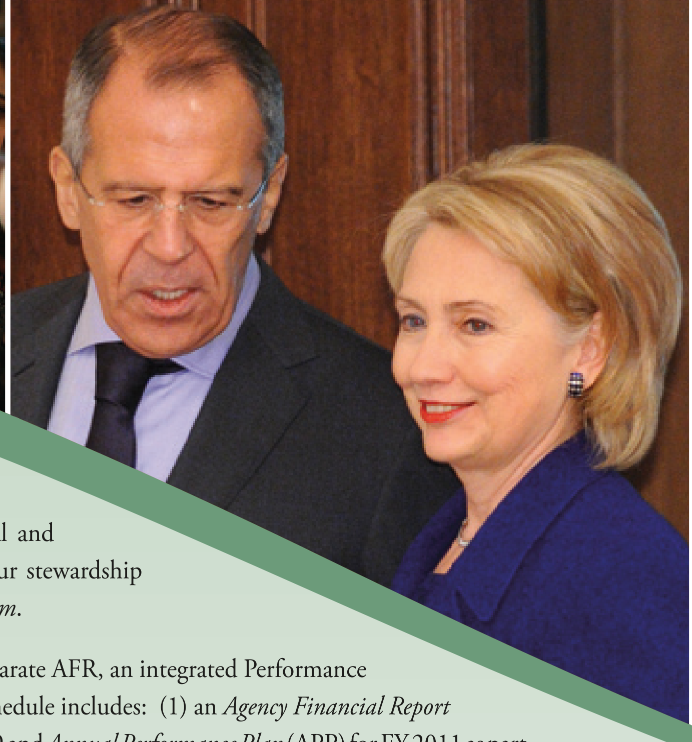
A NEW ERA OF ENGAGEMENT...

AGENCY FINANCIAL REPORT
FISCAL YEAR 2009
UNITED STATES DEPARTMENT OF STATE



ABOUT THIS REPORT

The United States Department of State's *Agency Financial Report* (AFR) for Fiscal Year (FY) 2009 provides an overview of the Department's financial and performance data to help Congress, the President and the public assess our stewardship over the resources entrusted to us. See *www.state.gov/s/d/rm/rls/perfrpt/2009/index.htm*.

The AFR is the first of a series of three reports for agencies choosing to produce a separate AFR, an integrated Performance Budget, and Summary of Performance and Financial information. The reporting schedule includes: (1) an *Agency Financial Report* issued in December 2009; (2) a complete agency *Annual Performance Report* for FY 2009 and *Annual Performance Plan* (APP) for FY 2011 as part of the FY 2011 *Congressional Budget Justification* (CBJ), State's budget request to Congress, in February 2010; and (3) a *Summary of Performance and Financial Information* to be released in February 2010. The last report will be produced jointly with the U.S. Agency for International Development (USAID).

We hope these reports provide a succinct and easily understood analysis of citizens' resources invested to conduct U.S. foreign policy so the reader can better understand the successes and challenges in implementing programs that pursue our country's foreign policy agenda.

All reports are available online at *http://www.state.gov/s/d/rm/c6113.htm.*

FY 2009 HIGHLIGHTS

(Dollars in Millions)	Percent Change 2009 over 2008	2009	2008 (Restated)	2007	2006
Balance Sheet Totals as of September 30					
Total Assets	+16%	$ 59,855	$ 51,717	$ 45,234	$ 39,958
Total Liabilities	+7%	22,482	21,102	19,894	17,893
Total Net Position	+22%	37,373	30,615	25,340	22,065
Results of Operations for the Year Ended September 30					
Total Net Cost of Operations	+22%	$ 21,613	$ 17,753	$ 13,636	$ 12,493
Budgetary Resources for the Year Ended September 30					
Total Budgetary Resources	+29%	$ 50,138	$ 38,825	$ 31,511	$ 26,433
Full-time, permanent employees in the Foreign Service	+6%	12,258	11,582	11,467	11,397
Full-time, permanent employees in the Civil Service	+3%	9,614	9,291	8,784	8,189
Full-time Foreign Service Nationals	-11%	6,010	6,736	7,802	8,270
Number of Passports Issued *(including passport cards 2009 and 2008)*	-17%	13.5 million	16.2 million	18.4 million	12.1 million

