issuing our report, the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the financial statements, as of and for the year ended, September 30, 2008.

On November 14, 2007, we issued our report on the Department's financial statements as of, and for the year ended, September 30, 2007. In that report, we disclaimed an opinion on the Department's 2007 annual financial statements because the Department was unable to respond to requests for evidential material in a timely manner and we were not able to perform auditing procedures to satisfy ourselves as to the accuracy of the financial statements in time to meet the November 15, 2007, deadline imposed by OMB for issuing our report.

The Department has since provided us with sufficient evidential material to support the amounts reported on the financial statements as of, and for the year ended, September 30, 2008. We have satisfied ourselves that the amounts presented in the Department's 2008 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 2008 financial statements, as presented herein, is different from the disclaimer of opinion identified in our previous report dated November 17, 2008, and that report should not be relied upon. While the Department provided sufficient evidential material to support the opening balances for its 2008 financial statements, we did not perform additional auditing procedures on the 2007 financial statements. Therefore, we continue to be unable to express, and do not express, an opinion on the 2007 financial statements.

We found the following:

- certain deficiencies in the Department's internal control that we considered to be significant deficiencies,
- instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management systems, and
- that the Department's financial management systems did not substantially comply with the requirements of 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.

ANNUAL FINANCIAL STATEMENTS

In our opinion, the Department's 2008 financial statements, including the notes thereto, present fairly, in all material respects, the Department's financial position as of September 30, 2008, and the net cost of operations, the changes in net position, and the use of budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

On November 14, 2007, we issued our report on the Department's financial statements as of, and for the year ended, September 30, 2007. In that report, we disclaimed an opinion on the Department's 2007 annual financial statements because the Department was unable to respond to requests for evidential material in a timely manner and we were not able to perform auditing procedures to satisfy ourselves as to the accuracy of the financial statements in time to meet the November 15, 2007, deadline imposed by OMB for issuing our report. While the Department provided sufficient evidential material to support the opening balances for its 2008 financial statements, we did not perform additional auditing procedures on the 2007 financial statements. Therefore, we continue to be unable to express, and do not express, an opinion on the 2007 financial statements.

INTERNAL CONTROL

In planning and performing our audits of the Department's annual financial statements as of, and for the years ended, September 30, 2008 and 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the annual financial statements but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control. We limited our consideration of internal control to those controls necessary to achieve the objectives described in OMB Bulletin 07-04, *Audit Requirements for Federal Financial*

Statements. We did not consider all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations.

The purpose of internal control is 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; and
- 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 Office of Inspector General has identified as being significant for which compliance can be objectively measured and evaluated.

Our consideration of the internal control over financial reporting would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. Under standards issued by the American Institute of Certified Public Accountants, a significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following four deficiencies to be significant deficiencies in internal control:

- The Department's financial and accounting system as of September 30, 2008, was inadequate. There is a risk of materially misstating financial information under the current conditions. This condition is a significant reason that the Department was unable to provide complete financial statements or respond to requests for evidential material in a timely manner, which led to our inability to express an opinion on the 2008 financial statements in time to meet the deadline imposed by OMB. The principal areas of inadequacy were the following:
    - The Department is unable to produce year-end financial data to be included in its Agency Financial Report in a timely manner.
    - The Department has not established or implemented effective information technology application controls for management of grants and other forms of financial assistance.

This deficiency was initially observed in our audit of the Department's 1997 financial statements and cited in subsequent audits.

- The Department's internal control process related to the management of undelivered orders was inadequate. The Department has made improvements in this area over the past several years. The Bureau of Resource Management (RM) has actively worked with other Department bureaus to validate undelivered orders and has successfully cleared up a significant number of obligations that were outstanding from past years. The Department, however, needs to perform additional work to correct this condition. Our tests indicated that excess obligations as of September 30, 2008, were approximately $200 million. Also, we noted that the Department's undelivered orders balance had grown to $15.4 billion as of September 30, 2008. 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 deficiencies in this process were cited in our report on the Department's 1997 financial statements and in subsequent reports.

- We have identified deficiencies related to the recording of personal property and related depreciation expense and accumulated depreciation. The Department's control over property acquired by, and in the hands of, contractors, while improved, has not fully matured. Further, weaknesses in the Department's controls over vehicles and other personal property have persisted. Our tests disclosed a continuation of assets acquired in prior years being reported as current year accessions and errors in depreciation resulting from incorrect in-service dates. The Department has begun to implement policies, which, if executed as designed, should effectively address this long-standing weakness. This deficiency was initially observed in our audit of the Department's 2005 financial statements and cited in subsequent reports.

- The Department is unable to determine the extent of its unfunded actuarial liability accruing from defined benefit supplemental pension plans for locally employed staff. This deficiency was initially observed in our report on the Department's 2007 financial statements.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We noted no matters that we considered to be material weaknesses as defined herein.

We are required to review the Department's current FMFIA report and disclose differences with the material weaknesses in our report. We did not identify any discrepancies.

We noted certain other internal control issues that we have reported to Department management in a separate letter dated November 17, 2008.

COMPLIANCE WITH LAWS AND REGULATIONS

Department 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 07-04, including the requirements 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 annual 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 07-04.

- *Budget and Accounting Procedures Act of 1950.* This act 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 in a timely manner.

- *Federal Managers' Financial Integrity Act of 1982.* This act 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 assets are not adequately protected from waste or loss.

- *Chief Financial Officers Act of 1990.* This act 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 does not produce year-end financial data in a timely manner.

- *OMB Circular A-127, Financial Management Systems.* This circular 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.

The above areas of noncompliance were cited in our audit of the Department's 1997 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. OMB implementation guidance states that agencies that can do the following would be substantially compliant with FFMIA:

- prepare financial statements and other required financial and budget reports using information generated by the financial management system(s);
- provide reliable and timely financial information for managing current operations;
- account for their assets reliably so they can be properly protected from loss, misappropriation, or destruction; and
- do all of the above in a way that is consistent with federal accounting standards and the Standard General Ledger.

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.

- 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 deficiencies 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.

In addition, we were initially unable to express an opinion on the annual financial statements as of, and for the year ended, September 30, 2008, because of limitations on the scope of our work. The Department was unable to respond to requests for evidential material in a timely manner, and we were not able to satisfy ourselves as to the accuracy of the financial statements in time to meet the deadline imposed by OMB.

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 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.

We noted certain other instances of noncompliance that we reported to the Department's management in a separate letter dated November 17, 2008.

RESPONSIBILITIES AND METHODOLOGY

Department management has responsibility for the following:

- preparing the annual financial statements, 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 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 financial statements are free of material misstatement 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 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 took the following actions:

- We examined, on a test basis, evidence supporting the amounts on the annual financial statements and related disclosures.
- We assessed the accounting principles used and significant estimates made by management.
- We evaluated the overall presentation of the annual financial statements.
- With respect to the Department's internal control over financial reporting, we obtained an understanding of the design effectiveness of internal controls, determined whether they had been placed in operation, assessed control risk, and performed tests of controls.
- We obtained an understanding of the process by which the Department identifies and evaluates weaknesses required to be reported under FMFIA and related Department implementing procedures.
- We tested compliance with selected provisions of laws and regulations that may have a direct and material effect on the financial statements.

- We obtained written representations from management.
- We performed other procedures as we considered appropriate under the circumstances.

Our audit was conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in the *Government Auditing Standards*, and the provisions of OMB Bulletin 07-04. We considered the limitations on the scope of our work in forming our conclusions.

The Management's Discussion and Analysis and Required Supplementary Information 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 solely for the information and use of Department management, the Inspector General of the U.S. Department of State and Broadcasting Board of Governors, OMB, the Government Accountability Office, the Department of the Treasury, and the Congress and is not intended to be and should not be used by anyone other than those specified parties. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Comments by Department management on this report are included in Appendix A to this report. The written response by Department management to the significant deficiencies identified in our report has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion on these comments.

Leonard G. Birnbaum and Company, LLP
Alexandria, Virginia

December 12, 2008

APPENDIX A

United States Department of State

Washington, D.C. 20520

December 12, 2008

MEMORANDUM

TO: OIG/AUD – Mr. Mark Duda

FROM: RM – Bradford R. Higgins

SUBJECT: Draft Audit Report on the Department of State's 2008 and 2007 Financial Statements

This is in response to your request for comments on the draft report titled "Audit of the U.S. Department of State's 2008 and 2007 Financial Statements" (Report).

The Department of State (Department) operates in over 260 locations in 172 countries, while conducting business in 150 currencies and an even larger number of languages. Few agencies or corporations have the variety of challenges that the men and women of the Department face daily. Despite these complexities, the Department pursues a commitment to financial integrity, transparency, and accountability that is the equal of any multi-national corporation.

It will always be a challenge for the Department to complete the audit and meet OMB's 45-day deadline given the complexity of our financial operations. With the tight timeframe for submitting audited statements (45 days versus 60 days in the corporate world), any major program change jeopardizes the ability to complete the audit on-time, and each year will bring challenges such as accounting for contractor held property in Iraq and Afghanistan and increased spending through allocations to other agencies for programs such as HIV/AIDS. As a direct result of these time constraints, we were disappointed that while the Department submitted its FY 2008 financial report to OMB on time, we received a disclaimer of opinion from the Independent Auditor because of a delay in providing certain evidential matter in a timely manner. Since that submission and disclaimer on November 17, with the cooperation of the Independent Auditor and the OIG, our efforts continued, and we were able to satisfy the Independent Auditor about

APPENDIX A

the amounts presented in the FY 2008 financial statements and footnotes. Therefore, on December 12, 2008, we have now received an unqualified ("clean") opinion on the financial statements, as of and for the year ended September 30, 2008.

Additionally, we are pleased about the progress we made in FY 2008 to improve our internal controls. The Department is committed to effective internal controls and throughout 2008 we worked closely with the Independent Auditor to address the material weaknesses in accounting for personal property and the management of undelivered orders reported in their FY 2007 *Independent Auditor's Report*. As a result, and as reflected in the Report, the Independent Auditor downgraded these items to significant deficiencies, and reports no material weaknesses in internal controls. Accordingly, for FY 2008, the Secretary was able to provide an overall unqualified statement of assurance to the FMFIA, and an unqualified statement of assurance for internal controls over financial reporting.

With respect to the significant deficiency for accounting for personal property, we will continue our efforts in FY 2009 to address the many causes of this deficiency for our multitude of global assets (aircraft, vehicles, security equipment). Our actions have improved our controls from a year ago, but more work remains and further corrective actions are planned for FY 2009. In FY 2009, the Senior Assessment Team (SAT) and Management Control Steering Committee (MCSC) will ensure that efforts to address weaknesses in this area continue.

The Report cites a significant deficiency for the management of undelivered orders, and notes that there have been improvements in this area as evidenced by the downgrading of this previously reported material weakness. Improvements in the management of undelivered orders will continue to be a priority for the Department in FY 2009. Further corrective actions are already underway including the distribution of aging reports, and using recently developed enhancements to our Global Financial Management System (GFMS) capabilities to automate deobligations. In addition, actions to improve contract and grant closeout procedures relative to undelivered orders are being enhanced, and the SAT will be actively engaged with the implementation and oversight of these corrective actions.

Significant improvements in the Department's management of Federal financial assistance were made in FY 2008, and the MCSC (with the OIG's concurrence) voted to downgrade and consider resolved a number of areas (e.g., lack of adequate policies and training) that had contributed to this significant deficiency. In regards to the lack of effective information technology application controls for the management of grants, in FY 2008 the Department selected the GrantsSolutions.gov system, operated by the Department of Health and Human Services, as its grants management system service provider under OMB's Grants

APPENDIX A

Management Line of Business initiative. GrantsSolutions.gov will automate the full range of assistance management activities, from solicitation through award, post-award monitoring, and closeout and will also interface with the GFMS.

In FY 2007, the Department implemented the GFMS as the next step in our multiyear effort to establish a single global financial system. GFMS replaced the Department's 20 year old Central Financial Management System (our core accounting system) that centrally accounts for Department's billions of dollars of finances through over 5 million annual transactions by 1,000+ users and over 25 "handshakes" with other internal and external systems. As part of the implementation of GFMS, a data warehouse, fixed asset module and a cost allocation module (for managerial cost accounting) were installed. In addition, we brought on a new customer, the International Boundary and Water Commission, providing a full range of financial management services. And, for the first time, the Department's acquisition and fixed asset systems have been integrated into a single software application. GFMS is already paying for itself with the recovery of millions of dollars from over-billings, while also providing the data platform that will enable RM to provide more timely financial information and prepare in-depth decision support data for senior management. During FY 2008, we have stabilized GFMS and are moving forward with plans to establish a virtual, single global financial management system.

With respect to the significant deficiency for defined benefit supplemental pension plans for locally employed staff, the Department will continue our efforts in FY 2009 to establish an accurate inventory of these plans. This will serve as a basis to work and establish an appropriate approach to determining any unfunded actuarial amounts.

The Department continues to make progress in implementing Managerial Cost Accounting Standards, and we are pleased that based on our efforts the Independent Auditor no longer considers this a significant deficiency.

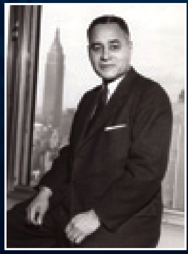
We thank you for the opportunity to comment on the draft report. Our work with the Independent Auditor and your office over the past 10 years has been collaborative, productive, and a catalyst for positive change. We would like to extend our appreciation to Leonard G. Birmbaum and Company, LLP, for their dedicated efforts on this year's audit. We believe, as detailed above, that considerable progress on a number of matters has been made this year, and the Department remains committed to improving the management of its programs and the quality of its financial reporting.

Financial Statements

Distinguished African Americans at the Department of State

1950 1954 1958 1962 1966 1970 1974

1950 ***First African American Recipient of the Nobel Peace Prize***
Ralph J. Bunche, (1903–1971)



Ralph J. Bunche, after whom the Department's Library is named, left in 1946 his position working on the future of colonial territories at the Department of State for the United Nations where his efforts for peace in Palestine won him the Nobel Peace Prize in 1950.

1959 ***First U.S. Ambassador to Republic of Guinea, 1959–1961***
John Howard Morrow, Sr.,
Alternate delegate to United Nations, 1961; U.S. permanent representative to UNESCO with personal rank of minister, Paris, France, 1961-63; U.S. Department of State, Foreign Service Institute, Washington, D.C., chairman of Foreign Service Officers university studies program, School of Foreign Affairs, 1963-1964.

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 2007 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. 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.

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 Stewardship Plant, Property and Equipment.

CONSOLIDATED BALANCE SHEET

(Dollars in Millions)

As of September 30,	Notes	2008	2007
ASSETS	2		
Intragovernmental Assets:			
Fund Balances With Treasury	3	$ 25,151	$ 19,779
Investments, Net	4	14,891	14,412
Interest Receivable		194	195
Accounts Receivable, Net	5	401	392
Other Assets		2	—
Total Intragovernmental Assets		40,639	34,778
Accounts and Loans Receivable, Net	5	76	33
Cash and Other Monetary Assets	6	70	60
Property and Equipment, Net	7	11,077	10,198
Other Assets	8	254	165
Total Assets		$ 52,116	$ 45,234
Stewardship PP&E	7		
LIABILITIES	9		
Intragovernmental Liabilities:			
Accounts Payable		$ 129	$ 5
Other Liabilities		783	658
Total Intragovernmental Liabilities		912	663
Accounts Payable		2,749	1,945
Foreign Service Retirement Actuarial Liability	10	15,139	14,729
Liability to International Organizations	11	1,507	1,477
Environmental Liabilities	9	381	393
Other Liabilities	9,12	795	687
Total Liabilities		21,483	19,894
Commitments and Contingencies	13		
NET POSITION			
Unexpended Appropriations		17,979	14,553
Cumulative Results of Operations—Earmarked Funds	14	231	(28)
Cumulative Results of Operations—Other Funds		12,423	10,815
Total Net Position		30,633	25,340
Total Liabilities and Net Position		$ 52,116	$ 45,234

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

CONSOLIDATED STATEMENT OF NET COST (NOTE 15)

(Dollars in Millions)

For the Year Ended September 30,	2008	2007
Achieve Peace and Security		
Total Cost	$ 6,880	$ 5,761
Earned Revenue	(1,032)	(849)
Net Program Costs	5,848	4,912
Governing Justly and Democratically		
Total Cost	808	697
Earned Revenue	(66)	(47)
Net Program Costs	742	650
Investing in People		
Total Cost	3,267	2,322
Earned Revenue	(30)	(21)
Net Program Costs	3,237	2,301
Promoting Economic Growth and Prosperity		
Total Cost	1,321	1,139
Earned Revenue	(108)	(76)
Net Program Costs	1,213	1,063
Providing Humanitarian Assistance		
Total Cost	1,158	1,099
Earned Revenue	(5)	-
Net Program Costs	1,153	1,099
Promoting International Understanding		
Total Cost	2,301	1,925
Earned Revenue	(219)	(151)
Net Program Costs	2,082	1,774
Strengthening Consular and Management Capabilities		
Total Cost	3,674	2,609
Earned Revenue	(2,659)	(2,662)
Net Program Costs	1,015	(53)
Executive Direction and Other Costs Not Assigned		
Total Cost	4,085	3,472
Earned Revenue	(1,634)	(1,582)
Net Program Costs	2,451	1,890
Total Cost	**23,494**	**19,024**
Total Revenue	**(5,753)**	**(5,388)**
Total Net Cost	**$ 17,741**	**$ 13,636**

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

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

(Dollars in Millions)

For the Year Ended September 30,	2008			2007
	Earmarked Funds	All Other Funds	Consolidated Total	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$ (28)	$ 10,815	$ 10,787	$ 8,970
Budgetary Financing Sources:				
Appropriations Used	—	20,083	20,083	16,373
Non-exchange Revenue	1	24	25	21
Donations	13	—	13	10
Transfers in(out) without Reimbursement	7	27	34	11
Other Financing Sources:				
Donations	89	—	89	—
Imputed Financing From Costs Absorbed by Others	—	121	121	124
Non-entity Collections	—	(757)	(757)	(1,086)
Total Financing Sources	110	19,498	19,608	15,453
Net Cost of Operations	149	(17,890)	(17,741)	(13,636)
Net Change	259	1,608	1,867	1,817
Cumulative Results of Operations	**231**	**12,423**	**12,654**	**10,787**
Unexpended Appropriations:				
Beginning Balances	$ —	$ 14,553	$ 14,553	$ 13,095
Budgetary Financing Sources:				
Appropriations Received	—	23,601	23,601	17,720
Appropriations transferred in(out)	—	217	217	240
Rescissions and Canceling Funds	—	(309)	(309)	(129)
Appropriations Used	—	(20,083)	(20,083)	(16,373)
Total Budgetary Financing Sources	—	3,426	3,426	1,458
Total Unexpended Appropriations	—	17,979	17,979	14,553
Net Position	**$ 231**	**$ 30,402**	**$ 30,633**	**$ 25,340**

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

COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 16)

(Dollars in Millions)

For the Year Ended September 30,	2008	2007
Budgetary Resources:		
Unobligated Balance, brought forward, October 1:	$ 6,310	$ 5,287
Recoveries of Prior Year Unpaid Obligations	779	751
Budget Authority:		
Appropriations	24,969	19,022
Spending authority from offsetting collections:		
Earned		
Collected	7,063	6,782
Change in receivable from Federal sources	(171)	(10)
Change in unfilled customer orders:		
Advance received	285	105
Without Advance from Federal sources	—	1
Nonexpenditure transfers, net	217	205
Temporarily not available pursuant to Public Law	(305)	(500)
Permanently not available	(322)	(132)
Total Budgetary Resources	**$ 38,825**	**$ 31,511**
Status of Budgetary Resources:		
Obligations Incurred:		
Direct	$ 23,092	$ 18,701
Reimbursable	7,570	6,500
Unobligated balance		
Apportioned	7,489	5,439
Exempt from apportionment	—	24
Unobligated balance not available	674	847
Total Status of Budgetary Resources	**$ 38,825**	**$ 31,511**
Change in Obligated Balance:		
Obligated Balance, net		
Unpaid Obligations, brought forward, October 1	$ 13,986	$ 11,195
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(627)	(416)
Obligations incurred, net	30,662	25,202
Less: Gross Outlays	(26,402)	(21,879)
Less: Recoveries of prior-year unpaid obligations, actual	(779)	(751)
Change in uncollected customer payments from Federal sources	171	8
Obligated balance, net, end of period:		
Unpaid obligations	17,467	13,986
Less: Uncollected customer payments from Federal sources	(456)	(627)
Net Outlays		
Gross outlays	26,402	21,879
Less: Offsetting collections	(7,348)	(6,886)
Less: Distributed Offsetting receipts	(352)	(260)
Net Outlays	**$ 18,702**	**$ 14,733**

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.