ABOUT THE COVER

Secretary of State Clinton met with Palestinian students in the West Bank city of Ramallah in March 2009. The Department of State has funded the English Access Microscholarship program for disadvantaged students there and in over 50 other countries since 2004. The program provides English language instruction and future prospects for these students with an American-style classroom experience that boosts skills and self-confidence. The program is run by the Office of English Language Programs of the Bureau of Educational and Cultural Affairs. *See www.exchanges.state.gov/englishteaching.* AP Image

Table of Contents

Images featured in Table of Contents are credited on the inside back cover

Message from the Secretary

It is my pleasure to present the U.S. Department of State's Agency Financial Report for Fiscal Year 2009. In these pages, you will find financial and performance information—a reflection of our commitment to pursue America's foreign policy goals while practicing fiscal responsibility. We take seriously our duty to spend taxpayer dollars effectively, invest in our nation's long-term success, and make our work transparent to Congress and the American people.

Today, the United States is facing a complex array of challenges, including our ongoing efforts to disrupt, dismantle, and defeat Al Qaeda and the Taliban; support long-term stability and prosperity in Iraq; create the conditions for peace in regions of the world torn apart by war; address the threat of climate change; fight pandemic disease and extreme poverty; and prevent the proliferation of nuclear weapons.

On their own, each of these challenges is significant. Together, they represent an urgent and extraordinary undertaking—one that demands the highest levels of talent, expertise, commitment, and coordination among our diplomats and our development experts around the globe.

We are called to generate fresh thinking about how to align the efforts of the State Department and USAID, to ensure that we develop and implement effective programs and expend our resources efficiently, both in the short- and long-term. This requires tracking our performance, measuring results, making them transparent, and holding ourselves accountable both when we succeed and when we fall short. We also seek to strengthen critical relationships by building robust partnerships and stronger institutions throughout the U.S. government and by engaging directly with people and organizations around the world.

All our work begins with maintaining the safety of our people. This year, the State Department completed seven new facilities and moved nearly 1,500 people into safer work environments. We also improved our efforts to safeguard the personal identifiable information of U.S. citizens worldwide through increased cooperation with other U.S. government agencies, including the Department of Veterans Affairs, the Social Security Administration, and the Department of Homeland Security.

To improve the overall efforts of State and USAID, this year I launched the first Quadrennial Diplomacy and Development Review (QDDR), a comprehensive review of our diplomacy and development tools and institutions, with the goal of making them more agile, responsive, and complementary. The QDDR will pursue long-term results by focusing on five strategic areas: building a global architecture of cooperation; leading and supporting whole-of-government solutions; investing in the building blocks of stronger societies; preventing and responding to crises and conflicts; and building operational and resource platforms for success. The progress we make in these five areas will have a major impact on our long-term success in achieving stability, prosperity, and opportunity around the world.

The State Department continues to take steps to improve our financial management. To that end, this Agency Financial Report includes several key documents: the CFO Message discussing our financial achievements and our audit challenges, principal financial statements and notes, along with a high-level discussion of performance information in the Management's Discussion and Analysis; the Independent Auditor's Report, including reports on internal controls and compliance with laws and regulations; and Management's Response to the Auditor's Report, as well as challenges identified by our Inspector General. We are working with our new independent auditor to ensure that the financial and summary performance data included in this Agency Financial Report are complete and reliable in accordance with the guidance from the Office of Management and Budget. By February 2010, performance information will be available and integrated within the Congressional Budget Justification, along with a joint State/USAID Summary of Performance and Financial Information Report available on our website, *www.state.gov*.

As always, I am proud to represent the State Department's thousands of employees, including both American and Foreign Service Nationals, serving at more than 260 posts worldwide. I look forward to continuing to serve alongside them as we work together to express America's values, advance America's interests, and help build a world in which all people have the chance to live healthy, peaceful lives and make the most of their God-given potential.

Hillary Rodham Clinton

Secretary of State

December 15, 2009

Secretary of State Hillary Rodham Clinton speaks at the Department of State Diplomatic Reception Room in Washington, D.C. on January 22, 2009, as (L to R) Richard Holbrooke, Special Envoy to Afghanistan and Pakistan, President Barack Obama, Vice President Joe Biden and George Mitchell, Special Envoy to the Middle East look on. AFP image

UNITED STATES DEPARTMENT OF STATE

Approved by S/ES May 2009

Management's Discussion and Analysis

About the Department

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 Organization

In the business of diplomacy and development, people are critical. The success of the Department of State and the USAID is directly tied to the creativity, knowledge, skills, and integrity of our dedicated employees. Their attitudes and actions determine whether or not they will move the world in the direction of building a world of economic stability and prosperity, clean and affordable energy, healthcare, housing, and education for a better future.

The Department is the lead institution for the conduct of American diplomacy. The Department 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, the Bureau of International Narcotics and Law Enforcement 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.

Additionally, to address the complex array of challenges we face, in FY 2009 the following Special Envoys/Representative Offices were created:

- Special Envoy to the Middle East Peace Process
- Special Representative for Afghanistan and Pakistan
- Special Envoy for Climate Change
- Special Representative for North Korea Policy
- Special Envoy for Eurasian Energy
- Special Envoy for Guantanamo Closing
- Special Presidential Envoy for Sudan
- Special Representative for Global Partnerships

- Special Advisor for Nonproliferation and Arms Control
- Special Representative to Muslim Communities
- Coordinator for International Energy Affairs
- Office of the Economic Envoy to Northern Ireland

Special Envoys are personally designated by the Office of the Secretary and are appointed to address a particular issue or *ad hoc* situation.

The Department's organizational chart appears on page 4.

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.

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.

The passport process is often the only contact most U.S. citizens have with the Department. There are 17 domestic passport agencies and 6,000 passport acceptance facilities nationwide. In 2009, the Department opened five new U.S. Passport and/or Visa Centers: Dallas, Texas; Hot Springs, Arkansas; Tucson, Arizona; Detroit, Michigan; and Minneapolis, Minnesota. Moreover, the Department opened one branch office in Cartagena, Columbia and two Consulates general, one in Hyderabad, India and one in Wuhan, China, and closed one American Presence Post in Lille, France.

The Department also operates several other types of offices 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. The map on pages 10-11 details the Departmental locations around the world.

Additionally, the Department is now exploiting the wide variety of technological tools to enhance its effectiveness and magnify its efficiency. Many offices increasingly rely on digital videoconferences, virtual presence posts, and websites to support their missions. The list of websites utilized at the Department includes several social networking web tools such as Facebook, Twitter, YouTube, and blog sites, which are leveraged to engage in dialogue with broader audiences.

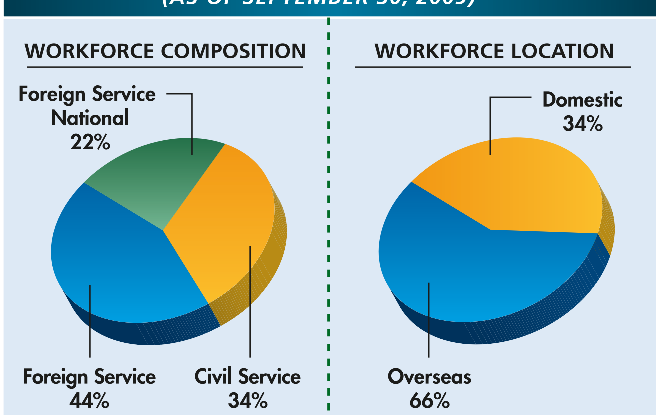
Our People

The Foreign Service and Civil Service officers and staff 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 more than 12,000 officers who 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, yet also 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 and management area – from democracy and human rights to narcotics control, trade, and environmental issues. Civil Service employees also serve as the domestic counterpart to Foreign Service consular officers who issue passports and assist U.S. citizens overseas.