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.

Basis of Presentation and Accounting

The accompanying 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*, as amended.

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.

Transactions are recorded on both an accrual and budgetary basis. Budgetary accounting facilitates compliance with legal constraints.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, and exercise judgment that affects the reported amounts of assets, liabilities and net position and disclosure of contingent liabilities as the date of the financial statements, and the reported amounts of revenues, financing sources, expenses and obligations incurred during the reporting period. These estimates are based on management's best knowledge of current events, historical experience, actions the Department may take in the future, and on various other assumptions that are believed to be reasonable under the circumstances. Due to the size and complexity of many of the Department's programs, the estimates are subject to a wide range of variables, including assumptions on future economic and financial events. Accordingly, actual results could differ from those estimates.

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.

Congress annually enacts one-year and multi-year appropriations that provide the Department with the authority to obligate funds within the respective fiscal years for necessary expenses to carry out mandated program activities. In addition, Congress enacts appropriations that are available until expended. All appropriations are subject to OMB apportionment as well as Congressional restrictions. 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.

Work performed for other Federal agencies under reimbursable agreements is financed through the account providing the service and reimbursements are recognized as revenue when earned. 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 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 certain 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.

Allocation Transfers

Allocation transfers are legal delegations by one federal agency of its authority to obligate budget authority and outlay funds to another agency. The Department processes allocation transfers with other federal agencies as both a "parent" agency transferring budget authority to a receiving (child) entity and as a receiving (child) agency of budget authority from another transferring (parent) entity. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. Subsequent obligations and outlays incurred by the child agency are charged to this allocation account as they execute the delegated activity on behalf of the parent agency.

Generally, all financial activities related to allocation transfers (i.e., budget authority, obligations, outlays) are reported in the financial statements of the parent agency. An exception to this rule is for transfers from the Executive Office of the President for whom the Department is the receiving agency. Per OMB guidance, State reports all activity relative to these allocation transfers in the Department's financial statements. In addition to these funds the Department receives allocation transfers, as the child, from USAID. The Department allocates funds, as the parent, to Department of Defense, Department of Labor, Treasury, Health and Human Services, Peace Corp, and the U.S. Agency for International Development.

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 Consolidated 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. Treasury processes domestic receipts and disbursements. The Department operates 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 U.S. Disbursing Officer at each Center has the delegated authority to disburse funds on behalf of the Treasury.

Accounts and Loans Receivable

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

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.

Accounts and Loans 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. Accounts Receivable is reduced to net realizable value by an Allowance for Uncollectable Accounts.

Interest Receivable

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

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 Department has several accounts that have the authority to invest cash resources. For these accounts, the cash resources not required to meet current expenditures are invested in interest-bearing obligations of the U.S. Government. These investments consist of U.S. Treasury special issues and securities. Special issues are unique public debt obligations for purchase exclusively by the Foreign Service Retirement and Disability Fund and for which interest is computed and paid semi-annually on June 30 and December 31. They are purchased and redeemed at par which is their carrying value on the Consolidated Balance Sheet.

Investments by the Department's Gift, Israeli-Arab Scholarship, Eisenhower Exchange Fellowship and Middle-Eastern-Western Dialogue accounts are in U.S. Treasury securities. Interest on these investments is paid semi-annually at various rates. These investments are reported at acquisition cost, which equals the face value net of unamortized discounts or premiums. Discounts and premiums are amortized over the life of the security using the straight-line method for Gift Funds investments, and effective interest method for the other accounts.

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, in Note 7 (Stewardship PP&E) to the financial statements, and included in the Required Supplementary Information—Heritage Assets.

Secretary's List of Culturally Significant Properties:

Palazzo Margherita, the U.S. Embassy office building in Rome, was designed by Gaetano Koch and built between 1886 and 1890 for Prince Boncompagni Ludovisi. The United States purchased the palazzo in 1946 using Italian lire war credits against U.S. surplus army property. *Department of State/Overseas Building Operations (OBO)*

The Department also owns several domestic real properties, including the National Foreign Affairs Training Center (Arlington, Va.); the International Center (Washington, D.C.); the Charleston Financial Services Center (S.C.); the Beltsville Information Management Center (Md.); the Florida Regional Center (Ft. Lauderdale); and consular centers in Charleston, S.C., Portsmouth, N.H. and Williamsburg, Ky. The International Boundary and Water Commission (IBWC) has buildings and structures related to its boundary preservation, flood control, and sanitation programs.

Buildings and structures are carried at either actual or estimated historical cost. The Department capitalizes all costs for constructing new buildings and building acquisitions regardless of cost, and capitalizes all other improvements greater than $250,000. Costs incurred for constructing new facilities, major rehabilitations, or other improvements in the design or construction stage are recorded as Construction-in-Progress. After these projects are completed, costs are transferred to Buildings and Structures or Leasehold Improvements as appropriate. Depreciation of buildings and other structures is computed on a straightline basis, principally over a 30-year period.

Personal Property

Personal property consists of several asset categories including aircraft, vehicles, security equipment, communication equipment, ADP equipment, reproduction equipment, and software. The Department holds title to these assets, some of which are operated in unusual conditions as described below.

The Department's Bureau of International Narcotics and Law Enforcement (INL) uses aircraft to help eradicate and stop the flow of illegal drugs. To accomplish its mission, INL maintains an aircraft fleet that is the third largest federal, nonmilitary fleet. Most of the aircraft are under direct INL airwing management. However, a number of aircraft are managed by host-countries. The Department owns title to the aircraft under these programs and is prohibited from giving title for any aircraft to foreign governments without Congressional approval. As such, these host-country managed aircraft are, for the most part, no-cost, long-term leases. INL contracts with firms to provide maintenance support depending on whether the aircraft are INL airwing or host-country managed. INL airwing managed aircraft are maintained to FAA standards that involves routine inspect, replace as necessary activity as well as scheduled maintenance and replacement of certain parts after given hours of use. Host-country managed aircraft are maintained to host country requirements, which are less than FAA standards.

The Department maintains a large vehicle fleet that operates overseas. Many vehicles require armoring for security reasons, and for some locations large utility vehicles are used instead of conventional sedans. In addition, the Department contracts with firms to provide support in strife-torn areas such as Iraq, Afghanistan and Darfur. The contractor support includes the purchase and operation of armored vehicles. Under the terms of the contracts, the Department has title to the contractor-held vehicles.

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. Except for contractor-held vehicles in Iraq and Afghanistan, depreciation is calculated on a straight-line basis over the asset's estimated life and begins when the property is put into service. Contractor-held vehicles in Iraq and Afghanistan, due to the harsh operating conditions, are depreciated on a double-declining balance basis. The estimated useful lives are as follows:

Asset Category	Estimated Useful Life
Aircraft:	
INL airwing managed	10 years
Host-country managed	5 years
Vehicles:	
Department managed	3 to 6 years
Contractor-held in Iraq and Afghanistan	2 1/2 years
Security Equipment	3 to 15 years
Communication Equipment	3 to 20 years
ADP Equipment	3 to 6 years
Reproduction Equipment	3 to 15 years
Software	Lesser of estimated useful life or 7 years

Capital Leases

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

Grants

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

Accounts Payable

Accounts payable represent the amounts accrued for contracts for goods and services received but unpaid at the end of the fiscal year and unreimbursed grant expenditures. In addition to accounts 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 four-year period. The Department also includes an estimate of 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. Throughout the 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.

Biometric technology, requiring digital fingerprints and a photograph for identification, is used by the Department of State to establish and verify the identities of visa applicants at embassies and consulates around the world through its BioVisa program. The Department of Homeland Security established the US-VISIT program under which a traveler's biometrics are collected in his country, compared against a watch list of known criminals and suspected terrorists, and then verified again upon arrival in the United States. Biometrics are unique and virtually impossible to forge. *AFP Photo/Paul J. Richards*

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 $121 and $124 million in 2008 and 2007, for unfunded pension 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 total actuarial liability for which the Department is responsible totaled $69 million and $68 million as of September 30, 2008 and 2007.

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

See separate Note on Foreign Service Retirement Actuarial Liability for the Department's accounting policy for Foreign Service retirement-related benefits.

Net Position

The Department's net position contains the following components. Amounts attributable to earmarked funds are separately disclosed. See separate Note on Earmarked Funds for a description of and the Department's accounting policy for earmarked funds.

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 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. Total non-entity assets at September 30, 2008 and 2007 were $15 million and $14 million, respectively, for amounts in the Chancery Development Trust Account. These items are included in amounts reported as Cash and Other Monetary Assets (See Note 6, "Cash and Other Monetary Assets " for further information).

3 Fund Balances with Treasury

Fund Balances with Treasury at September 30, 2008 and 2007, are summarized below *(Dollars in Millions)*.

Fund Balances	2008	2007
Appropriated Funds	$ 24,387	$ 19,220
Revolving Funds	541	388
Trust Funds	186	99
Special Funds	17	11
Deposit & Receipt Accounts	20	61
Total	$ 25,151	$ 19,779

Status of Fund Balance	2008	2007
Unobligated Balances Available	$ 7,489	$ 5,462
Unobligated Balances Unavailable	674	847
Obligated Balances not yet Disbursed	$ 16,968	13,409
Total Unobligated and Obligated	$ 25,131	$ 19,718
Deposit and Receipt Funds	20	61
Total	$ 25,151	$ 19,779

4 Investments

SUMMARY OF INVESTMENTS

Investments at September 30, 2008 and 2007 are summarized below *(Dollars in Millions)*. All investments are classified as Intragovernmental.

At September 30, 2008:	Net Investment	Market Value	Maturity Dates	Interest Rates Range	Interest Receivable
Non-Marketable Special Issue Securities	$ 14,855	$ 14,855	2009-2023	3.50-7.25%	$ 194
Notes, Israeli-Arab Scholarship Fund	4	4	2008-2009	3.125-4.75%	—
Notes, Eisenhower Exchange Fellowship Fund	8	8	2009-2018	3.5-6.0%	—
Notes, Middle Eastern-Western Dialogue Fund	17	17	2008-2010	2.625-6.5%	—
Treasury Bills, Gift Funds	7	7	2008-2009	.978-3.5%	—
Total Investments	$ 14,891	$ 14,891			$ 194

At September 30, 2007:	Net Investment	Market Value	Maturity Dates	Interest Rates Range	Interest Receivable
Non-Marketable Special Issue Securities	$ 14,378	$ 14,378	2008-2022	3.50-7.25%	$ 194
Notes, Israeli-Arab Scholarship Fund	4	4	2008	4.75-5.00%	—
Notes, Eisenhower Exchange Fellowship Fund	8	8	2008-2015	3.25-6.00%	—
Notes, Middle Eastern-Western Dialogue Fund	17	17	2008-2010	3.375-6.50%	1
Treasury Bills, Gift Funds	5	5	2007	1.93%	—
Total Investments	$ 14,412	$ 14,412			$ 195

The Department's activities that have the authority to invest cash resources are earmarked funds (see Note 14 "Earmarked Funds"). The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the Department as evidence of its receipts. Treasury securities are an asset to the Department and a liability to the U.S. Treasury. Because the Department and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the (component entity) with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the Department requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

5 Accounts and Loans Receivable, Net

The Department's Accounts Receivable and Loans Receivable at September 30, 2008 and 2007 are summarized here *(Dollars in Millions)*. All are entity receivables.

	2008			2007		
	Entity Receivables	Allowance for Uncollectible	Net Receivables	Entity Receivables	Allowance for Uncollectible	Net Receivables
Intragovernmental Accounts Receivable	$ 441	$ (40)	$ 401	$ 408	$ (16)	$ 392
Non-Intragovernmental Accounts and Loans Receivable	85	(9)	76	43	(10)	33
Total Receivables	$ 526	$ (49)	$ 477	$ 451	$ (26)	$ 425

Included in Accounts and Loans Receivable, Net are $2 million and $1 million, in 2008 and 2007, of Repatriation Loans administered by the Department. Repatriation Loans enable destitute American citizens overseas to return to the United States. Repatriation 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 direct 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, the Department borrows from Treasury the difference between the face value of loans disbursed and the appropriated subsidy costs, currently 60 percent of face value. The administrative costs associated with loan administration are separately budgeted and funded.

6 Cash and Other Monetary Assets

The Cash and Other Monetary Assets at September 30, 2008 and 2007, are summarized below *(Dollars in Millions)*. There are no restrictions on entity cash. Non-Entity cash is restricted as discussed below.

	2008			2007		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Chancery Development						
Trust Account:						
Treasury Bills, at par	$ —	$ 15	$ 15	$ —	$ 14	$ 14
Unamortized Discount	—	—	—	—	—	—
Cash-Imprest and Other Funds	55	—	55	46	—	46
Total	$ 55	$ 15	$ 70	$ 46	$ 14	$ 60

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.

7 Property and Equipment, Net

Property and equipment balances at September 30, 2008 and 2007, are shown in the following table *(Dollars in Millions)*:

	2008			2007		
Major Classes	**Cost**	**Accumulated Depreciation**	**Net Value**	**Cost**	**Accumulated Depreciation**	**Net Value**
Real Property:						
Overseas —						
Land and Land Improvements	$ 2,229	$ (12)	$ 2,217	$ 2,108	$ (7)	$ 2,101
Buildings and Structures	9,304	(3,609)	5,695	7,892	(3,310)	4,582
Construction-in-Progress	1,735	—	1,735	2,076	—	2,076
Assets Under Capital Lease	86	(35)	51	77	(31)	46
Leasehold Improvements	368	(178)	190	347	(154)	193
Domestic —						
Structures, Facilities and Leaseholds	591	(257)	334	590	(247)	343
Construction-in-Progress	33	—	33	18	—	18
Land and Land Improvements	81	(6)	75	81	(5)	76
Total — Real Property	14,427	(4,097)	10,330	13,189	(3,754)	9,435
Personal Property:						
Aircraft	682	(407)	275	643	(344)	299
Vehicles	456	(264)	192	402	(242)	160
Communication Equipment	71	(59)	12	53	(45)	8
ADP Equipment	65	(50)	15	64	(46)	18
Reproduction Equipment	12	(10)	2	13	(11)	2
Security	95	(60)	35	91	(55)	36
Software	327	(198)	129	287	(164)	123
Software-in-Development	26	—	26	54	—	54
Other Equipment	215	(154)	61	222	(159)	63
Total — Personal Property	1,949	(1,202)	747	1,829	(1,066)	763
Total Property and Equipment, Net	$ 16,376	$ (5,299)	$ 11,077	$ 15,018	$ (4,820)	$ 10,198

STEWARDSHIP PP&E

The Department has collections of art, furnishings and real property (Culturally Significant Property) 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. As the lead institution in the conduct of American diplomacy, this property is used to promote national pride and the distinct cultural diversity of American artists and to recognize the historical, architectural and cultural significance of the Department's overseas operations.

The Department has six separate collections of art and furnishings: 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, shown in the following table and described in the Required Supplementary Information (RSI) section of this report, 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 stewardship PP&E items that the Department owns are considered heritage assets (see "Required Supplementary Information — Heritage Assets"). In accordance with SFFAS No. 29, *Heritage Assets and Stewardship Land*, 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.

8 Other Assets

The Department's other assets at September 30, 2008 and 2007, include advances and prepayments in support of HIV/AIDS, Child Health, Diplomatic and Consular, and Overseas Building Operations program plus salary/travel advances to employees and inventory.

9 Liabilities

The Environmental Liabilities on the Balance Sheet at September 30, 2008 and 2007 were $381 million and $393 million, respectively, and represent the estimated cost of upgrades, construction, and projected operation and maintenance costs of wastewater treatment plants owned and operated by IBWC.

The Department's Other Liabilities at September 30, 2008 and 2007, are summarized below *(Dollars in Millions)*.

At September 30,	2008	2007
Current Liabilities:		
Accrued Salaries Payable	$ 135	$ 125
Federal Employees Compensation Act Benefits	69	68
Pension Benefits Payable	52	50
Capital Lease Liability	5	4
Deferred Revenues	721	657
Contingent Liability	27	—
Other	212	117
Total Other Liabilities – Current	1,221	1,021
Accrued Annual Leave	272	254
Funds Held in Trust and Deposit Accounts	15	14
Capital Lease Liability	68	56
Other	2	—
Total Other Liabilities	$ 1,578	$ 1,345

HERITAGE ASSETS
For Year Ended September 30, 2008

	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	Collections include fine and decorative arts and other cultural objects.	Collectibles - Rare books and other publications of historic value	Noncollection - Buildings of historic, cultural, or architectural significance
Number of Items - 9/30/2008	3,445	2,248	1,176	6,416	1,033	20

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 liabilities in this category at September 30, 2008 and 2007, are summarized below *(Dollars in Millions)*.

Liabilities Not Covered by Budgetary Resources	**2008**	**2007**
Payable to International Organizations	$ 1,507	$ 1,477
Environmental Liabilities	315	393
Foreign Service Retirement Actuarial Liability	142	209
Accrued Annual Leave	272	254
Contingent Liability	27	—
Other Intragovernmental	18	18
Other Liabilities	156	141
Total Liabilities Not Covered By Budgetary Resources	2,437	2,492
Total Liabilities Covered By Budgetary Resources	19,046	17,402
Total Liabilities	$ 21,483	$ 19,894

10 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 retirees receive a monthly annuity benefit from three sources: a basic benefit (annuity) from FSPS, Social Security, and the Thrift Savings Plan.