Foreign Service National (host country) FSN and other Locally Employed (LE) Staff contribute to advancing the work of the Department overseas. Both FSNs and other LE Staff contribute local expertise and provide continuity as they work with their American colleagues to perform vital services for U.S. citizens. In recent years, as staff leave, new employees are hired using Personal Service Agreements (PSA) reducing the number of direct-hire appointments.

FULL-TIME PERMANENT EMPLOYEES
(AS OF SEPTEMBER 30, 2009)



Secretary of State Clinton during an interview in Indonesia on February 20, 2009. Department of State

SMART POWER

The Obama Administration recognizes that the United States and the world face great perils and urgent foreign policy challenges including ongoing wars and regional conflicts, the global economic crisis, terrorism, weapons of mass destruction, climate change, worldwide poverty, food insecurity, and pandemic disease. Military force may sometimes be necessary to protect our people and our interests. But diplomacy and development will be equally important in creating conditions for a peaceful, stable and prosperous world. That is the essence of smart power – using all the tools at our disposal. Smart power requires reaching out to both friends and adversaries, bolstering old alliances and forging new ones. Even if we disagree with some governments, America shares a bond of common humanity with the people of every nation, and we will work to invest in that common humanity.

> *"We must use what has been called smart power: the full range of tools at our disposal – diplomatic, economic, military, political, legal, and cultural – picking the right tool, or combination of tools, for each situation."*
>
> — Secretary of State Hillary Rodham Clinton

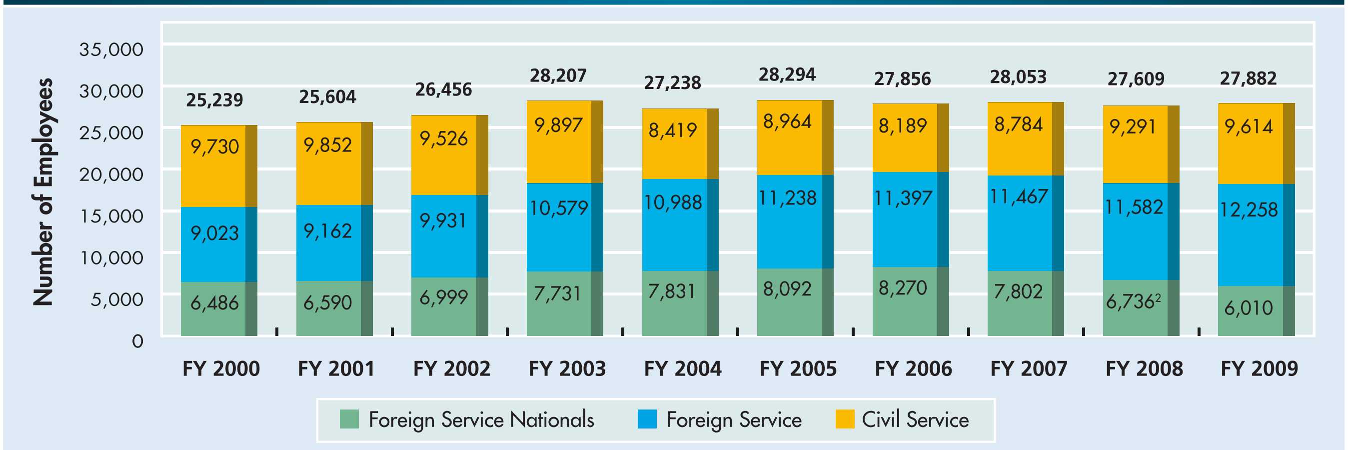
Deputy Secretary James Steinberg (L), French counterpart Bernard Kouchner and Russian Foreign Minister Sergey Lavrov (R) spoke to the press in Athens, Greece. AFP Image

EMPLOYEE COMPOSITION AND NUMBERS

The pie charts on page 7 show the distribution of the Department's workforce by employment category, as well as what proportion of the workforce is located overseas. At the close of FY 2009, the Department was comprised of 27,882 full-time employees with no substantial increase during the 2009 fiscal year.

The Department has many hard–to-fill positions vacant overseas and faces an ongoing challenge of ensuring it has the right people, with the right skills, in the right places to accomplish priority tasks. The Department faces persistent shortages of staff with critical language skills, despite the importance of foreign language proficiency in advancing U.S. foreign policy and economic interests overseas. The U.S. Government Accountability Office (GAO) reported in 2009 that the Department had not undertaken these initiatives in a comprehensive and strategic manner. As a result, per GAO, it is unclear when the staffing and skill gaps at risk will close. The Department is in the first year of an ambitious, multi-year hiring program entitled *Diplomacy 3.0* to ensure the front lines of diplomacy are adequately staffed. See page 9 for more information.

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] As full-time employee Foreign Service Nationals leave, new employees for these positions are being hired through Personal Service Agreements (PSA) reducing the number of direct-hire appointments.

DEPARTMENT OF STATE RANKS AMONG TOP FIVE BEST PLACES TO WORK IN 2009

The Department of State placed fifth among the 30 large Federal agencies, up from sixth place in 2007 in ranking based on the U.S. Office of Personnel Management's biannual Federal Human Capital Survey of over 200,000 executive branch employees in over 250 federal organizations.

Best Places to Work is the most comprehensive ranking of federal government organizations on overall employee engagement, as well as in ten workplace dimensions. The rankings are designed to offer job seekers insight into the best opportunities for public service and to provide managers and government leaders a roadmap for improving employee engagement and commitment.

It is worth noting that out of 30 large agencies, the Department of State ranked third on support for diversity; third on effective leadership; third on performance based rewards and advancement; and third on teamwork.

To view the rankings and analyses of the results, please visit *www.bestplacestowork.org*.

The Best Places to Work in the Federal Government ranking is conducted by The Partnership for Public Service and American University's Institute for the Study of Public Policy Implementation.

Secretary of State Clinton and Defense Secretary Robert Gates discuss "the reach and limitations of American power and how the U.S. can most effectively use this power" at George Washington University, Washington, DC. *AFP Image*

CIVILIAN CAPACITY

Diplomacy 3.0

"Diplomacy 3.0" represents the three essential pillars of U.S. foreign policy: diplomacy, development, and defense. With Diplomacy 3.0, we are building diplomatic readiness, ensuring that diplomacy is again ready and able to address our nation's growing and increasingly complex foreign policy challenges. To meet our expanding mission, we need Foreign Service personnel prepared to engage on a growing list of complex global issues from stabilization and reconstruction, to terrorism and international crime, to nuclear nonproliferation and the environment. Our diplomats also must be prepared to engage foreign audiences directly in their own languages, languages that may well require two or more years of study. To meet these needs, Secretary Clinton envisions a multi-year hiring plan that increases the Department's Foreign Service by 25 percent. Meeting an expanding mission and properly staffing overseas posts, many of which are either difficult or dangerous, requires more personnel trained in the various skills demanded of the 21st Century's *smart* diplomacy.

We seek to find and attract a talented, diverse pool of candidates with the skills that we need. Along with Washington-based recruiters, we recruit via our "Diplomats in Residence" program located on university campuses around the country, various intern programs, social and career networking media, and recruitment events organized by partner organizations.