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.

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 the valuation (other than the assumed merit salary increases) match the economic assumptions approved by the Board of Actuaries of the Civil Service Retirement and Disability Fund for use in performing the dynamic actuarial valuations of CSRS and FERS. All the other assumptions used for the valuation are based upon the actual past experience of the covered lives under the two retirement systems. 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 Board of Actuaries economic assumptions since the last valuation did not change. The general salary increase remained at 4.25% and the inflation rate stayed at 3.50%. Based on the economic assumptions, the plan actuary kept the normal cost percentages the same. The table below presents the normal costs for FY 2008 and FY 2007.

Normal Cost:	**FY 2008**	**FY 2007**
FSRDS	30.35%	30.35%
FSPS	25.38%	25.38%

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. 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, 2008 and 2007 *(Dollars in Millions)*.

For the Year Ended September 30,	2008	2007
Pension Actuarial Liability, Beginning of Year	$ 14,729	$ 14,215
Pension Expense:		
Normal Cost	311	299
Interest on Pension Liability	906	875
Actuarial (Gains) or Losses	(16)	93
Total Pension Expense	1,201	1,267
Less Payments to Beneficiaries	(791)	(753)
Pension Actuarial Liability, End of Year	15,139	14,729
Less: Net Assets Available for Benefits	(14,997)	(14,520)
Actuarial Pension Liability - Unfunded	$ 142	$ 209
Actuarial Assumptions:		
Rate of Return on Investments	6.25%	6.25%
Rate of Inflation	3.50%	3.50%
Salary Increase	4.25%	4.25%

Net Assets Available for Benefits at September 30, 2008 and 2007, consist of the following *(Dollars in Millions)*:

	2008	2007
Accounts and Interest Receivable	$ 206	$ 204
Investments in US government securities	14,855	14,378
Total Assets	15,061	14,582
Less: Liabilities Other Than Actuarial	(64)	(62)
Net Assets Available for Benefits	$ 14,997	$ 14,520

11 Liabilities to International Organizations

The United States, through the Department, maintains membership in and sends representatives to international organizations, such as the United Nations and UN Peacekeeping Missions, which promote international peace and security, economic and social development and human rights. The participation of the United States in these organizations is funded by dues paid from appropriations bills passed by Congress annually. Congress in the past has mandated withholding of dues payments because of policy restrictions or caps on the percentage of the organization's operating costs financed by the United States.

Without authorization from Congress, the Department cannot pay certain arrears in dues. These amounts requested but not authorized to be paid do not appear as liabilities on the Balance Sheet of the Department.

In recent years, funding for dues assessed for certain of the international organizations has not been received until the year following assessment. These amounts payable but unfunded do appear as liabilities of the Department, since authorization for payment is expected.

Further information about the Department's mission to the UN is at *www.usunnewyork.usmission.gov*. Details of Liabilities to International Organizations follow *(Dollars in Millions)*:

As of September 30,	2008	2007
Regular Membership Assessments Payable to UN	$ 772	$ 788
Dues Payable to UN Peacekeeping Missions	1,602	1,137
Liabilities to Other International Organizations	1,033	1,078
	3,407	3,003
Less Amounts not Authorized to be Paid	(680)	(680)
Liabilities to International Organizations	$ 2,727	$ 2,323
Accounts Payable - Funded	$ 1,220	$ 846
Liabilities to International Organizations - Unfunded	1,507	1,477
Total Liabilities to International Organizations	$ 2,727	$ 2,323

12 LEASES

The Department is committed to over 7,000 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 US 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 $78M 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.

The following is a summary of Net Assets under Capital Leases and Future Minimum Lease payments as of September 30, 2008 *(Dollars in Millions)*:

	2008	2007
Net Assets Under Capital Leases:		
Land and Buildings	$ 86	$ 77
Accumulated Depreciation	(35)	(31)
Net Assets under Capital Leases	$ 51	$ 46

Future Minimum Lease Payments:

2008

Fiscal Year	Lease Payments
2009	$ 5
2010	4
2011	4
2012	4
2013	4
2014 and thereafter	174
Total Minimum Lease Payments	195
Less: Amount Representing Interest	(122)
Obligations under Capital Leases	$ 73

2007

Fiscal Year	Lease Payments
2008	$ 4
2009	4
2010	4
2011	4
2012	3
2013 and thereafter	144
Total Minimum Lease Payments	163
Less: Amount Representing Interest	(103)
Obligations under Capital Leases	$ 60

OPERATING LEASES

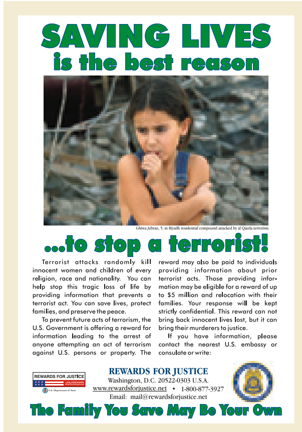
The Department leases real property in overseas locations under operating leases. These leases expire in various years. Minimum future rental payments under operating leases having remaining terms in excess of one year as of September 30, 2008, for each of the next 5 years and in aggregate are as follows *(Dollars in Millions)*.

Year Ended September 30,	Operating Lease Amounts
2009	$ 310
2010	221
2011	148
2012	90
2013	60
2014 and thereafter	154
Total Minimum Future Lease Payments	$ 983

13 Commitments and Contingencies

COMMITMENTS

In addition to the future lease commitments discussed in Note 12, "Leases," the Department is committed under obligations for goods and services which have been ordered but not yet received at fiscal year end. These are termed undelivered orders — see Note 16, "Statement of Budgetary Resources".



CONTINGENCIES

The Department is a party in various administrative proceedings, legal actions, environmental suits, and claims brought against it. We periodically review these matters pending against us. As a result of these reviews, we classify and adjust our contingencies for claims that we think it is probable that we will lose and for which we can reasonably estimate the amount of the unfavorable outcome.

Additionally, as part of our continuing evaluation of estimates required in the preparation of our financial statements, we evaluated the materiality of cases determined to have a reasonably possible chance of adverse outcome. These cases, involving contract disputes related to embassy construction, class action suits related to passport applications, and claims made under the North American Free Trade Agreement, are considered by management to be immaterial to our financial statements taken as a whole.

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 2008 and 2007 had a material effect on the financial position or results of operations of the Department.

Rewards Programs: The Department operates three rewards programs for information that have been critical to combating international terrorism, narcotics trafficking, and war crimes for over 20 years. The Rewards for Justice Program offers and pays rewards for information leading to the arrest or conviction in any country of persons responsible for acts of international terrorism against United States persons or property, or to the location of key terrorist leaders. See further details at *www.rewardsforjustice.net*. The Narcotics Rewards Program has the authority under 22 U.S.C. 2708 to offer rewards for information leading to the arrest or conviction in any country of persons committing major foreign violations of U.S. narcotics laws or the killing or kidnapping of U.S. narcotics law enforcement officers or their family members. The War Crimes Information Rewards Program offers rewards for information leading to the arrest, transfer, or conviction of persons indicted by a judge of the International Criminal Tribunal for the former Yugoslavia, the International Criminal Tribunal for Rwanda, or the Special Court of Sierra Leone for serious violations of international humanitarian law. Pending rewards currently offered under the three programs total $685 million. We have paid out $104 million since FY 2003. Reward payments are funded with current year appropriations as necessary and, in the opinion of management and legal counsel, no further contingent liability is required because probable payments will not materially affect the financial position or results of operations of the Department.

Claims Filed in Response to Embassy Bombings: The families of eleven of the twelve Americans killed in the terrorist bombing of the American Embassy in Nairobi, Kenya on August 7, 1998, filed administrative tort claims with the Department alleging that Department negligence led to the death of their family members in Nairobi. Recent Supreme Court jurisprudence has ruled out liability under the Act for injuries or deaths suffered abroad. We are reviewing the claims under the Secretary's discretion as authorized by the Basic Authorities Act and in conjunction with proposed litigation for compensation to victims of terrorism. Any settlements made under the Secretary's discretionary authority in excess of $2,500 would be funded and paid from the Department of Justice's Judgment Fund maintained by the Treasury.

North American Free Trade Agreement (NAFTA) Arbitrations: The United States is currently defending itself against five claims submitted to arbitration under Chapter Eleven (investment) of the North American Free trade Agreement. The United States also has received two notices of intent to submit claim to arbitration. The United States has successfully defended itself against previous claims submitted to arbitration and intends to vigorously contest any such claims. Any adverse award in any of these cases would be paid out of the Judgment Fund.

14 Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and accounted for separately from the Government's general revenues. See Note 4 "Investments" for further information on investments in U.S. Treasury securities for earmarked funds. There are no intradepartmental transactions between the various earmarked funds.

The Department administers thirteen earmarked funds as listed below. A brief description of the individually reported earmarked funds and their purpose follows.

Treasury Fund Symbol	Description	Statute
19X5497	Foreign Service National Defined Contribution Fund	22 USC 3968(a)(1)
19X8166	American Studies Endowment Fund	108 Stat. 425
19X8167	Trust Funds	22 USC 1479
19X8186	Foreign Service Retirement and Disability Fund	22 USC 4042-4065
19X8271	Israeli Arab Scholarship Programs	105 Stat. 696, 697
19X8272	Eastern Europe Student Exchange Endowment Fund	105 Stat. 699
19X8340	Foreign Service National Liability Trust Fund	105 Stat. 672
19X8341	Foreign Service National Liability Trust Fund	105 Stat. 672
19X8812	Gifts and Bequests, National Commission on Educational, Scientific, and Cultural Cooperation	22 USC 287q
19X8813	Center for Middle Eastern-Western Dialogue Trust Fund	118 Stat. 84
19X8821	Unconditional Gift Fund	22 USC 809, 1046
19X8822	Conditional Gift Fund	22 809, 1046
95X8276	Eisenhower Exchange Fellowship Program Trust Fund	PL 101-454

FOREIGN SERVICE NATIONAL DEFINED CONTRIBUTIONS RETIREMENT FUND (FSNDCF) (19X5497)

The Foreign Service National Defined Contributions Retirement Fund is a retirement savings program designed to provide benefits upon separation to locally employed staff under local compensation plans at overseas U.S. diplomatic or consular missions or establishments. Contributions are made to the FSNDCF by the Department's appropriations from which the benefits are paid.

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 $6.3 million in both 2008 and 2007, respectively. Cash is invested in U.S. Treasury securities until it is needed for disbursement. The Department also issues separate annual financial statements for the FSRDF.

FOREIGN SERVICE NATIONAL SEPARATION LIABILITY TRUST FUNDS (FSNSLTF) (19X8340 AND 19X8341)

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.

Condensed Financial Information for Earmarked Funds ***(Dollars in Millions)***	**FSRDF**	**FSNSLTF**	**FSNDCF**	**GIFT**	**All Other Earmarked**	**Total Earmarked Funds**
Balance Sheet As of September 30, 2008:						
Assets:						
Fund Balances with Treasury	$ —	$ 165	$ —	$ 17	$ 4	$ 186
Investments	14,855	—	—	7	29	14,891
Taxes and Interest Receivable	194	—	—	—	—	194
Other Assets	12	—	52	98	—	162
Total Assets	**$ 15,061**	**$ 165**	**$ 52**	**$ 122**	**$ 33**	**$ 15,433**
Liabilities:						
Actuarial Liability	$ 15,139	$ —	$ —	$ —	$ —	$ 15,139
Other Liabilities	64	(1)	—	—	—	63
Total Liabilities	**$ 15,203**	**$ (1)**	**$ —**	**$ —**	**$ —**	**$ 15,202**
Net Position:						
Unexpended Appropriations	$ —	$ —	$ —	$ —	$ —	$ —
Cumulative Results of Operations	(142)	166	52	122	33	231
Total Liabilities and Net Position	**$ 15,061**	**$ 165**	**$ 52**	**$ 122**	**$ 33**	**$ 15,433**
Statement of Net Cost for the Year Ended September 30, 2008:						
Gross Program Costs	$ —	$ 20	$ 4	$ 9	$ 1	$ 34
Less: Earned Revenues	1,268	105	11	—	—	1,384
Net Program Costs	(1,268)	(85)	(7)	9	1	(1,350)
Costs Not Attributable to Program Costs	1,201	—	—	—	—	1,201
Less Earned Revenues Not Attributable to Program Costs	—	—	—	—	—	—
Net Cost of Operations	**$ (67)**	**$ (85)**	**$ (7)**	**$ 9**	**$ 1**	**$ (149)**
Statement of Changes in Net Position for the Year Ended September 30, 2008:						
Net Position Beginning of Period	$ (209)	$ 81	$ 45	$ 22	$ 33	$ (28)
Non-Exchange Revenue	—	—	—	13	1	14
Other Financing Sources	—	—	—	96	—	96
Net Cost of Operations	67	85	7	(9)	(1)	149
Taxes and Other Nonexchange Revenue	—	—	—	—	—	—
Change in Net Position	67	85	7	100	—	259
Net Position End of Period	**$ (142)**	**$ 166**	**$ 52**	**$ 122**	**$ 33**	**$ 231**

Condensed Financial Information for Earmarked Funds *(Dollars in Millions)*	**FSRDF**	**FSNSLTF**	**FSNDCF**	**GIFT**	**All Other Earmarked**	**Total Earmarked Funds**
Balance Sheet As of September 30, 2007:						
Assets:						
Fund Balances with Treasury	$ —	$ 81	$ —	$ 15	$ 3	$ 99
Investments	14,378	—	—	5	29	14,412
Taxes and Interest Receivable	194	—	—	—	1	195
Other Assets	10	—	45	2	—	57
Total Assets	**$ 14,582**	**$ 81**	**$ 45**	**$ 22**	**$ 33**	**$ 14,763**
Liabilities:						
Actuarial Liability	$ 14,729	$ —	$ —	$ —	$ —	$ 14,729
Other Liabilities	62	—	—	—	—	62
Total Liabilities	**$ 14,791**	**$ —**	**$ —**	**$ —**	**$ —**	**$ 14,791**
Net Position:						
Unexpended Appropriations	$ —	$ —	$ —	$ —	$ —	$ —
Cumulative Results of Operations	(209)	81	45	22	33	(28)
Total Liabilities and Net Position	**$ 14,582**	**$ 81**	**$ 45**	**$ 22**	**$ 33**	**$ 14,763**
Statement of Net Cost for the Year Ended September 30, 2007:						
Gross Program Costs	$ —	$ 17	$ 4	$ 7	$ 2	$ 30
Less: Earned Revenues	1,251	11	15	—	—	1,277
Net Program Costs	(1,251)	6	(11)	7	2	(1,247)
Costs Not Attributable to Program Costs	1,267	—	—	—	—	1,267
Less Earned Revenues Not Attributable to Program Costs	—	—	—	—	—	—
Net Cost of Operations	**$ 16**	**$ 6**	**$ (11)**	**$ 7**	**$ 2**	**$ 20**
Statement of Changes in Net Position for the Year Ended September 30, 2007:						
Net Position Beginning of Period	$ (193)	$ 87	$ 34	$ 18	$ 34	$ (20)
Non-Exchange Revenue	—	—	—	11	1	12
Other Financing Sources	—	—	—	—	—	—
Net Cost of Operations	(16)	(6)	11	(7)	(2)	(20)
Taxes and Other Nonexchange Revenue	—	—	—	—	—	—
Change in Net Position	(16)	(6)	11	4	(1)	(8)
Net Position End of Period	**$ (209)**	**$ 81**	**$ 45**	**$ 22**	**$ 33**	**$ (28)**

15 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).

The presentation of program results by strategic objectives and strategic goals is based on the Department's current

CONSOLIDATING SCHEDULE OF NET COST

For the year ended September 30, 2008

(Dollars in Millions)

	Under Secretary for							
STRATEGIC GOAL	**Arms Control, Int'l Security**	**Economic, Business and Agriculture**	**Global Affairs**	**Political Affairs**	**Public Diplomacy and Public Affairs**	**Management-Consular Affairs**	**Eliminations**	**Total**
Achieving Peace and Security								
Total Cost	$ 186	$ 31	$ 2,576	$ 4,457	$ 1	$ —	$ (371)	$ 6,880
Earned Revenue	(42)	(7)	(692)	(662)	—	—	371	(1,032)
Net Program Costs	144	24	1,884	3,795	1	—	—	5,848
Governing Justly and Democratically								
Total Cost	33	5	40	796	—	—	(66)	808
Earned Revenue	(7)	(1)	(6)	(118)	—	—	66	(66)
Net Program Costs	26	4	34	678	—	—	—	742
Investing in People								
Total Cost	209	41	189	2,858	—	—	(30)	3,267
Earned Revenue	(3)	(1)	(3)	(53)	—	—	30	(30)
Net Program Costs	206	40	186	2,805	—	—	—	3,237
Promoting Economic Growth and Prosperity								
Total Cost	54	9	65	1,301	—	—	(108)	1,321
Earned Revenue	(12)	(2)	(9)	(193)	—	—	108	(108)
Net Program Costs	42	7	56	1,108	—	—	—	1,213
Providing Humanitarian Assistance								
Total Cost	—	—	1,159	1	—	—	(2)	1,158
Earned Revenue	—	—	(7)	—	—	—	2	(5)
Net Program Costs	—	—	1,152	1	—	—	—	1,153
Promoting International Understanding								
Total Cost	66	11	79	1,573	703	—	(131)	2,301
Earned Revenue	(15)	(2)	(12)	(233)	(88)	—	131	(219)
Net Program Costs	51	9	67	1,340	615	—	—	2,082
Strengthening Consular and Management Capabilities								
Total Cost	—	—	—	941	466	2,886	(619)	3,674
Earned Revenue	—	—	—	(202)	(84)	(2,992)	619	(2,659)
Net Program Costs	—	—	—	739	382	(106)	—	1,015
Executive Direction and Other Costs Not Assigned								
Total Cost	3	5	85	5,605	597	1	(2,211)	4,085
Earned Revenue	(2)	(3)	(51)	(3,412)	(360)	(1)	2,195	(1,634)
Net Program Costs	1	2	34	2,193	237	—	(16)	2,451
Total Cost	551	102	4,193	17,532	1,767	2,887	(3,538)	23,494
Total Revenue	(81)	(16)	(780)	(4,873)	(532)	(2,993)	3,522	(5,753)
Total Net Cost	$ 470	$ 86	$ 3,413	$ 12,659	$ 1,235	$ (106)	$ (16)	$ 17,741

Strategic Plan established pursuant to the Government Performance and Results Act of 1993. The Department's strategic goals and strategic priorities are defined in Management's Discussion and Analysis section of this report.