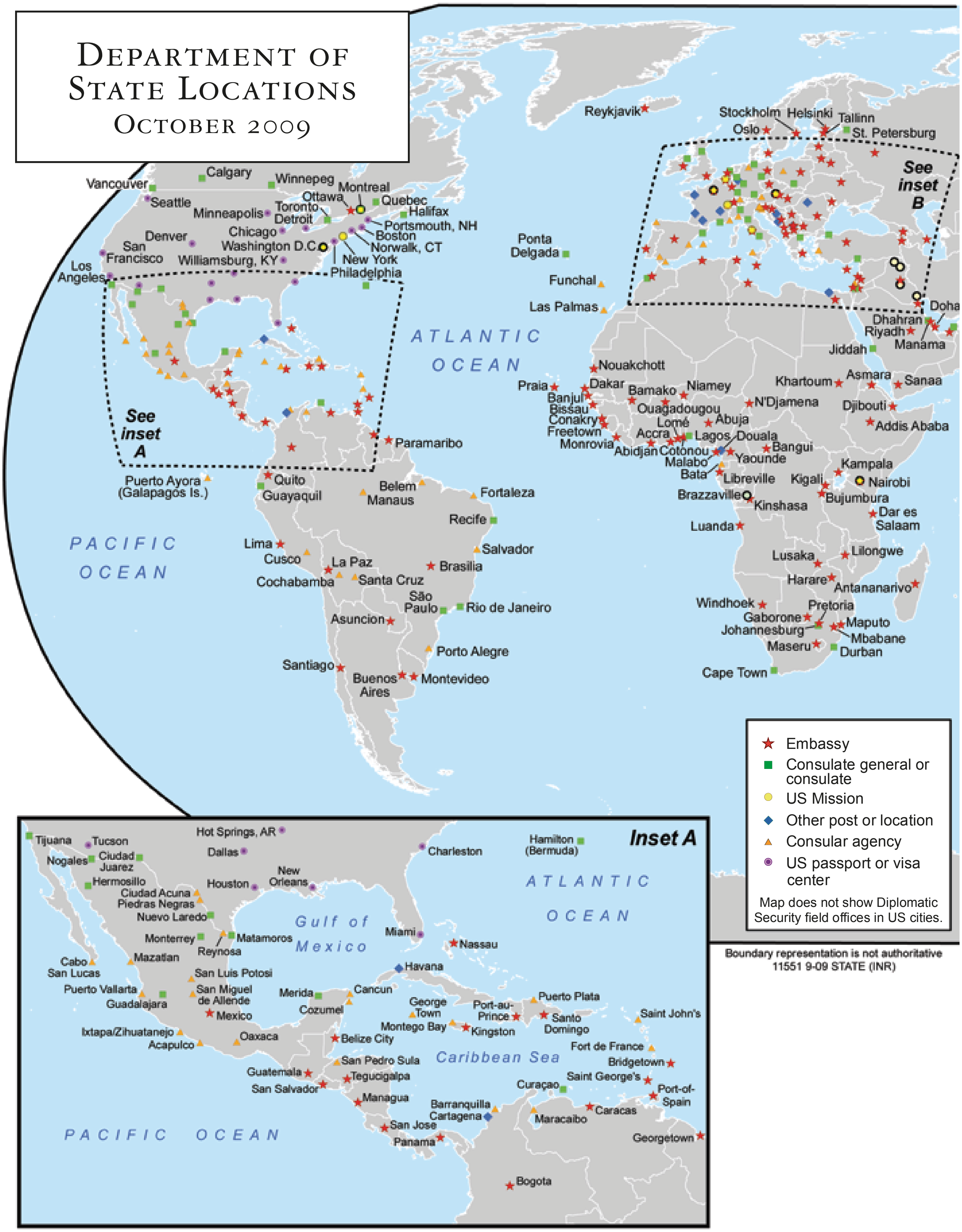
Deputy Secretary of State for Management and Resources Jacob Lew, News Anchor Judy Woodruff, Department of State Director of Policy and Planning Anne-Marie Slaughter, and U.S. Agency for International Development (USAID) Acting Administrator Alonzo Fulgham at the first public dialogue on the Department's QDDR. *Department of State*