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, 2008 and 2007, these consist of costs and earned revenue summarized below *(Dollars in Millions)*:

	2008			2007		
Program	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**
Costs:						
Executive Direction & Other	$ 3,478	$ 499	$ 2,979	$ 2,648	$ 467	$ 2,181
FSRDF	1,201	557	644	1,267	441	826
ICASS	1,516	1,154	362	1,323	959	364
International Commissions	101	1	100	103	2	101
Total Costs	6,296	2,211	4,085	5,341	1,869	3,472
Earned Revenue:						
Executive Direction & Other	1,010	604	406	878	466	412
FSRDF	1,268	436	832	1,251	422	829
ICASS	1,540	1,154	386	1,295	960	335
International Commissions	11	1	10	8	2	6
Total Earned Revenue	3,829	2,195	1,634	3,432	1,850	1,582
Total Net Cost for Executive Direction and Other Costs Not Assigned	$ 2,467	$ 16	$ 2,451	$ 1,909	$ 19	$ 1,890

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 Strengthening Consular and Management Capabilities charges for central support functions performed in 2008 and 2007 under the Under Secretary for Management by the following organizations *(Dollars in Millions)*:

Bureau (or equivalent)	2008	2007
Bureau of Diplomatic Security	$ 2,004	$ 1,485
Office of Overseas Buildings Operations	971	339
Bureau of Administration	1,699	880
Bureau of Information Resource Management	302	284
Bureau of Personnel	524	280
Bureau of Resource Management	508	1,180
Foreign Service Institute	143	101
Medical Services and Other	232	229
Total Central Support Costs	$ 6,383	$ 4,778

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 2008 and 2007 was as follows *(Dollars in Millions)*:

Program Receiving Allocation	2008	2007
Achieving Peace and Security	$ 1,354	$ 1,144
Governing Justly and Democratically	240	199
Investing in People	108	90
Promoting Economic Growth and Prosperity	392	325
Providing Humanitarian Assistance	1	—
Promoting International Understanding	474	393
Strengthening Consular and Management Capabilities	1,849	1,079
Executive Direction and Other Costs Not Assigned	1,965	1,548
Total	$ 6,383	$ 4,778

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 Millions)*:

Under Secretary	2008	2007
Political Affairs	$ 8,738	$ 6,343
Public Diplomacy	1,102	826
Management (Consular Affairs)	1,612	973
Arms Control, International Security Affairs	348	1,084
Global Affairs	381	315
Economic, Business and Agriculture Affairs	72	34
Total	$ 12,253	$ 9,575

Inter-Entity Costs and Imputed Financing: 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.

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, 2008 and 2007 *(Dollars in Millions)*:

Inter-Entity Cost	2008	2007
Other Post-Employment Benefits:		
Civil Service Retirement Program	$ 24	$ 26
Federal Employees Health Benefits Program	97	98
Federal Employees Group Life Insurance Program	—	—
Litigation funded by Treasury Judgment Fund	—	—
Subtotal – Imputed Financing Source	121	124
Future Workers' Compensation Benefits	18	18
Total Inter-Entity Costs	$ 139	$ 142

Secretary's List of Culturally Significant Properties:

The Seoul Old American Legation, Seoul, South Korea, built in 1883 and now used as a guesthouse, is an exceptionally well preserved example of traditional Korean residential architecture. Originally serving as both home and office of America's representative, it has been acknowledged by the Korean people as a symbol of freedom against aggressors. *Department of State/OBO*

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, 2008 and 2007, consist of the following *(Dollars in Millions)*:

	2008			2007		
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	$ 764	$ —	$ 764	$ 1,092	$ —	$ 1,092
Machine Readable Visa	952	—	952	741	—	741
Expedited Passport	164	—	164	315	—	315
Passport, Visa and Other Surcharges	590	—	590	386	—	386
Fingerprint Processing, Diversity Lottery, and Affadavit of Support	23	—	23	24	—	24
Subtotal – Consular Fees	2,493	—	2,493	2,558	—	2,558
FSRDF	1,268	436	832	1,251	422	829
ICASS	1,540	1,154	386	1,295	960	335
Other Reimbursable Agreements	2,792	874	1,918	2,205	721	1,484
Working Capital Fund	1,046	941	105	744	643	101
Other	136	117	19	107	26	81
Total	$ 9,275	$ 3,522	$ 5,753	$ 8,160	$ 2,772	$ 5,388

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.

Under Secretary for Management Patrick F. Kennedy, center, receives the Restore America Hero Award presented to the Department of State by the National Trust for Historic Preservation. National Trust President Richard Moe, left, presents the award as Master of Ceremonies Carter Oosterhouse, right, looks on.

National Trust President Richard Moe commended the Department for its strong stewardship and professional excellence in establishing a framework for the systematic care of the 20 properties on the Secretary's Register of Culturally Significant Property. This was the first time in the Trust's history that an award was given for preservation of American-owned property abroad. *Department State/ State Magazine*

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 2008 and 2007 were $245 and $234 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 2008 and 2007 were $242 million and $241 million, respectively. FSRDF cash resources are invested in special non-marketable securities issued by the Treasury. Total interest earned on these investments in 2008 and 2007 was $781 million and $776 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 costs 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.

16 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, 2008 and 2007. 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 2008 and 2007, the Department received approximately $38.8 billion and $31.0 billion in budgetary resources, respectively, primarily consisting of the following:

Source of Budgetary Resources	2008	2007
Budget Authority:		
Direct or related appropriations	$ 23.6 billion	$ 17.7 billion
Authority financed from Trust Funds	1.4 billion	1.3 billion
Spending authority from providing goods and services	7.2 billion	6.9 billion
Unobligated Balances – Beginning of Year	6.3 billion	5.3 billion
Other	0.3 billion	0.3 billion
Total Budgetary Resources	$ 38.8 billion	$ 31.5 billion

The Department received permanent indefinite appropriations of $41 million for 2008 and 2007. 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, 2008 and 2007 was approximately $16.0 billion and $12.8 billion, respectively. This includes amounts of $559 million for September 30, 2008 and $419 million for September 30, 2007, 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 2010 – 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 2008 Statement of Budgetary Resources will differ from "2008 Actual" reported in the *P&F Schedules* for the Department's accounts as detailed in the schedule on the next page.

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.

(Dollars in Millions)	Budget Authority	Unobligated Balance Beginning of Year	Unobligated Balance End of Year	Obligations Incurred	Obligated Balance Beginning of Year	Obligated Balance End of Year	Net Outlays	Offsetting Receipts
FY 2008:								
International Security Assistance Programs	$ 1,070	$ 402	$ 291	$ 1,399	$ 992	$ 1,049	$ 1,203	$ —
Undelivered Orders Adjustment	—	—	196	—	—	(380)	—	—
Expired Accounts Unobligated Balances	—	307	454	5	3,969	829	2,809	—
Undistributed Offsetting Receipts	—	—	—	—	—	—	—	737
Total FY 2008 Differences	$ 1,070	$ 709	$ 941	$ 1,404	$ 4,961	$ 1,498	$ 4,012	$ 737
FY 2007:								
International Security Assistance Programs	$ 1,186	$ 273	$ 402	$ 1,194	$ 837	$ 992	$ 969	$ —
Undelivered Orders Adjustment	—	—	—	—	—	—	—	—
Expired Accounts Unobligated Balances	—	363	287	118	2,778	946	1,760	—
Undistributed Offsetting Receipts	—	—	—	—	—	—	—	1,069
Total FY 2007 Differences	$ 1,186	$ 636	$ 689	$ 1,312	$ 3,615	$ 1,938	$ 2,729	$ 1,069

The Statement of Budgetary Resources includes amounts the Department received in 2008 and 2007 to administer programs related to International Security Assistance. Amounts for these programs are not directly presented under the Department in the *Appendix*, but are reported in the *Appendix* under the section titled International Assistance Programs. In addition, the Statement of Budgetary Resources includes amounts of unavailable unobligated and obligated balances (primarily for expired annual accounts) that will not be reported in the *Appendix*. These unavailable unobligated balances in expired accounts (2007 and prior) remain available for adjustment, liquidation of obligations and other purposes authorized by law, until such accounts are closed as required by law 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.

17 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 2008 and 2007, the Department collected $24 million and $19 million, respectively, in custodial revenues that were transferred to Treasury.

18 Reconciliation of Net Cost of Operations to Budget

Budgetary accounting used to prepare the Statement of Budgetary Resources and proprietary accounting used to present the other principal financial statements are complementary, but both the types of information about assets, liabilities, income and expenses and the timing of their recognition are different. The reconciliation of budgetary resources obligated during the current period to the net cost of operations explains the difference between the sources and uses of resources as reported in the budgetary reports and in the net cost of operations.

The first section of the reconciliation below presents total resources used in the period to incur obligations. Generally, those resources are appropriations, net of offsetting collections and receipts. The second section adjusts the resources. Some resources are used for items that will be reflected in future net cost. Some are used for assets that are reported on the Balance Sheet, not as net cost. The final section adds or subtracts from total resources those items reported in net cost that do not require or generate resources. As an example, the Department collects regular passport fees that are reported as revenue on the Statement of Net Cost. However, because the fees are returned to Treasury and cannot be obligated or spent by the Department, they are not shown as a resource. 2007 amounts have been recategorized for comparability to the 2008 presentation.

(Dollars in Millions) **For the Year Ended September 30,**	**2008**	**2007**
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 30,662	$ 25,202
Spending Authority from Offsetting Collections and Recoveries	(7,956)	(7,629)
Distributed Offsetting Receipts	(352)	(260)
Net Obligations	22,354	17,313
Imputed Financing	121	124
Other Resources	161	42
Total Resources Used to Finance Activities	**22,636**	**17,479**
Resources Used to Finance Items not Part of Net Cost:		
Resources Obligated for Future Costs - goods ordered but not yet provided	(2,940)	(2,473)
Resources that Finance the Acquisition of Assets	(1,828)	(1,022)
Other	(26)	(32)
Total Resources Used to Finance Items not Part of Net Cost	**(4,794)**	**(3,527)**
Total Resources Used to Finance the Net Cost of Operations	**17,842**	**13,952**
Components of the Net Cost of Operations that will not require or generate Resources in the Current Period:		
Increase in Actuarial Liability	410	513
Passport Fees Reported as Revenue Returned to Treasury General Fund	(738)	(1,068)
Depreciation and Amortization	571	478
Increase in Unfunded Liability to International Organizations	30	321
Interest Income of Trust Funds	(784)	(776)
Other	410	216
Total Components of the Net Cost of Operation that will not require or generate Resources in the Current Period	**(101)**	**(316)**
Net Cost of Operations	**$ 17,741**	**$ 13,636**

African American Chiefs of Mission

1949	Edward R. Dudley	Liberia
1953	Jessie D. Locker	Liberia
1955	Richard L. Jones	Liberia
1959	John Howard Morrow	Guinea
1961	Clifton R. Wharton*	Norway
	Mercer Cook	Niger
1963	Carl T. Rowan	Finland
1964	Mercer Cook	Senegal
	Clinton E. Knox	Dahomey
1965	Mercer Cook	The Gambia
	Patricia Roberts Harris	Luxembourg
	Hugh H. Smythe	Syrian Arab Republic
	Franklin H. Williams	Ghana
1966	Elliot P. Skinner	Upper Volta
1967	Hugh H. Smythe	Malta
1968	Samuel C. Adams	Niger
1969	Clinton E. Knox*	Haiti
	Terence A. Todman*	Chad
	Samuel Z. Westerfield*	Liberia
1970	Jerome Heartwell Holland	Sweden
	Clarence Clyde Ferguson, Jr.	Uganda
1971	Charles J. Nelson	Botswana, Lesotho, and Swaziland
	John E. Reinhardt**	Nigeria
1972	W. Beverly Carter***	Tanzania
	Terence A. Todman*	Guinea
1973	O. Rudolph Aggrey**	Senegal and The Gambia
1974	David B. Bolen	Botswana, Lesotho, and Swaziland
	Theodore R. Britten, Jr.	Barbados and Grenada
	Terence A. Todman*	Costa Rica
1976	W. Beverly Carter**	Liberia
	Ronald D. Palmer*	Togo
	Charles A. James***	Niger
1977	Andrew Young	USUN New York
	Wilbert J. LeMelle	Kenya
	Ulrich Haynes	Algeria
	Mabel M. Smythe	Cameroon
	Richard K. Fox, Jr.*	Trinidad and Tobago
	David B. Bolen*	German Dem. Rep.
	William B. Jones*	Haiti
	Maurice D. Bean*	Burma
	O. Rudolph Aggrey***	Romania
1978	Terence A. Todman*	Spain
1979	Donald F. McHenry	USUN New York
	Horace G. Dawson**	Botswana
	Anne F. Holloway	Mali
1980	Walter C. Carrington	Senegal
	Barbara M. Watson	Malaysia
1981	John A. Burroughs, Jr. *	Malawi
	Ronald D. Palmer*	Malaysia
	Melvin H. Evans	Trinidad and Tobago
	Gerald E. Thomas	Guyana
1982	Howard K. Walker*	Togo
1983	Arthur W. Lewis**	Sierra Leone
	Terence A. Todman*	Denmark
	Gerald E. Thomas	Kenya
	George E. Moose*	Benin
1985	Edward J. Perkins*	Liberia
	Irvin Hicks*	Seychelles
1986	Ronald D. Palmer*	Mauritius
	Cynthia Shepard Perry	Sierra Leone
	Edward J. Perkins*	South Africa
1988	George E. Moose	Senegal
1989	Cynthia Shepard Perry	Burundi
	Stephen J. Rhodes	Zimbabwe
	Terence A. Todman*	Argentina
	Howard K. Walker*	Madagascar
	Ruth V. Washington	The Gambia
	Johnny Young*	Sierra Leone
1990	Aurelia Erskine Brazeal*	Micronesia
	Arlene Render*	The Gambia
	Leonard O. Spearman, Sr.	Lesotho
1991	Charles R. Baquet, III*	Djibouti
	Johnnie Carson	Uganda
1992	Ruth A. Davis*	Benin
	Kenton Wesley Keith**	Qatar
	Edward J. Perkins*	USUN New York
	Joseph Monroe Segars*	Cape Verde
1993	Aurelia Erskine Brazeal*	Kenya
	Walter C. Carrington	Nigeria
	Edward J. Perkins*	Australia
	Leslie M. Alexander*	Mauritius
	Howard F. Jeter*	Botswana
1994	Sidney Williams	Bahamas
	Irvin Hicks*	Ethiopia
	Johnny Young*	Togo
	Carl B. Stokes	Seychelles
	Jerome Gary Cooper	Jamaica
1995	Johnnie Carson*	Zimbabwe
	Bismark Myrick*	Lesotho
	Mosina H. Jordan***	Central African Republic
	James A. Joseph	South Africa
1996	Leslie M. Alexander*	Ecuador
	John F. Hicks, Sr.***	Eritrea
	Arlene Render*	Zambia
	Sharon P. Wilkinson*	Burkina Faso
1997	Betty Eileen King	US Rep. ECOSOC/UN
	George E. Moose*	Geneva
	Johnny Young*	Bahrain
1998	Shirley E. Barnes*	Madagascar
	William D. Clarke*	Eritrea
	George Williford Boyce Haley	The Gambia
	Elizabeth McKune*	Qatar
	Robert C. Perry*	Central African Republic
	George McDade Staples*	Rwanda
	Charles R. Stith	Tanzania
1999	Johnnie Carson*	Kenya
	Harriet L. Elam-Thomas*	Senegal
	Gregory L. Johnson*	Swaziland
	Delano Eugene Lewis, Sr.	South Africa
	Carol Moseley-Braun	New Zealand
	Bismark Myrick*	Liberia
	Sylvia Gaye Stanfield*	Brunei Darussalam
	Diane E. Watson	Micronesia
2000	Howard F. Jeter*	Nigeria
	Pamela E.Bridgewater*	Benin
	Sharon P. Wilkinson*	Mozambique
2001	George McDade Staples*	Cameroon/Equatorial Guinea
	Johnny Young*	Slovenia
	Roy L. Austin	Trinidad and Tobago
	Arlene Render*	Cote d'Ivoire
	Mattie R. Sharpless*	Central African Republic
	Wanda L. Nesbitt*	Madagascar
2002	James David McGee*	Swaziland
	Larry L. Palmer*	Honduras
	Richard Lewis Baltimore*	Oman
	Joseph Huggins*	Botswana
	James I. Gadsden*	Iceland
	Aurelia Erskine Brazeal*	Ethiopia
	Robin Renee Sanders*	Congo
	Charles Aaron Ray*	Cambodia
	Gail Denise Mathieu*	Níger
2003	Harry K. Thomas, Jr.*	Bangladesh
	Roland W. Bullen*	Guyana
2004	Margarita Ragsdale*	Djibouti
	June Carter Perry*	Lesotho
	Joyce A. Barr*	Namibia
	James D. McGee*	Madagascar
	Jendayi E. Frazer	South Africa
2005	Pamela E. Bridgewater*	Ghana
	Roger D. Pierce*	Cape Verde
2006	Bernadette Allen*	Niger
	Eric M. Bost	South Africa
	Gayleatha B. Brown*	Benin
	Cindy L. Courville	African Union
	Clyde Bishop*	Marshall Islands
2007	Wanda L. Nesbitt*	Cote d'Ivoire
	Maurice S. Parker*	Swaziland
	June Carter Perry*	Sierra Leone
	John L. Withers*	Albania
	Gail Denise Mathieu*	Namibia
	James D. McGee*	Zimbabwe
	Eunice S. Reddick*	Republic of Gabon, Democratic Republic of Sao Tome and Principe
	Robin R. Sanders*	Nigeria
	Barry L. Wells****	The Gambia
2008	Marcia S. Bernicat*	Senegal and Guinea Bissau
	John Jones*	Guyana
	Linda Thomas-Greenfield*	Liberia
	C. Steven McGann	The Fiji Republics

*Career Foreign Service Officer **Career Foreign Service Information Officer ***Career Foreign Service AID Officer ****Career Civil Service Officer

Required Supplementary Information

Distinguished African Americans at the Department of State

1962 1964 1966 1968 1970 1972 1974

1965 ***First African American woman ambassador***
Patricia Roberts Harris (1924–1985)
First African American woman to hold the rank of ambassador (Luxembourg 1965-1967) in U.S. history.

1973 ***First African American Deputy Secretary of State***
Clifton R. Wharton, Jr.
First African American to hold the number two position in the Department, Deputy Secretary of State from January 27 to November 8, 1973 and son of pioneering Foreign Service Officer Ambassador Clifton R. Wharton, Sr.

COMBINING SCHEDULE OF BUDGETARY RESOURCES

For the Year Ended September 30, 2008 ***(Dollars in Millions)***

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Budgetary Resources:						
Unobligated Balance, brought forward, October 1:	$ 3,824	$ 91	$ 12	$ 399	$ 1,984	$ 6,310
Recoveries of Prior Year Unpaid Obligations	384	15	(2)	84	298	779
Budget Authority:						
Appropriations	10,669	3,495	194	1,083	9,528	24,969
Spending authority from offsetting collections (gross):						
Earned						
Collected	6,517	—	6	75	465	7,063
Change in receivable from Federal sources	(170)	—	2	—	(3)	(171)
Change in unfilled customer orders:						
Advance received	28	—	—	—	257	285
Without Advance from Federal sources	—	—	—	—	—	—
Nonexpenditure transfers, net	54	—	—	112	51	217
Temporarily not available pursuant to Public Law	(288)	—	—	—	(17)	(305)
Permanently not available	(148)	(26)	(2)	(28)	(118)	(322)
Total Budgetary Resources	**$20,870**	**$ 3,575**	**$ 210**	**$ 1,725**	**$12,445**	**$38,825**
Status of Budgetary Resources:						
Obligations Incurred:						
Direct	$ 9,274	$ 3,245	$ 88	$ 1,370	$ 9,115	$ 23,092
Reimbursable	6,657	—	11	41	861	7,570
Unobligated balance:						
Apportioned	4,444	318	109	204	2,414	7,489
Exempt from appotionment	—	—	—	—	—	—
Unobligated balance not available	495	12	2	110	55	674
Total Status of Budgetary Resources	**$20,870**	**$ 3,575**	**$ 210**	**$ 1,725**	**$12,445**	**$38,825**
Change in Obligated Balance:						
Obligated Balance, net						
Unpaid Obligations, brought forward, October 1	$ 6,342	$ 755	$ 15	$ 1,089	$ 5,785	$ 13,986
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(606)	—	(5)	(2)	(14)	(627)
Obligations incurred, net	15,932	3,244	99	1,410	9,977	30,662
Less: Gross Outlays	(15,321)	(3,089)	(80)	(1,260)	(6,652)	(26,402)
Less: Recoveries of prior-year unpaid obligations, actual	(384)	(15)	2	(84)	(298)	(779)
Change in uncollected customer payments from Federal sources	170	—	(2)	—	3	171
Obligated balance, net, end of period:						
Unpaid obligations	6,568	896	36	1,155	8,812	17,467
Less: Uncollected customer payments from Federal sources	(436)	—	(7)	(2)	(11)	(456)
Net Outlays:						
Gross outlays	15,321	3,089	80	1,260	6,652	26,402
Less: Offsetting collections	(6,545)	—	(6)	(75)	(722)	(7,348)
Less: Distributed Offsetting receipts	(352)	—	—	—	—	(352)
Net Outlays	**$ 8,424**	**$ 3,089**	**$ 74**	**$ 1,185**	**$ 5,930**	**$18,702**

Heritage Assets

For the Fiscal Years Ended September 30, 2008 and 2007

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.

Top left: The Adams Room

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

Right: Thomas Jefferson State Reception Room.

Department of State

Art Bank works include "Untitled," a 2003 monotype by Judith Linhares (right), and "Forever is Both Ways for All Time," a 2007 intaglio by Chris Johanson (above).

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.

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 Overseas Buildings Operations, Interiors & Furnishings Division, Program Management Branch, is responsible for identifying and maintaining cultural objects owned by the Department of State in its properties abroad. The collections are identified based upon their historic importance, antiquity, or intrinsic value.

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

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.

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. *Department of State/OBO*

HERITAGE ASSETS
For Years Ended September 30, 2006 through 2008

	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	Collections include fine and decorative arts and other cultural objects.	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.	The program provides assessment, preservation, and restoration as needed.	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 - 9/30/2006	3,421	2,165	979	4,541	1,033	17
Acquisitions	5	38	—	272	—	—
Adjustments	43	—	—	9	—	—
Disposals	29	—	—	3	—	—
Number of Items - 9/30/2007	3,440	2,203	979	4,819	1,033	17
Deferred Maintenance - 9/30/2007	N/A	N/A	N/A	N/A	N/A	$6,000
Acquisitions	9	45	197	1,603	—	3
Adjustments	—	—	—	—	—	—
Disposals	4	—	—	6	—	—
Number of Items - 9/30/2008	3,445	2,248	1,176	6,416	1,033	20
Deferred Maintenance - 9/30/2008	N/A	N/A	N/A	N/A	N/A	$3,770,000

Deferred Maintenance for the Fiscal Year Ended September 30, 2008

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 $137 million and $152 million in 2008 and 2007 for buildings and facilities-related equipment and heritage assets that have not been funded.

A mother polar bear and her cubs rest on the frozen tundra near Canada's Hudson Bay. An important aspect of U.S. foreign policy is our commitment to scientific inquiry and education, and attention to polar regions. The Department is involved in many initiatives including International Polar Year, running from March 2007 to March 2009, which serves to focus attention on this fascinating and beautiful region.

The first International Polar Year was launched in 1881. The polar scientists and explorers of 126 years ago, representing a dozen or so nations, provided detailed scientific information that we still use today. They demonstrated early on how science can bring people of many nations together, and how international cooperation advances scientific knowledge. This spirit of cooperation still holds true in the polar regions in our time. Researchers from over 60 nations are working together to further our understanding of the interdependency of land, oceans, and atmosphere.

Many U.S. agencies are involved in this effort. The Department coordinates federal policy with respect to the Arctic and Antarctic, and heads U.S. delegations to international fora such as the Antarctic Treaty Consultative Meeting, the Commission on the Conservation of Antarctic Marine Living Resources, and the Arctic Council. We are focused on four areas: general international scientific cooperation, health, energy and indigenous groups. For example, marine science forms an important component of the International Polar Year, and our vessel clearance program ensures that marine scientific research by U.S. entities can take place in foreign Arctic waters, and vice versa.

The U.S. Government has invested considerable effort and resources in projects related to the polar regions-over $350 million per year-and we are excited about International Polar Year. For more information, see the International Polar Year at: *www.ipy.org*. *AFP Photo/Paul J. Richards*

Milestones of American Diplomacy

1778: Treaty of Alliance with France, engineered by Benjamin Franklin, enabled the fledgling republic to continue its struggle for independence.

1783: Treaty of Paris-Great Britain recognized American independence and control over western lands as far as the Mississippi.

1795: Jay's Treaty required Great Britain to remove troops from northwestern frontier; Pinckney's Treaty with Spain opened mouth of Mississippi River to U.S. navigation.

1803: Louisiana Purchase removed foreign control of Mississippi's mouth and doubled U.S. territory.

1819: Adams-Onis Treaty with Spain, transferring Florida, extended the U.S. to present boundaries in southeast.

1823: Monroe Doctrine established U.S. policy of opposing European intervention or new colonization in Western Hemisphere.

1842: Webster-Ashburton Treaty with Great Britain delimited northeastern U.S. (Maine) boundary.

1846: Oregon Treaty with Great Britain extended U.S. sole dominion to the Pacific.

1848: Treaty of Guadalupe-Hidalgo, ending 1846-48 war with Mexico, confirmed U.S. claim to Texas and completed U.S. expansion to Pacific.

1867: Alaska purchase ended Russian territorial presence and completed U.S. expansion on North American mainland.

1898: Treaty of Paris, at end of Spanish-American War, transferred to the United States Puerto Rico, Guam, and the Philippines, expanding U.S. power into the Pacific.

1918: Allies and Germany accepted Wilson's 14 points as basis for just and lasting peace ending World War I.

1945: U.S. and 50 other countries founded the United Nations.

1947: Truman Doctrine asserted U.S. policy of containing Soviet expansion through economic and military aid to threatened countries.

1947: Marshall plan of aid to Europe set foundation for economic cooperation among industrial democracies.

1948: Ninth International Conference of American States created the Organization of American States (OAS) to intensify U.S. and Latin American collaboration in all fields.

1948: NATO, first U.S. alliance concluded in peacetime, provided integrated force for defense of Western Europe and North America.

1963: Limited Nuclear Test Ban Treaty, first major-power agreement regulating atomic weapons testing, banned explosions in the atmosphere, in outer space and under water.

1967: Nonproliferation Treaty, now signed by 110 governments, banned the spread of atomic weapons.

1972: Strategic Arms Limitation Talks (SALT) agreements with U.S.S.R. prescribed mutual limitations on defensive and offensive weapons and established SALT as a continuing process.

1972: President Nixon's February visit to China followed Secretary Kissinger's earlier negotiations in Peking, marking first important step in the process of normalizing relations with the People's Republic of China.

1979: U.S. established diplomatic relations with the People's Republic of China ending 30 years of nonrecognition.

1979: Israel-Egypt Peace Treaty (Camp David Accords) ended 30 years of conflict between the two countries and provided possible framework for comprehensive peace in the Middle East.

1986: The U.S. Congress implemented strong economic sanctions against South Africa, which helped to bring an end to apartheid in 1991.

1989-1991: As President George H.W. Bush stated a desire to integrate the Soviet Union into the community of nations, the Cold War ended when communist regimes collapsed across Eastern Europe and the Soviet Union disintegrated.

1990-1991: In response to the Iraqi invasion of Kuwait, the United States built an international coalition to defend Saudi Arabia and, after United Nations approval, to eject Iraq from Kuwait through Operation Desert Storm.

1992: Representatives of more than 175 nations, including the United States, met at the Earth Summit in Rio de Janeiro, which produced a treaty on climate change and was the largest international meeting on the environment ever convened.

1994: The North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico took effect and the United States joined another structure that promoted global free trade, the World Trade Organization.

1995: The General Framework Agreement for Peace in Bosnia and Herzegovina ended the Bosnian civil war by providing for NATO troops to serve as peacekeepers.

2001: The United States led a global coalition that fought a war against terrorism in the wake of the September 11 terrorist attacks in New York and Washington D.C.

2003: After Iraq's repeated refusals to comply with UN resolutions, the United States led a coalition to depose the regime of Saddam Hussein.

2005: General elections held in Iraq to form a new government. Iraqis vote to elect a 275-member National Assembly, provincial councils and a Kurdish regional assembly.

Other Accompanying Information

Distinguished African Americans at the Department of State

2000 — 2001 — 2002 — 2003

2001 ***First African American Secretary of State***

Colin L. Powell

First African American Secretary of State appointed by President George Bush. Prior to Secretary Powell, Clifton R. Wharton, Jr. had been the highest ranking African-American in the Department.

2002 ***First African American woman appointed as Career Ambassador***

Ruth A. Davis

First African American woman to be promoted to the rank of Career Ambassador, the highest rank in the Foreign Service. As Director of the Foreign Service Institute (1977-2001) Davis established the School of leadership and Management and as Director General of the Foreign Service (2001 to 2003) she led the Diplomatic Readiness Initiative, increasing staffing and better enabling the Department to meet the foreign policy challenges of the 21st century.

Financial Management Plans and Reports

Overview

INTRODUCTION

The Department of State conducts financial activities in approximately 260 locations in 172 countries. We transact business in over 150 currencies and even more languages and cultures. Hundreds of financial and management professionals around the globe allocate, disburse and account for billions of dollars in annual appropriations, revenues and assets. The Department's customers include more than 40 U.S. Government agencies in every corner of the world, served twenty-four hours a day, seven days a week.

The Bureau of Resource Management (RM), headed by the Assistant Secretary for Resource Management and Chief Financial Officer, is the Department's corporate financial manager and strategic planner. There are over 500 people employed by RM around the globe, primarily in Washington, D.C.; Charleston, S.C.; and Bangkok, Thailand. RM has overall responsibility for the preparation and execution of the State Operations budget; management of financial systems, reporting and internal controls; management of global financial operations and services; direction of the Department's strategic planning and performance reporting efforts; administration of the interagency support cost sharing system related to our overseas missions and interagency resource planning efforts with the intelligence community; and operation of the recently created Global Partnership Center, which promotes the broader use of multi-sector partnerships to achieve Department strategic goals. RM produces a number of essential documents including the Joint State/USAID Strategic Plan, Department Performance Plan, Agency Financial Report, Performance Report, Citizens' Report, Budget-in-Brief, and the Congressional Budget Justification Document.

RM's services to its customers are critical in order that they can do their job and effectively carry out the Department's mission. The RM management team and staff have a proven record of outstanding achievement as evidenced by (but not limited to):

- Successful resourcing of all Secretarial-level priorities while simultaneously resolving a huge funding shortfall for current services;
- Successful implementation of a new financial management system;
- Successful implementation of a grading system to measure transparency and quality of budget requests for all interagency activities at post (ICASS);
- Creation of a Global Partnership Center (GPC) focused on finding and developing areas where the public and private sectors have a mutual interest in order to maximize program funding potential;
- Growth in requests for and use of the Post Support Unit (PSU) as a centralized financial processing unit for overburdened post financial management staff;
- Implementation of a Quality Management System under ISO 9001 standards for core financial operations; and
- Ongoing progress in establishing an outcome focus and culture of performance, as evidenced by "Green" status on the President's Management Agenda Scorecard for Performance Improvement.

MISSION

To integrate strategic and performance planning with budgeting and provide world-class financial services to the Department and its overseas posts.

The RM mission statement is incorporated into the Department's strategic goal for Strengthening Consular and Management Capabilities. The RM Assistant Secretary also serves as the Department's Chief Financial Officer. Pursuant to the CFO Act of 1990, this designation makes the Assistant Secretary responsible for all financial management activities related to Department programs and operations. This overview relates to the CFO role and financial management responsibilities set forth under the CFO Act.

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.

The President's Management Agenda initiative for Improved Financial Performance provides federal agencies a set of measurable financial management performance goals that gauge whether taxpayer funds are being properly accounted for. 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.

Performance measures include timely financial reporting, elimination of material weaknesses in internal control, the achievement of unqualified ("clean") audit opinions, elimination of improper payments, and implementing financial systems and processes that meet Federal requirements. In addition to these, RM endeavors to consolidate and standardize financial operations, leverage best business practices and electronic technologies (E-Gov), and build a first-rate finance team.

FY 2008 RESULTS

Timely Reporting. For the fifth consecutive year, the Department met the Government-wide performance target to issue our audited financial statements within 45 days of the close of the fiscal year.

Unqualified ("Clean") Audit Opinions. The Department submitted its FY 2008 financial report to OMB on time, but received a disclaimer of opinion from the Independent Auditor because of a delay in providing certain evidential matter in a timely manner. Since FY 1996 when the Government Management Reform Act required the preparation and issuance of annual audited agency-wide financial statements, the Department has achieved a number of unqualified opinions on its financial statements. However, since the start of accelerated financial reporting five years ago, given the breadth and complexity of our financial operations, it has been and will continue to be a challenge for the Department to complete its financial statements, obtain an audit opinion and meet OMB's 45-day deadline. Further, given the tight timeframe for submitting audited statements (45 days versus 60 days in the corporate world), any major program changes jeopardize the ability to complete the audit on-time, and each year will bring new challenges such as accounting for contractor held property in Iraq/Afghanistan and increased spending through allocations to other agencies for programs such as HIV/AIDS.

Elimination of Material Weaknesses in Internal Control. The Department maintains a robust system of internal controls overseen by senior leadership and administered by RM. During the past year, the Department worked closely with the Independent Auditor to address the material weaknesses reported for FY 2007 related to the management of unliquidated obligations and the accounting for personal property. As a result of improvements made, these areas were downgraded and the Department ended the year with no material weaknesses in internal control. Accordingly, for FY 2008, the Secretary was able to provide an overall unqualified statement of assurance for FMFIA, and an unqualified statement of assurance for internal controls over financial reporting.

Elimination of Improper Payments. Based on a series of internal control review techniques, the Department determined that none of its programs are risk-susceptible for making significant improper payments at or above the threshold levels set by OMB. Although the Department does not have programs determined risk-susceptible for making significant improper payments, the Department performed elective procedures to determine if improper payments were made in association with business class travel. For 2008 there were no instances where the travelers flying business class were found to be ineligible, though there was one error found that stemmed from weaknesses where supporting documentation was not readily available.

Implementing Financial Systems and Processes that Meet Federal Requirements. In FY 2007, the Department implemented the Global Financial Management System (GFMS) as the next step in our multiyear effort to establish a single global financial system. GFMS is already paying for itself with the recovery of millions of dollars from over-billings, while also providing the data platform that will enable RM to prepare in-depth decision support data for senior management. Over the past year we have stabilized GFMS and are moving forward with plans for our final step to establish a virtual, single global financial management system.

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, S.C. and Bangkok, Thailand locations. Building on this success, and leveraging the work and benefits from the single platform for the Department's overseas financial system, RM created a Post Support Unit (PSU) in Charleston, S.C. to take on more of the burden of repetitive, standardized financial processing from the posts and perform those tasks centrally at a substantially lower cost. The PSU was deployed initially to support missions operating in distressed conditions, such as Baghdad, the first post supported by PSU. This new model demonstrated a cost-effective alternative to and supplement for financial services at posts where security, staffing, costs, and other challenges made it advantageous to relocate some "backroom" transactional financial activities. RM quickly realized that the idea of "distressed" was too restrictive and expanded the concept to accommodate all types of posts. The PSU now services nearly 20 posts, such as Baghdad, Paris, and RPSO Frankfurt, processing about 1,000 vouchers per month.

Leveraging Best Business Practices and Electronic Technologies (E-Government). The President's Management Agenda includes an aggressive strategy to secure better services at lower cost through electronic government (E-government). In the Department, RM is advancing this E-Government strategy through projects, such as Global eTravel. Global eTravel uses a web-based travel system solution (Carlson Wagonlit's E2 Solutions) that provides an electronic, paper-less platform for processing temporary-duty (TDY) travel. At the end of FY 2008, Global eTravel is in use by 25 domestic bureaus, and 29% of overseas travel vouchers are being processed through the new system. An important milestone was also achieved in FY 2008 with the implementation of an automated interface between the Global eTravel and the overseas Regional Financial Management System, for the first time eliminating duplicate entry of travel authorization and voucher transactions at our posts using Global eTravel overseas.

A significant goal of the Administration is to modernize grants management through a number of initiatives including the migration of grant-making agencies to the Grants Management Line of Business (GMLoB) consortia. In FY 2008, the Department selected the GrantsSolutions.gov system, operated by the Department of Health and Human Services, as its grants management system service provider under OMB's GMLoB initiative. GrantSolutions.gov will be the technical solution for the Department's State Assistance Management System (SAMS) initiative, and will automate the full range of assistance management activities, from solicitation through award, post-award monitoring and closeout. SAMS will also interface with the GFMS.

Building a First-Rate 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 2008, the CFO sponsored a Financial Management Officer (FMO) Workshop, bringing together senior financial management professionals from around the world to jointly develop the tools, standards and best practices that will provide the transparency, flexibility and accountability needed to meet the Department's pressing challenges and top unfunded priorities. A key focus was on improving the analytic and evaluation capabilities to support more informed decision making. Following the workshop and leveraging the opportunity, the CFO hosted for the first time an Advanced Financial Management Course in which several financial management officers were able to participate and further develop their skills and competencies.

LOOKING FORWARD

RM will continue to work to ensure fundamental financial management "compliance" results—on-time, accurate financial statements that achieve an unqualified ("clean") audit opinion, financial systems and processes that meet Federal requirements, and effective internal controls. In FY 2009, RM will continue to expand PSU services to support additional posts and wholesale systematic consolidation of some financial processes. For Global eTravel, we will complete full deployment domestically. And approximately 66% of our overseas TDY travel voucher volume, network connections permitting, will be supported by Global eTravel as part of a single worldwide TDY travel management process, fully interfaced with the Department's financial systems. In regards to our grants management, we will pilot the first domestic bureau on GrantsSolutions.gov in January 2009, with full domestic deployment to be completed in FY 2010, followed by deployment overseas.