QUADRENNIAL DIPLOMACY AND DEVELOPMENT REVIEW (QDDR)

The challenges of the 21st century are increasingly unconventional and transnational, and demand a response that effectively integrates all aspects of American power. At the same time, this evolving global environment presents new opportunities for the United States leadership role. By using all the tools of American power, the United States can solve problems, seize opportunities, and pave the way for greater and more widely shared peace, progress, and prosperity. U.S. success in exercising effective global leadership depends upon a strong and well-equipped Department of State and USAID to develop and implement diplomatic and development solutions to key foreign policy challenges.

In July 2009, Secretary Clinton announced the Department of State's Quadrennial Diplomacy and Development Review (QDDR). The QDDR will provide the short-, medium-, and long-tem blueprint for our diplomatic and development efforts. The goal is to use this process to guide the United States to agile, responsive, and effective institutions of diplomacy and development, including how to transition from approaches no longer commensurate with current challenges; leveraging the full range of American policy tools and resources; measurably impacting global progress in security, prosperity, and well-being; preventing and responding to crises and conflict; and providing strong, flexible management platforms to support institutional objectives. The QDDR will, among other things, offer guidance on how State and USAID should update methodologies; deploy staff; add new tools and hone old ones; and exercise new or restored authorities. At base, it will begin to align policy, strategy, capabilities, authorities, and resources—human and financial—to ensure effective execution of solutions to national security priorities.

Department of State Locations
October 2009



Boundary representation is not authoritative
11551 9-09 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
PACIFIC OCEAN
INDIAN OCEAN
See inset B
Yekaterinburg
Astana
Ulaanbaatar
Bishkek
Almaty
Tashkent
Ashgabat
Dushanbe
Vladivostok
Shenyang
Sapporo
Beijing
Seoul
Busan
Fukuoka
Tokyo
Nagoya
Osaka-Kobe
Kabul
Peshawar
Islamabad
Lahore
New Delhi
Chengdu
Wuhan
Shanghai
Kathmandu
Dubai
Abu Dhabi
Muscat
Karachi
Dhaka
Calcutta
Guangzhou
Naha (Okinawa)
Chiang Mai
Hanoi
Hong Kong
Mumbai (Bombay)
Hyderabad
Rangoon
Vientiane
Honolulu
Sanaa
Manila
Chennai (Madras)
Bangkok
Phnom Penh
Ho Chi Minh City
Cebu
Colombo
Koror
Kolonia
Majuro
Kuala Lumpur
Bandar Seri Begawan
Medan
Singapore
Jakarta
Surabaya
Bali (Denpasar)
Dili
Port Moresby
Honiara
Apia
Suva
Papeete (Tahiti)
Antananarivo
Port Louis
Perth
Sydney
Canberra
Melbourne
Auckland
Wellington
Inset B
ATLANTIC OCEAN
Black Sea
Mediterranean Sea
Edinburgh
Belfast
Dublin
Copenhagen
Bremen
Amsterdam
Hamburg
The Hague
Berlin
London
Brussels
Dusseldorf
Bonn
Leipzig
Poznan
Warsaw
Riga
Vilnius
Minsk
Moscow
Luxembourg
Frankfurt am Main
Prague
Krakow
Kyiv
Rennes
Paris
Munich
Vienna
Bratislava
Strasbourg
Bern
Zurich
Salzburg
Budapest
Cluj-Napoca
Chisinau
Geneva
Trieste
Ljubljana
Zagreb
Lyon
Milan
Genoa
Venice
Banja Luka
Belgrade
Bucharest
Bordeaux
Nice
Toulouse
Marseille
A Coruña
Florence
Mostar
Sarajevo
Pristina
Sofia
Rome
Holy See
Podgorica
Skopje
Istanbul
Tbilisi
Baku
Barcelona
Naples
Tirana
Thessaloniki
Ankara
Yerevan
Madrid
Lisbon
Valencia
Palma de Mallorca
Izmir
Palermo
Athens
Sevilla
Fuengirola (Malaga)
Algiers
Tunis
Valetta
Adana
Mosul
Kirkuk
Nicosia
Rabat
Casablanca
Tripoli
Beirut
Damascus
Haifa
Tel Aviv
Amman
Jerusalem
Baghdad
Al Hillah
Al Basrah
Kuwait
Alexandria
Cairo