RM will also undertake activities that support effective strategic decision-making and mission performance. These activities include strengthening the Department's financial management analytic capabilities. RM will work to expand its analytical capability to provide the Department's senior management with timely and thorough financial/cost analysis to support funding decisions. At a time when the USG is facing a potential $1 trillion deficit in FY 2009, the new Secretary will undoubtedly be faced with some difficult choices over critical but competing priorities. Having the CFO establish or independently verify the fully loaded costs of a program or an initiative, with affordable cost alternatives and expected results, will be essential in maximizing the effectiveness of the Department's likely constrained funding. This ability to better quantify costs with results will also bolster the Department's credibility with Congress and OMB.

Financial Management Systems

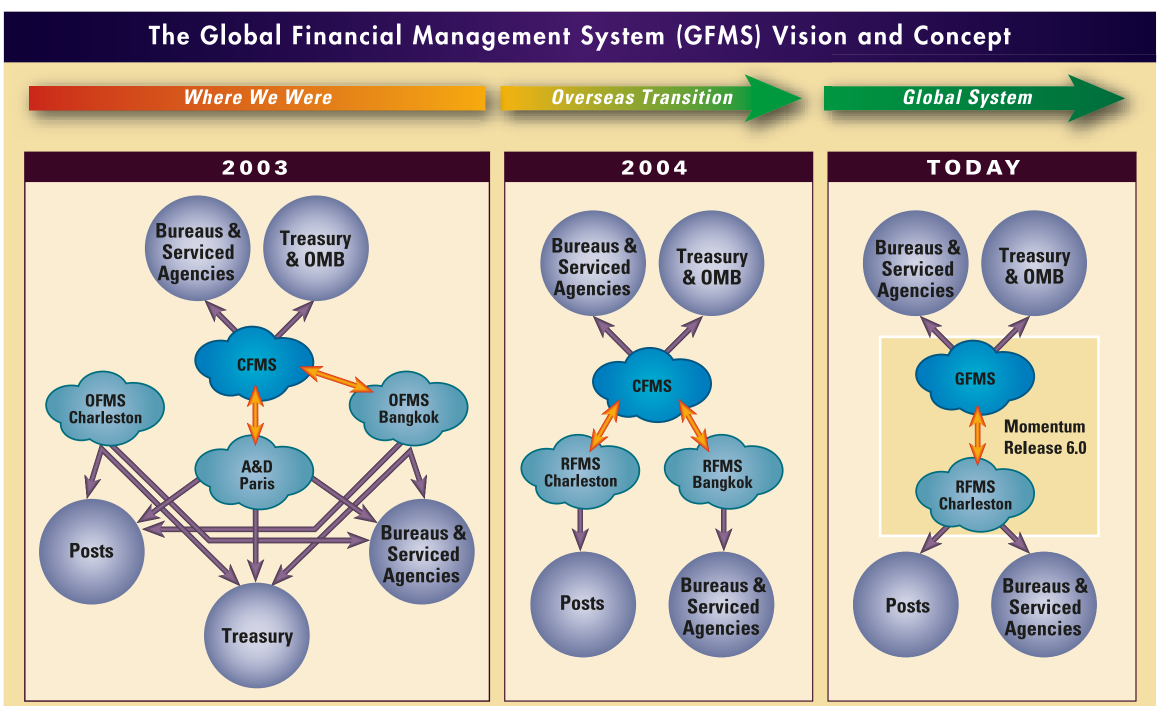
IMPLEMENTATION OF A GLOBAL FINANCIAL MANAGEMENT SYSTEM

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).

Through the Joint Financial Management System (JFMS) Program, the Department is integrating its overseas and domestic financial operations onto a common, global financial management software platform in Charleston, S.C. This is dramatically improving operations and reducing costs by eliminating system redundancies and replacing obsolete and unsupported financial systems. It is also providing the infrastructure for integrating other administrative activities within the Department, such as the Integrated Logistics Management System (ILMS) and Global e-Travel.

The diagram below depicts the end state of our global vision for a virtual single global financial management system.

The common platform underlying the Department's global financial management solution is CGI-Federal's Momentum financial management system. Momentum is a certified Federal financial system used widely in the Federal market place. This solution uses the same software (CGI Momentum) and technical platform to support the Global Financial Management System (GFMS) domestically, the Regional Financial Management System (RFMS) overseas, and USAID's Phoenix financial management system. Together with our efforts on Global Direct Connect, this enables 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. The GFMS, RFMS and Global Direct Connect components of State's solution are further described below.



GLOBAL FINANCIAL MANAGEMENT SYSTEM (GFMS)

In FY 2007, the Department implemented the GFMS as the next step in this multiyear effort to establish a single global financial system. With the implementation of GFMS (CGI-Federal's Momentum), we have now aligned our domestic financial management systems environment with the Department's enterprise architecture. GFMS replaced the Department's 20 year old Central Financial Management System (our core accounting system) and centrally accounts for billions of dollars through over 5 million annual transactions by 1,000+ users and over 25 "handshakes" with other internal and external systems. As part of the implementation of GFMS, a data warehouse, fixed asset module and a cost allocation module (for managerial cost accounting) were installed. In addition, we brought on a new customer, the International Boundary and Water Commission, for which we provide a full range of financial management services. And, for the first time, the Department's acquisition and fixed asset systems have been integrated into a single software application. Upgrading a financial system of this size and complexity is a large and challenging undertaking. During FY 2008, we have stabilized GFMS and are moving forward with plans for our final step in establishing a virtual, single global financial management system.

REGIONAL FINANCIAL MANAGEMENT SYSTEM (RFMS)

RFMS is the global accounting and disbursing system that has been implemented for posts around the world. RFMS is comprised of a commercial-off-the-shelf (CGI-Federal's Momentum), accounting system for funds management, obligation, and voucher processing, and the RFMS/D disbursing system developed by the Department for disbursing services. The successful 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 GFMS, 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 provides daily updates of overseas financial transactions to GFMS. These daily updates allow headquarters managers to ascertain the worldwide balance of our accounts on a daily basis, something never before possible. In addition, RM continues to enhance its COAST reporting tool, which provides daily updates on all financial transactions to 168 posts overseas and domestic bureaus, allowing them to analyze, and "slice and dice" their financial data for local reporting purposes using modern reporting and query tools on their local workstation.

GLOBAL DIRECT CONNECT

Our Global Direct Connect initiative moves posts that have operationally practical and reliable network connections (estimated at over 85 percent of our embassies) from their batch processing environment to a real-time, on-line connection. As a result of our efforts to date, there are now over 130 (out of a possible 180) posts using Global Direct Connect. In FY 2008, we converted 25 posts to Global Direct Connect. Moving forward, our plan is to convert another 15 posts to Global Direct Connect during FY 2009 and we will continue to convert remaining posts (with reliable networks) beyond that.

FINANCIAL MANAGEMENT INFORMATION TO IMPROVE DECISION MAKING

With the consolidation and streamlining of our worldwide financial systems operations, the ability to capture and maintain accurate, meaningful financial information, and provide it to decision makers in a timely fashion, has vastly improved. To support overseas financial management officers and post decision makers, RM implemented COAST Reporting in FY2007. In FY 2008, improvements were added to provide information "drill down" and budget and planning versus actual reporting capabilities. Further improvements are planned for FY 2009, including the rollout of a much improved encryption capability which will replace our outdated Electronic Certification System at all of our posts overseas. Domestically, and in support of Department-wide reporting, RM implemented the GFMS Data Warehouse

(DW) in FY 2007. Based on a modern, browser-based technology platform, the GFMS DW enables users to access financial information from standard, prepared reports, or customize queries and reports in real time to compile the financial information needed for informed decision making on a day-to-day basis. In addition to adding and improving reports and queries, managerial cost accounting and acquisitions reporting modules were added to the GFMS DW in FY 2008. Plans for FY 2009 include expanding available content and further enhancing management reporting capabilities.

Secretary's List of Culturally Significant Properties:

The American Embassy in the Schoenborn Palace in Prague has a long and complex history of adaptations to accommodate a wide range of royal, noble and governmental owners. The United States purchased the property in 1924 for use as an American Legation. Five medieval residences and a malthouse were combined together in the early decades of the seventeenth century to create the original palace, apartments and garden.

Department of State/OBO

Management of Obligations to the Department

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	BALANCE OUTSTANDING SEPTEMBER 30, 2007	FISCAL YEAR 2008 ASSESSMENTS	FISCAL YEAR 2008 COLLECTIONS	BALANCE OUTSTANDING SEPTEMBER 30, 2008
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	$ 3,371,428	$ —	$ 1,685,714	$ 1,685,714
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	—	—	1,500,000
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	8,000,000	3,000,000	—	1,500,000	1,500,000
ORBIT ADVANCED TECHNOLOGIES INC.	Violating the terms and conditions of the Department's munitions and licenses by agreeing to sell defense articles (Radone Measurement System – AL8098/ AL8099) to the People's Republic of China	08/29/05	500,000	166,666	—	—	166,666
GOODRICH CORPORATION	Exporting unauthorized defense articles and services (to foreign person employees of proscribed countries) in violation of the terms and conditions of the Department's International Traffic in Arms Regulations (ITAR).	03/28/06	1,250,000	500,000	1,750,000	250,000	2,000,000

(continued)

COMPANY NAME	VIOLATION	DATE ASSESSED	AMOUNT ASSESSED	BALANCE OUTSTANDING SEPTEMBER 30, 2007	FISCAL YEAR 2008 ASSESSMENTS	FISCAL YEAR 2008 COLLECTIONS	BALANCE OUTSTANDING SEPTEMBER 30, 2008
L-3 COMMUNICATIONS	Exporting unauthorized defense articles and services (to foreign person employees of proscribed countries) in violation of the terms and conditions of the Department's International Traffic in Arms Regulations (ITAR).	02/28/06	2,000,000	__	2,000,000	500,000	1,500,000
THE DIRECTTV GROUP INC. & HUGHES NETWORK SYSTEMS INC.	Exporting unauthorized defense articles and services (to foreign person employees of proscribed countries) in violation of the terms and conditions of the Department's International Traffic in Arms Regulations (ITAR).	1/26/2005	5,000,000	1,500,000	__	1,000,000	500,000
LOCKHEED MARTIN (SIPPICAN) CORPORATION	Exporting unauthorized classified and unclassified technical data and defense articles and services in violation of the terms and conditions of the Department's International Traffic in Arms Regulations (ITAR).	12/12/06	3,000,000	2,000,000	__	1,000,000	1,000,000
SECURITY ASSISTANCE INTERNATIONAL, INC. & HENERY L. LAVERY III	Violating the terms and conditions of the Department's munitions licenses and exporting defense services without munitions licenses or other authorizations to the People's Republic of China.	12/12/2006	75,000	75,000	__	__	75,000
ITT SPACE SYSTEM	ITT Corporation has entered into a consent agreement to settle 208 violations of the AECA and ITAR in connection with the unauthorized export of defense articles and technical data.	6/11/2007			20,000,000	4,000,000	16,000,000
NORTHROP GRUMMAN (ELECTRONIC SYSTEMS)	Northrop Grumman Corporation has entered into consent agreement to settle 110 violations of the AECA and ITAR in connection with the unauthorized export of defense articles and defense services.	3/14/2008			10,000,000	3,000,000	7,000,000
LOCKHEED MARTIN (MISSILE & FIRE CONTROL DIV.)	Lockheed Martin Corporation has entered in a consent agreement to settle 8 violations of the AECA and ITAR in connection with export of classified technical data.	2008			3,000,000	2,000,000	1,000,000
BOEING (MCDONNELL AIRCRAFT & MISSILE DIV.)	The Boeing Company has entered in a consent agreement to settle 40 violations of the AECA and ITAR in connection with the valuation of manufacturing license agreements.	6/9/2008			3,000,000	1,000,000	2,000,000
GOVERNMENT OF ISRAEL	**				500,000	500,000	__
DIRECT TV GROUP	**				2,500,000	2,500,000	__
TOTAL			$ 65,575,000	$12,113,094	$42,750,000	$18,935,714	$35,927,380

** The details of the violations were not yet available.

Debt Management

Outstanding debt from non-federal sources (net of allowance) increased from $32.5 million in FY 2007 to $55.3 million in FY 2008.

Non-federal receivables consist of debts owed to the International Boundary and Water Commission, Civil Monetary Fund, and amounts owed for Repatriation Loans, medical costs, travel advances, and other miscellaneous receivables.

Of the delinquent receivables over 365 days old, $6.9 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 collections of delinquent receivables. In accordance with the agreement and the Debt Collection Improvement Act of 1996 (Public Law 104-134), the Department referred $1,644,602 to Treasury for cross-servicing in FY 2008. Of the current and past debts referred to Treasury, $821,775 was collected in 2008.

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

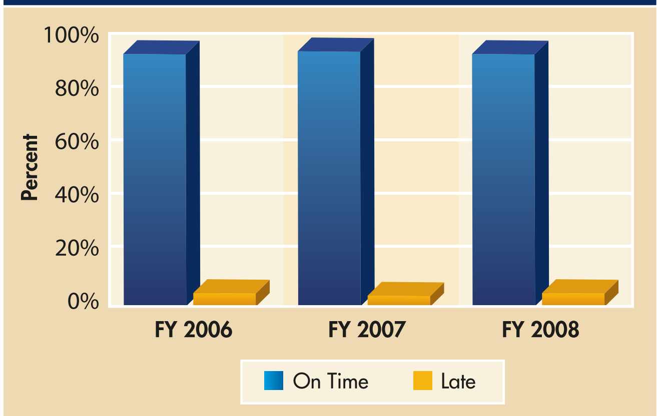
	FY 2008	FY 2007	FY 2006	FY 2005
Number of Accounts	864	884	1,044	772
Amounts Referred (In Thousands)	$ 1,645	$ 1,445	$ 1,673	$ 401

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. In FY 2008, the Department made 728,596 payments subject to prompt payment regulations; 620,473 of these payments were paid overseas and 108,123 were paid domestically. The Department paid 692,808 or 95% of its payments on time. Presented below is a chart that reflects the timeliness of the Department's payments from FY 2006 through FY 2008.

Timeliness of DOS Payments
FY 2006 – FY 2008

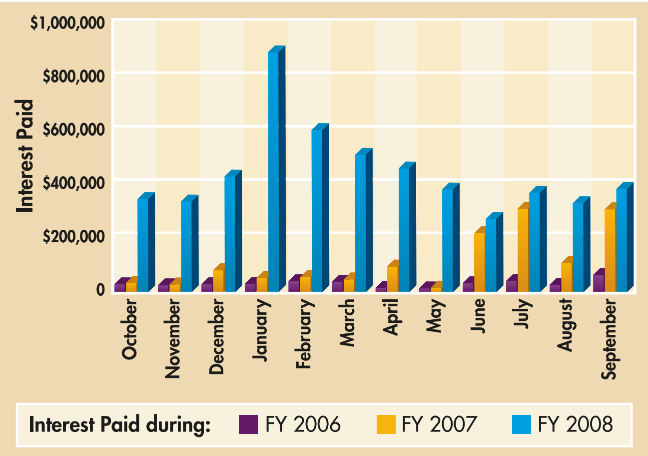


During FY 2008, the Department paid $5.4 million in accrued interest penalties, compared to $1.4 million the previous year, a 286 percent increase. The increase in Prompt Payment penalties was primarily due to domestic payment delays caused by the transition to a new accounting system in FY 2007. The Department averaged $736 in interest penalties per million dollars of prompt payments made in FY 2008.

SELECTED PAYMENT DATA

	2008	2007	2006
Interest Paid ($000)	5,411	1,420	405
Interest Under $1 Not Due ($000)	—	—	—
Interest Due But Not Paid ($000)	—	—	—
Number of Procurement Card Transactions			
Domestic	40,470	41,524	45,804
Overseas	103,529	93,480	82,023

Domestic Prompt Payment Interest
FY 2006 – FY 2008



Electronic Payments

Ninety percent of total domestic and overseas payments were made through electronic funds transfer (EFT). EFT payments made for the Domestic operations were 95 percent of the total domestic payments. EFT payments for overseas operations were 87 percent of the total number of overseas payments. Fewer payments are made overseas due to the complexities of banking operations in some foreign countries.

EFT AND CHECK PAYMENT VOLUMES

	2008		2007		2006	
Payment Type	**Number**	**Percent**	**Number**	**Percent**	**Number**	**Percent**
EFT:						
Domestic	1,260,246	95	1,263,429	97	1,095,691	98
Overseas	1,756,368	87	1,586,790	85	1,455,055	81
EFT Subtotal	3,016,614	90	2,850,219	90	2,550,746	87
Checks:						
Domestic	62,085	5	39,924	3	26,869	2
Overseas	254,415	13	289,585	15	352,092	19
Checks Subtotal	316,500	10	329,509	10	378,961	13
Total Domestic	1,322,331	38	1,303,353	41	1,122,560	38
Total Overseas	2,010,783	62	1,876,375	59	1,807,147	62
Total Payments	**3,333,114**	**100**	**3,179,728**	**100**	**2,929,707**	**100**

Improper Payments Information Act

The Improper Payments Information Act of 2002 (IPIA), Public Law No. 107-300, requires agencies to annually review their programs and activities to identify those susceptible to significant improper payments. OMB Circular A-123 Appendix C, *Requirements for Effective Management and Remediation of Improper Payments,* defines significant improper payments as annual improper payments in a program that exceed both 2.5 percent of program annual payments and $10 million. Once those highly susceptible programs and activities are identified, agencies are required to estimate and report the annual amount of improper payments. Generally, an improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, and administrative or other legally applicable requirement.

IPIA REPORTING DETAILS

Based on a series of internal control review techniques, the Department determined that none of its programs are risk-susceptible for making significant improper payments at or above the threshold levels set by OMB. These reviews were conducted in addition to audits under the Single Audit Act, the CFO Act, GAO reviews, and reviews by the Department's Office of Inspector General. The Department also conducted risk assessments of programs exceeding $35 million in annual outlays. These risk assessments showed that the Department is at low risk for making significant improper payments at or above the threshold levels set by OMB. The Department's future plans include developing a process to integrate risk assessment efforts between reviews conducted to meet compliance requirements with OMB Circular A-123 Appendix A and C, as well as with our FMFIA program.

RECOVERY AUDIT PROGRAM RESULTS

The Department of State, Bureau of Resource Management, has established a two-tiered erroneous payment monitoring and review program that supplements the formal account receivable process. The Global Financial Services (GFS), Office of Claims, has integrated erroneous payment identification and collection as key functions of the accounts payable process and the paying office's operations. The claims office has established an internal debt management unit, whose primary mission is the identification and collection of erroneous payments, coordinating with the Accounts Receivable Division (ARD) as necessary. In addition, the GFS Office of Oversight Management & Analysis conducts a monthly query of all domestic payments, focusing on identifying potential erroneous and duplicate payments. The GFS approach has incorporated various manual and automated data analysis techniques and processes to identify, validate and collect erroneous payments, including use of data mining software, manual sampling of internal payment records, U.S. Treasury taxpayer identification number matching, and sampling of vendors.

In fiscal year 2008, the GFS domestic claims debt management process identified and validated 501 actual duplicate/erroneous payments, totaling $15 million, out of 129,504 total payments, totaling $4.8 billion. The claims office has collected or recovered 466 of the 501 erroneous payment debts, totaling $14 million (93 percent). The primary reasons for these improper payments and debts continues to be the use of wrong vendor payment records in the funding of the awards and/or authorization of payment on submitted claims.

RECOVERY AUDIT PROGRAM RESULTS

Agency Component	Amount Subject to Review for CY Reporting	Actual Amount Reviewed and Reported CY	Amounts Identified for Recovery CY	Amounts Recovered CY	Amounts Identified for Recovery PY	Cumulative Amounts Identified for Recovery (CY + PY)	Cumulative Amounts Recovered (CY + PY)	Outstanding
Number	129,504	129,504	501	466	783	1,284	1,197	87
Amount	$ 4.8 billion	$ 4.8 billion	$15.4 million	$14.3 million	$14.63 million	$30.03 million	$28.53 million	$1.5 million

The GFS duplicate or erroneous payment program has proven to be a cost effective tool (the program operates at an annual cost of $100 thousand) to supplement the ARD domestic commercial debt management and recovery. Identified debts not collected by the office of claims are transferred to ARD for follow-up collection. Since fiscal year 2005, this GFS program has identified 1,284 duplicate/erroneous payments ($30 million), and collected 1,197 identified debts ($29 million or a collection rate of 95 percent).

BUSINESS CLASS TRAVEL REVIEWS

Although the Department does not have programs determined risk-susceptible for making significant improper payments at or above the threshold levels set by OMB, the Department performed elective procedures to determine if improper payments were made in association with business class travel. The Department's mission is conducted throughout the world and requires extensive travel, sometimes of a significant duration. Because of the high volume of travel, the Department has made concerted efforts to determine if official travel has adhered to government-wide and Department regulations for premium class travel.

In March 2006, GAO issued a report that identified shortcomings in the Department of State's authorization and administration of business class travel. In response to the report, the Department instituted additional measures to strengthen internal controls over the approval and use of business class travel. The GAO report recommended that the Secretary of State conduct regular reviews of the Department's use of business class travel and report the findings to senior management. In response to this recommendation, the Department incorporated the review of business class travel into the ongoing reviews conducted in accordance with the IPIA, the GAO guide, and other guidelines for evaluating and testing controls over sensitive payments.

During fiscal years 2006, 2007, and 2008, a random sample was selected by a statistician to yield an estimate with a 90 percent confidence level and interval of approximately 2.5 percent. There were no instances where evidence was found that a business class travel payment was unapproved and needed to be recovered. For 2008 there were no instances where the travelers flying business class were found to be ineligible, though there was one error found that stemmed from weaknesses where supporting documentation was not readily available. This was projected to an overall error rate of 1% or $5,385. The FY 2006 review's error rate was 24 percent or $348,567 and the FY 2007 error rate was 4 percent or $17,038. The improvement shown in the sampling results demonstrates that the additional controls the Department put in place in 2006 have been effective in ensuring improper payments were not made for business class travel.

Secretary's List of Culturally Significant Properties:

The residence of the U.S. Ambassador to Japan, with its spacious reception rooms and large garden, offers serenity in the center of downtown Tokyo. In 1925, the U.S. government acquired the land from the Japanese government for $115,000 after an earthquake and fire had destroyed a former Prince's residence there and the adjacent U.S. Embassy buildings. This residence, a blend of Moorish and Asian styles with colonial overtones, was one of the first projects of the new Foreign Services Building Commission established by President Herbert Hoover. Dubbed "Hoover's Folly" at the time, the chancery and residence with imported Georgia walnut panels and Vermont marble flooring were completed during the Depression for $1.25 million.

During World War II, the compound was under the protection of the Swiss government. From 1945 to 1951, General Douglas MacArthur lived in what his staff called "The Big House." On September 27, 1945 Emperor Hirohito came to the residence to speak with MacArthur and the next day a now-famous photograph of their meeting in the living room was on the front page of every newspaper in Japan. *Department of State/OBO*

Inspector General's Assessment of Management and Performance Challenges

The *Reports Consolidation Act of 2000* requires that the Department's Performance and Accountability Report include a statement by the Inspector General that summarizes the most serious management and performance challenges facing the Department and briefly assesses the progress in addressing those challenges. For FY 2008, the Office of Inspector General (OIG) considers the most serious management and performance challenges for the Department to be in the following areas:

Acting Inspector General, Harold W. Geisel.

1. Protection of People and Facilities
2. Information Security
3. Financial Management
4. Contracting and Procurement
5. Human Resources
6. Counterterrorism and Border Security
7. Public Diplomacy
8. Coordinating Foreign Assistance

1 Protection of People and Facilities

Making its people, facilities, and information more secure continues to be one of the Department's highest priorities and greatest challenges. The Department has been successful in addressing security vulnerabilities at a number of overseas posts through its new construction and security upgrade programs. Recently, terrorist attacks have been thwarted and loss of life has been limited to those assigned to protect the perimeter of overseas diplomatic facilities, as most recently experienced in Istanbul and Sanaa.

Interim Solutions Challenge. The Department remains challenged to identify and fund interim solutions to address security vulnerabilities at facilities awaiting long-term new construction or the completion of major security upgrades. Providing security for a large diplomatic corps in a war zone, where diplomats move in convoys as they conduct official business, places an inordinate amount of strain on security resources. Managing protective security details that operate both on the ground and in the air create new management challenges to find people with both these needed skills. Additionally, plans for evacuating thousands of American citizens either for government collapse or natural disaster require updates to an emergency action plan and a sound method for safely transporting people.

Emergency Action Plans. These plans often do not have updated evacuation routes and communication procedures. The Department has been making progress in this area with the implementation of a computer-based application and in requiring tripwires as part of a sophisticated plan for draw-downs and ordered departures.

NSDD-38 Agency Cost. Increasing approvals to NSDD-38 requests from other agencies desiring to become part of an overseas mission usually means additional security expenses and sometimes the need for additional security personnel and equipment. Some of these agencies have special activities off embassy compounds, which greatly increase the challenge for the diplomatic mission.

2 Information Security

PIERS System Controls. The protection of personally identifiable information is a significant information security challenge for the Department.

As of April 2008, the Department's Passport Information Electronic Records System (PIERS) contained records on about 192 million passports for about 127 million passport holders. Bureau of Consular Affairs officials said that there were about 20,500 users with active PIERS accounts as of May 2008 and that about 12,200 of these users were employees or contractors of the Department. PIERS is also accessed by users at other federal departments and agencies to assist in conducting investigations, security assessments, and analyses.

Based on the results of a 2008 OIG review, there are many control weaknesses—including a general lack of policies, procedures, guidance, and training—relating to the prevention and detection of unauthorized access to passport and applicant information and the subsequent response and disciplinary processes when a potential unauthorized access is substantiated.

In some cases, Department officials stated that the lack of resources contributed to the lack of controls and to the Department's ability to assess vulnerabilities and risk. In response, the Bureaus of Consular Affairs and Administration took a number of corrective actions. These actions included issuing interim guidance on the various steps to be followed and decisions to be made in response to a potential incident of unauthorized access to passport records and applicant personally identifiable information and issuing a Department-wide personally identifiable information breach response policy. Additional actions to address the 22 recommendations made by OIG are underway by the Department, including conducting vulnerability and risk assessments of all passport systems.

Use of Laptops. Another challenge is the proliferation of and reliance on mobile computers, including laptops, personal digital assistants, and telephones, in the work place domestically and abroad. These devices present challenges for protecting sensitive personal and program-specific information that could be exploited if obtained in an unauthorized manner. The Department is challenged with balancing the operational need to use these mobile devices while protecting the information they contain and with developing security controls, policies, and procedures that keep pace with the emerging technologies.

3 Financial Management

Financial management continues to be a major challenge within the Department. During FY 2007, the Department was unable to respond to requests for evidential material during the annual audit of the financial statements in a timely manner. As a result, the independent external auditor was unable to express an opinion on the financial statements by the November 15, 2007, deadline imposed by the Office of Management and Budget.

Personal Property and Undelivered Orders. In its findings, the independent external auditor identified two material weaknesses: one related to personal property and another related to undelivered orders. The external auditor again noted significant deficiencies that had been identified in prior reports related to the adequacy of the financial and accounting systems and the lack of a managerial cost accounting system. Also, the auditor identified the Department's inability to determine the extent of the unfunded actuarial liability accruing from supplemental pension plans for locally employed staff.

A continuing challenge has been evident for years. There are a number of the identified weaknesses had been reported for several years without being corrected by the Department. The independent external auditor again noted that the Department continues to have difficulty producing year-end financial data in a timely manner.

Several Improvements. During FY 2007, the Department took steps to improve some of these weaknesses. Its efforts allowed two significant deficiencies, related to information technology security and accounting for real property, to be downgraded. In addition, the Department implemented a new financial management system, which was part of its efforts to establish a single global financial system. The Department also installed an integrated acquisition and fixed assets module and a cost allocation module. The Department has made some improvements related to personal property, including implementing a tool to manage the vehicle fleet and developing better guidance. The Department is also working to expand the ability at post to record acquisitions and dispositions and is focusing additional efforts on undelivered orders and plans to automatically de-obligate certain of these items.

In addition, the Department is distributing aging reports to bureaus for review and is working to improve the contract close-out process. The Department has developed an initial cost model for bureaus and plans to incorporate cost allocations into the model. In addition, the Department plans to develop an inventory of supplemental pension plans.

4 Contracting and Procurement

Concern about the procurement process is a government-wide problem and the Department of State is no exception. In report Bureau of Administration's Office of the Procurement Executive, Office of Acquisition Management and Office Small and Disadvantaged Business Utilization (# ISP-I-07-12 of December 2006), the OIG stated that the Department's procurement function was "approaching a crisis situation." State Department contracting, like many federal agencies in recent years, has grown dramatically, but procurement force staffing has not followed suit. For example, from fiscal years 2000 to 2005, Department contract spending increased 213 percent while procurement staffing increased from 130 to 150 FTEs – a 16% increase.

OIG has examined procurement operations in a number of inspections and reports and made numerous recommendations to Bureaus and offices responsible for procurement, including the Bureau of Administration, Office of the Procurement Executive (A/OPE provides advice and support on contracting) and the Office of Acquisitions Management (AQM conducts contract operations in support of activities worldwide). Some recommendations have yielded positive action on the part of responsible parties, while others have not.

For example, OIG recommended A/OPE conduct a comprehensive review of AQM management using a Government Accountability Office (GAO) framework for assessing the acquisition function at federal agencies. A/OPE reported in November 2006 that the review identified potential process improvements as well as some areas of regulatory non-compliance.

Local Guard Contracting. OIG also recommended that A, in coordination with the Bureau of Diplomatic Security (DS), establish a plan to progressively consolidate into AQM local guard contracting, a longstanding problem area overseas. In February 2008, AQM announced that under its new "procurement shared services" system, it will assess a 1 percent surcharge on all acquisitions it performs for the Department. This surcharge will enable AQM, with the support of DS, to gradually assume responsibility for the local guard contracting program. These are positive developments that should result in more efficient procurement and use of financial and human resources.

Overseas Building Operations (OBO). On the other hand, other problems identified by OIG remain. The Department's Construction Security Program to construct safe and secure embassies is ambitious (construction of 150 new embassy buildings and office annexes between 2001 and 2018) and expensive (costing some $17.5 billion by current estimates). In 2006, OIG determined that awards for new embassy construction were made too late in the fiscal year, resulting in a compressed award schedule that caused inefficiency and other procurement problems. This was largely due to the late arrival at AQM of OBO's complete technical requirements packages for new construction projects. OIG then recommended that A, in coordination with OBO, establish written timelines for the submission of technical requirements packages. This was not done and the compressed award schedule problem remained when OIG inspected OBO in 2008.

OIG noted in 2006 that AQM will face challenges in acquiring additional procurement staff as the existing procurement workforce retires. To meet the work surge, AQM has recently hired approximately 30 contract employees to assist in procurements. As contract employees, these personnel cannot act as contracting officers, who perform inherently governmental duties, which contract employees must avoid. However, these contract employees will assist contracting officers and perform only allowable duties in the procurement process. It remains to be seen if AQM's efforts in this regard will pay dividends as Department contracting expenditures increase.

5 Human Resources

The Director General of the Foreign Service (DG) and the Bureau of Human Resources (HR) face significant challenges in implementing the Secretary of State's vision of transformational diplomacy and ensuring the availability of a dynamic diplomatic corps that has a broad range of knowledge, skills, and capabilities. In responding to these challenges, the DG and his team must balance high-stakes problems in international relations with a series of major personnel-related initiatives.

Global Repositioning. The Secretary's Global Repositioning Program (GRP) was designed to increase U.S. diplomatic engagement with high-priority countries around the world. The GRP achieved results quickly by breaking through various constraints to reallocate positions across regional and bureau lines. If repositioning becomes regularized, however, it needs to take greater account of the Department's strategic planning mechanisms and prioritize posts in terms of overall U.S. interests and assessments of relative workload. Given ongoing budget and staffing shortfalls, the scale of repositioning may have to be smaller. More attention should be given to the impact on the "losing" posts and bureaus, and the "gaining" posts must receive sufficient resources to enable additional personnel to carry out their GRP functions.

Locally Employed Staff. The Department employs a workforce of almost 38,000 locally employed staff (LES). At many posts, the adequacy and transparency of the local employee compensation and benefits packages are perennial and complex issues that affect LES morale and retention. In countries plagued by fraud or instability, local retirement accounts and pension plans are unreliable at best. The complexities of local labor laws have thus far thwarted the Department's efforts to create a universal, off-shore plan, which would help ensure the future security of LES employees. The Department needs to strive to resolve these issues.

Human Capital Planning. Like other federal agencies, the Department is facing a wave of retirements within the next several years as the baby boom population ages. At least 35 percent of Department employees will be eligible to retire within the next five years. The Department is working to implement a human capital plan to ensure the continuous recruitment, training, deployment, and retention of qualified foreign service and civil service employees whose skills and experience are aligned with the goals of transformational diplomacy and evolving strategic objectives. Workforce planning and HR resource management are one of the Department's top management priorities.

HR Services Delivery. Currently, HR services in the Department are fragmented, duplicative, and inconsistent. Customers are often confused and frustrated. In an effort to correct these longstanding weaknesses, the Secretary announced an initiative with the goal of creating a single, integrated, tiered-service delivery system to improve, streamline, and automate HR services. This delivery model is based on best practices of private industry and other government agencies. The Bureau of Diplomatic Security will lead the effort by launching a pilot program in November 2008. During the first phase, approximately 30 routine transactional services will be transferred to a new office located at the Department's Charleston services center. The Department will pursue a phased approach to rolling out the new model, with the ultimate goal of centralizing all routine Department-wide HR services in Charleston and consolidating more complex processes among selected bureaus in Washington. This is an ambitious undertaking that has the potential to result in significant improvements. However, in order to succeed, there must be sustained support from the highest levels of the Department and a willingness among the bureaus and Department employees to accept new ways of doing business.

Retiree Services. Over the past year, the Department has taken steps to strengthen the HR Office of Retirement (HR/RET). With a history of sub par performance and outdated IT systems, OIG recommended in 2007 that the Department take immediate efforts to improve office operations or consider transferring the function to an outside provider. In October 2008, HR/RET will deploy the Employee Benefits Information System (EBIS), which will streamline and accelerate the system for submitting Civil Service retirement packages. HR/RET hopes to implement the first Foreign Service modules of EBIS in early 2009.

It remains to be seen if EBIS will be a success story. Further, high staff turnover continues to plague the office. HR/RET appears headed in the right direction, but much remains to be accomplished, especially in light of the exponential increase in retirements expected over the next 5-10 years.

6 Counterterrorism and Border Security

Cross-border problems, which have a direct impact on U.S. business interests, environmental safety, quality of life, and border security, continue to challenge the Department. In its strategic plan, the Bureau of Consular Affairs projects significant changes to the Border Security Program. Expansion of the Visa Waiver Program to Korea and other countries is likely to reduce visa demand in some places, but will also reduce revenue retained in the Department.

Demand for passports and passport cards, while flat in FY 2008, is expected to surge in FY 2009 when Western Hemisphere Travel Initiative (WHTI) compliant travel documents are required for all land, sea and air travelers.

Border crossing card replacement is expected to add significantly to demand for visa adjudications in Mexico.

The effect of globalization on travel patterns in India, China, and Brazil will also add significantly to demand for services. The Department will require flexibility to add new staff and redeploy existing positions to meet shift and increases in demand. To meet the projected demand, more than 275 new positions will be needed in Mexico alone.

With looming increases in consular workload and in demands on consular resources over the next five years, there is also a need to address non-consular issues and their priority in the operations of the border posts. If non-consular issues are not properly managed now, it will be impossible to do so once the wave of U.S. passport and nonimmigrant visa applications hits the border.

7 Public Diplomacy

The Department has made important progress in ensuring that public diplomacy is seen as a part of a total diplomatic effort rather than as something that is added as an after thought to a particular policy, but further integration within the Department and interagency still remains. There should be more mission-level integration of public diplomacy objections in all mission goals. Particularly in areas such as foreign assistance and countering violent extremism, the Department should work closely with other agencies to coordinate and evaluate strategic communication plans and messages.

The Diplomatic Readiness Initiative and expanded training have helped address shortfalls in the ranks of public diplomacy officers, but gaps in staffing still remain. As a result, too many public diplomacy positions are occupied by officers without sufficient language skills or public diplomacy experience. This situation is particularly acute in smaller missions where adequate supervision or mentoring may not always be available to first-time public affairs officers.

In recent years, several Caribbean basin posts have had to cut their public affairs officer (PAO) positions at the same time that public diplomacy is becoming an increasingly important part of embassy operations requiring professional guidance. While resources are not available to recreate all of the PAO positions that have been cut, a regional position could support multiple posts at a fraction of the cost. Inspectors in Georgetown recommended the establishment of a regional public diplomacy officer position that could support the several Caribbean basin posts that have lost their PAO positions.

Although there have been notable improvements in obtaining the human and program resources needed to implement an effective public diplomacy effort, these efforts started from a low post-consolidation baseline. Resource gains in some areas and regions have come at the cost of neglecting other competing regions and issues; short-term benefits have sometimes come at the cost of neglecting long-term strategies. The Department needs not only to measure the effectiveness of efforts in countering violent extremism, it should evaluate and develop plans for addressing other pressing economic and political challenges to U.S. foreign policy objectives and marshal the program resources required to implement them.

8 Coordinating Foreign Assistance

The Office of the Director of Foreign Assistance is developing its coordinating role for overseas foreign assistance activities. However, several of the inspections conducted during FY 2008 indicate separate USAID and Department entities are supplying redundant assistance programs in a number of countries. These redundancies, while difficult to address on a country-by-country basis, could be resolved by senior decision makers at post and in Washington reviewing both in-country and regional support.

In Brasilia, for example, inspectors recommended the Embassy establish a foreign assistance coordinating group to get a mission-wide understanding of the scope of all U.S. assistance to the country. Inspections in Africa and Afghanistan have noted the same lack of clarity on total assistance to a country or region and inspection teams encourage the work of the Office of the Director of Foreign Assistance in leading a global effort to identify sources and amounts of assistance. Similarly, as functional bureaus continue to support transformational diplomacy by offering grants through embassies, several inspections have identified as a common problem the inadequate training of officers asked to manage grants. OIG recommended increased training for officers managing foreign assistance awards and for financial management officers certifying award payments. Inspection teams have also found missions are not always aware of ongoing assistance programs funded and managed by the functional bureaus.

Summary of Financial Statement Audit and Management Assurances

As described in this report's section called Departmental Governance, the Department tracks audit material weaknesses as well as other requirements of the Federal Manager's Financial Integrity Act of 1982 (FMFIA). Below is management's summary of these matters as required by OMB Circular A-136.

Summary of Financial Statement Audit

Audit Opinion: **Unqualified**

Restatement: **No**

MATERIAL WEAKNESSES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
Management of Unliquidated Obligations	1	0	1	0	0	0
Accounting for Personal Property	1	0	1	0	0	0
Total Material Weaknesses	**2**	**0**	**2**	**0**	**0**	**0**

Summary of Management Assurances

	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING (FMFIA § 2)						
Statement of Assurance:	Unqualified					
MATERIAL WEAKNESS	Management of Unliquidated Obligations					
Total Material Weaknesses	1	0	1	0	0	0
EFFECTIVENESS OF INTERNAL CONTROL OVER OPERATIONS (FMFIA § 2)						
Statement of Assurance:	Unqualified					
MATERIAL WEAKNESS	Management of Unliquidated Obligations					
Total Material Weaknesses	1	0	1	0	0	0
CONFORMANCE WITH FINANCIAL MANAGEMENT SYSTEM REQUIREMENTS (FMFIA § 4)						
Statement of Assurance:	Systems conform to financial system management requirements					
Total Non-conformances	1	0	1	0	0	0

	AGENCY	AUDITOR
COMPLIANCE WITH FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA)		
Overall Substantial Compliance	Yes	No
1. System Requirements	Yes	No
2. Accounting Standards	Yes	Yes
3. USSGL at Transaction Level	Yes	Yes

DEFINITION OF TERMS

Beginning Balance: The beginning balance shall agree with the ending balance of material weaknesses from the prior year.

New: the total number of material weaknesses that have been identified during the current year.

Resolved: The total number of material weaknesses that have dropped below the level of materiality in the current year.

Consolidation: The combining of two or more findings.

Reassessed: The removal of any finding not attributable to corrective actions (e.g., management has re-evaluated and determined a material weakness does not meet the criteria for materiality or is redefined as more correctly classified under another heading (e.g., section 2 to a section 4 and vice versa).

Ending Balance: The agency's year-end balance.

Financial Performance Metrics

The Department, along with other USG agencies, submits various data to the Federal Interagency Database Online at www.fido.gov. Included there is the Metric Tracking System (MTS), a performance measurement system that captures key financial management indicators across the Federal Government. The tool's intent is to provide government managers, Congress, and other stakeholders the information to assess the financial management health of the Federal Government as a whole and for each individual agency. Tracking performance on indicators helps to guide financial management reforms and targets resources to areas where better stewardship of Federal financial resources is needed.

Agency data is published and compared monthly within MTS by the government-wide CFO Council and is available at *www.fido.gov/mts/cfo*.

In FY 2008, the Department's rating did not change in five of the nine categories, but fell to red or yellow in four others. We equal the government-wide rating in four categories and rank below the average in five categories.

Measure and Frequency	Why Is It Important	State Sept 2008		State Sept 2007		Governmentwide Performance Standards			Governmentwide May 2008	
		Actual	Rating	Actual	Rating	Fully Successful	Minimally Successful	Unsuccessful	Actual	Rating
Fund Balance With Treasury - Net Percent Unreconciled [Monthly]	Smaller reconciliation differences translate to greater integrity of financial reports and budget results.	0.30%		1%		< = 2%	> 2% to < = 10%	> 10%	0.09%	
Percent of Amount in Suspense (Absolute) Greater than 60 Days Old [Quarterly]	Timely reconciliation supports clean audits and accurate financial information.	36%		15%		< = 10%	> 10% to < = 20%	> 20%	18%	
Percent of Accounts Receivable from Public Delinquent Over 180 Days [Quarterly]	Actively collecting debt improves management accountability and reduces Treasury borrowing.	32%		53%		< = 10%	> 10% to < = 20%	> 20%	15%	
Percent of Vendor Payments made Electronically [Monthly]	Use of electronic funds transfer saves money, reduces paperwork, and improves cash management.	91%		97%		> = 96%	> = 90% to < 96%	< 90%	97%	
Percent Non-Credit Card Invoices Paid On-Time [Monthly]	Timely payment reduces interest charges and reflects a high degree of accountability and integrity.	81%		84%		> = 98%	> = 97% to < 98%	< 97%	98%	
Interest paid under Prompt Payment Act ($ Interest per Million Dollars of Payments)	Smaller amounts of interest paid per million show that an agency is paying its bills on time which saves money and allows funds to be used for their intended purpose.	$653 per million		N/A indica-tor was changed		< = $200.00	> $200.01 to $300.00	> $300.01	$121 per million	
Travel Card Delinquency Rates - Individually Billed Accounts [Monthly]	Reducing outstanding travel card balances helps increase rebates to agencies.	2%		2%		> = 2%	> 2% to < = 4%	> 4%	3%	
Travel Card Delinquency Rates - Centrally Billed Account [Monthly]	Reducing outstanding travel card balances helps increase rebates to agencies.	2%		0.0%		>= 0%	> 0% to < = 1.5%	> 1.5%	4%	
Purchase Card Delinquency Rate [Monthly]	Reducing outstanding purchase card balances helps increase rebates to agencies and reduces interest payments.	0.20%		0.1%		>= 0%	> 0% to < = 1.5%	> 1.5%	1%	

When Senator Edward Kennedy met with world leaders this past year, he had a Foreign Service officer nearby. When House Armed Services Committee Chairman Ike Skelton held a hearing this spring on cooperation between the Departments of State and Defense, a foreign service officer was there, prepared to give support and advice. When Senator Chuck Hagel took a hard look at the Balkans, he turned to a foreign service officer on his staff. Who are these FSOs and why are members of Congress turning to them for advice? They are Pearson Fellows, selected from the ranks of the Department of State worldwide FSOs and assigned to a House or Senate office, committee or commission, typically for a year.

The program gives Congress a foreign policy perspective and international expertise while the Department benefits through improved communication with and understanding of Congress. Similar programs are sponsored by the American Political Science Association, and by the Brookings Institution for federal civil service employees. Each of these programs assists in our mission of achieving our foreign policy goals. *Department of State/State Magazine*

~from an article by Andrew Hyde and Deby Jones, Pearsons Fellows, appearing in State Magazine, September, 2008.

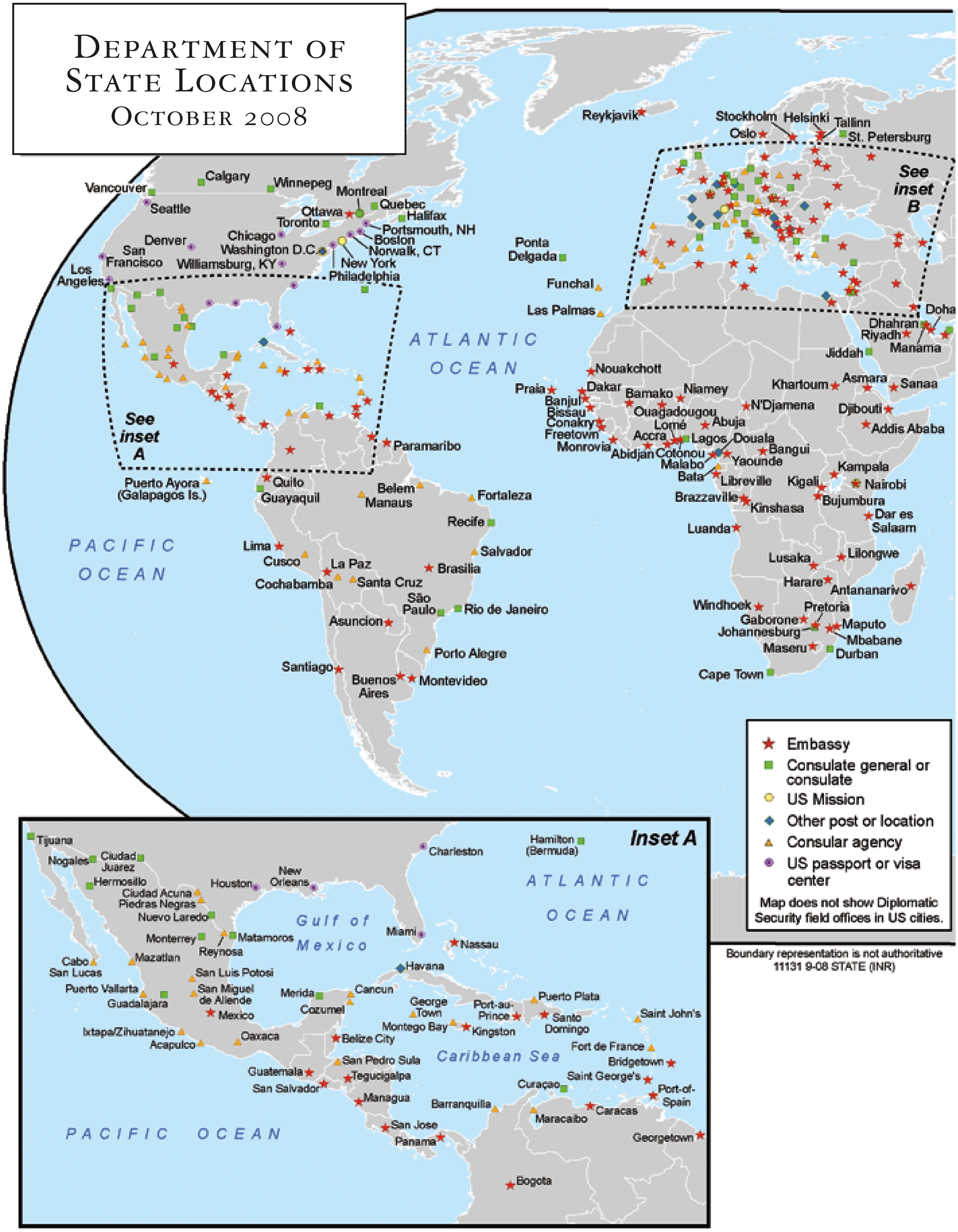
Appendices

Distinguished African Americans at the Department of State

2002 2003 2004 2005 2006 2007 2008

2005 ***First African American woman Secretary of State***
Condoleezza Rice
First African American woman to become Secretary of State, appointed by President George Bush.

2007 ***First African American Civil Service employee to serve as a U.S. Ambassador***
Barry L. Wells
Barry L Wells is the first African American Civil Service employee to serve as a United States Ambassador. Before his December 2007 appointment as Ambassador to the Republic of The Gambia, Wells was named in February 2007, as the Department's first Chief Diversity Officer following a 17 year career at the Foreign Service Institute which culminated as Deputy Director.



Boundary representation is not authoritative
11131 9-08 STATE (INR)


Cities with multiple Department of State facilities
Brussels:
Embassy Brussels
US Mission to European Union
US Mission to NATO
Paris:
Embassy Paris
US Mission to OECD
US Mission to UNESCO
Montreal:
Consulate General Montreal
US Mission to ICAO
Nairobi:
Embassy Nairobi
US Mission to UNEP and Habitat
New York:
US Mission to UN
New York Passport Center
Portsmouth, NH:
National Passport Center
National Visa Center
Rome:
Embassy Rome
Embassy Holy See
US Mission to FAO
Vienna:
Embassy Vienna
US Mission to OSCE
US Mission to UNVIE
Washington, DC:
Department of State
US Mission to OAS
Washington Passport Agency
ARCTIC OCEAN
See inset B
Yekaterinburg
Astana
Ulaanbaatar
Bishkek
Almaty
Tashkent
Ashgabat
Dushanbe
Vladivostok
Shenyang
Sapporo
Beijing
Seoul
Busan
Tokyo
Fukuoka
Nagoya
Osaka-Kobe
Kabul
Peshawar
Islamabad
Lahore
Chengdu
Shanghai
New Delhi
Kathmandu
Naha (Okinawa)
Dubai
Abu Dhabi
Muscat
Karachi
Dhaka
Calcutta
Guangzhou
Chiang Mai
Hanoi
Hong Kong
Honolulu
Mumbai (Bombay)
Vientiane
Sanaa
Rangoon
Manila
Chennai (Madras)
Bangkok
Phnom Penh
Ho Chi Minh City
Cebu
Colombo
Koror
Kolonia
Majuro
Kuala Lumpur
Bandar Seri Begawan
Medan
Singapore
PACIFIC OCEAN
Jakarta
Surabaya
Bali (Denpasar)
Dili
Port Moresby
Honiara
Apia
Papeete (Tahiti)
Suva
Antananarivo
Port Louis
INDIAN OCEAN
Perth
Canberra
Sydney
Melbourne
Auckland
Wellington
Inset B
Riga
Moscow
Edinburgh
Copenhagen
Vilnius
Belfast
Bremen
Minsk
Dublin
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Podgorica
Holy See
Skopje
Tbilisi
Barcelona
Tirana
Istanbul
Madrid
Naples
Thessaloniki
Ankara
Yerevan
Baku
Lisbon
Valencia
Palma de Mallorca
Izmir
Sevilla
Fuengirola (Malaga)
Palermo
Athens
Adana
Algiers
Tunis
Mosul
Valetta
Nicosia
Kirkuk
Rabat
Casablanca
Mediterranean Sea
Beirut
Damascus
Baghdad
Haifa
Tripoli
Tel Aviv
Amman
Al Hillah
Alexandria
Jerusalem
Al Basrah
Cairo
Kuwait

Glossary of Acronyms

AFR	Agency Financial Report
Appendix A	(Refers to) OMB Circular A-136, Appendix A
CFO	Chief Financial Officer
CSRS	Civil Service Retirement System
DOS	U.S. Department of State
EFT	Electronic Funds Transfer
ESCM	Embassy Security, Construction, Maintenance Appropriation
FAA	Federal Aviation Agency
FASAB	Federal Accounting Standards Advisory Board
FECA	Federal Employees Compensation Act
FEGLIP	Federal Employees Life Insurance Program
FEHB	Federal Employees Health Benefits Program
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FISMA	Federal Information Security Act
FMFIA	Federal Managers' Financial Integrity Act
FSC	Financial Services Center
FSN	Foreign Service Nationals
FSNDCF	Foreign Service National Defined Contributions Retirement Fund
FSO	Foreign Service Officer
FSRDF	Foreign Service Retirement and Disability Fund
FSRDS	Foreign Service Retirement and Disability System
FSPS	Foreign Service Pension System
FTE	Full-Time Employee
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GFMS	Global Financial Management System
GFS	Global Financial Services
GMRA	Government Management Reform Act
GPRA	Government Performance and Results Act
HHS	Department of Health and Human Services
HR	Bureau of Human Resources (DoS)
IBWC	International Boundary and Water Commission
ICASS	International Cooperative Administrative Support Services (DoS)
IG	Inspector General
IIP	Bureau of International Information Programs (DoS)
INL	Bureau of International Narcotics and Law Enforcement Affairs (DoS)
IPIA	Improper Payments Information Act
IT	Information Technology
JAMS	Joint Assistance Management System
OBO	Overseas Building Operations
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
P&F	Program and Financing Schedule
PART	Program Assessment Rating Tool
PEPFAR	President's Emergency Plan for AIDS Relief
PMA	President's Management Agenda
PMS	Payment Management System (HHS)
PP&E	Property, Plant and Equipment
PSC	Personal Service Contractor
PSU	Post Support Unit
RM	Bureau of Resource Management (DoS)
RSI	Required Supplementary Information
SAT	Senior Assessment Team (FMFIA)
S/CRS	Office of the Coordinator for Reconstruction and Stabilization (DoS)
SFFAS	Statements of Federal Financial Accounting Standards
UDO	Undelivered Orders
UN	United Nations
USAID	United States Agency of International Development
USG	U.S. Government
WCF	Working Capital Fund

ACKNOWLEDGMENTS

This Agency Financial Report (AFR) was produced with the energies and talents of Department of State staff in Washington, D.C. and our offices and posts around the world. We offer our sincerest thanks and acknowledgement. In particular, we recognize the following individuals and organizations for their contributions:

Office of the Deputy Chief Financial Officer:

Chris Flaggs, Deputy Chief Financial Officer.

Timothy Macdonald, Managing Director of Financial Policy, Reporting & Analysis.

Barbara Clark, AFR Editor.

Silvie Ao, Anthony Berini, Nadine Bradley, Steven Chu, Melissa Clark, Carole Clay, Melinda DeCorte, Tynesha Douglass, Nancy Durham, Dominique Foster, Carol Gower, Michelle Green, Kenny Johnson, Matt Johnson, Ola Kabazzi, Yen Le, Jeffrey Long, Dori Perry, Frank Rosado, Troy Scaptura, Meredith Shears, Nora Smith, Mark Terman, Lisa Wyffels, Sam Yang, Jennifer Yount.

Office of Strategic and Performance Planning:

Yaro Kulchyckyj, Vira David.

Global Financial Services *personnel in Charleston, Bangkok, Paris and Washington, D.C.*

We would also like to acknowledge the Office of Inspector General for their objective review of the Department's performance and Leonard J. Birnbaum and Company for the professional manner in which they conducted the audit of the FY 2008 financial statements.

We offer special thanks to our designers, Michael James, Sheri Beauregard and Don James.

FY 2008 PHOTO CREDITS

Associated Press: *Pages 12, 13, 14, 16*

Department of State: *Pages 12, 29, 15, 30, 45, 55, 66, 79, 81, 87, 101, 109; State/OBO: Pages 54, 73, 83, 94, 100; State Magazine: Pages 74, 108*

AFP Photo: *Pages 1, 7, 23, 27, 57, 85*

The *Agency Financial Report for Fiscal Year 2008* is published by the

U.S. Department of State

Bureau of Resource Management
Office of Financial Policy, Reporting and Analysis

An electronic version is available on the World Wide Web at

http://www.state.gov/s/d/rm/rls/perfrpt/

Please call (202) 261-8620 with comments, suggestions, or requests.

U.S. Department of State Publication

Bureau of Public Affairs
December 2008

Note: The Bureau of Public Affairs, Office of Electronic Information (PA/EI) assisted the Bureau of Resource Management with the production of the *FY 2008 Agency Financial Report*, including photos from AP/Wide World.

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