Performance at the Department of State

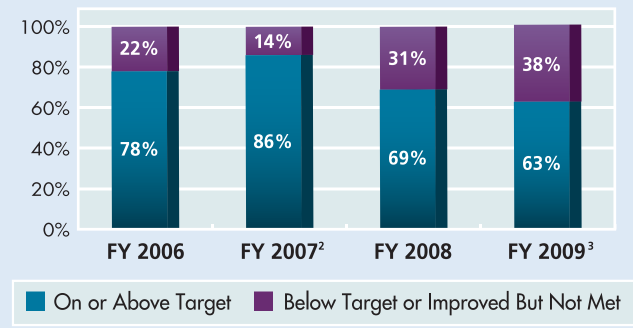
The Department of State has focused on building a culture of planning and results across the agency and the government. Since the passage of the Government Performance and Results Act in 1993, requiring federal agencies to prepare strategic plans of agency goals, the Department has improved capacity and successfully transitioned performance focus from high-level, general goals to better defining and assessing the results of diplomatic efforts and assistance programs with specific goals. Since November 2007, the Department has had a Performance Improvement Officer (PIO) who oversees and reviews for greater effectiveness the strategic plans, annual performance plans and report, and the goals of the agency.

The Department and USAID work closely together to meet the global challenges of the 21st century through long-term and short-term planning and performance initiatives. The agencies manage long-term performance through the joint State-USAID strategic plan (JSP) and the Quadrennial Diplomacy and Development Review (QDDR). Both processes build the framework for effective integration of diplomacy and development and institutionalize an ethic of review, analysis, and responsiveness within the agencies. The two global performance planning processes draw support from the short-term planning and performance of the headquarters-based Bureaus and overseas Missions. At the Mission level, strategic planning enables each country team to execute a coordinated delivery of program services that emphasizes one integrated U.S. government effort.

Each year, the Department plans and organizes its foreign policy resources and efforts based on an annual assessment of progress towards achieving seven strategic goals. To measure progress towards these goals in FY 2009, an intra-agency working group selected performance indicators that best reflect U.S Government foreign policy priorities and major areas of investment.

Marked by increasing rigor and intensive engagement at multiple levels of the organization, the process for developing and selecting performance indicators changed significantly in FY 2009. The performance management team, on behalf of the Performance Improvement Officer, engaged Department bureaus in a widespread campaign to develop more outcome-oriented indicators, replacing qualitative with quantitative indicators when appropriate and improving overall indicator quality. When possible, these indicators were designed to show quantitatively the Department's progress on achieving its strategic goals and priorities.

Performance Ratings FY 2006-2009[1]



[1] *Data sources: 2006 - Performance and Accountability Report, Fiscal Year 2006; 2007 - Joint Highlights of Performance, Budget, and Financial Information, Fiscal Year 2007; 2008 - Citizens' Report, Fiscal Year 2008, Summary of Performance and Financial Results. Performance ratings calculated from performance data provided in Department reports at the time of publication. Indicator ratings for which result data were not yet available at the time of publication have been omitted.*

[2] *The Department of State and USAID jointly reported indicators in the FY 2007 Joint Highlights Report. As a result, 2007 indicator ratings featured in this chart include USAID indicators. All other years include only Department of State indicators.*

[3] *Fiscal Year 2009 data featured in this chart reflects only indicators for which data are currently available. The Department will report on Foreign Assistance indicators for programs managed by State and/or shared with USAID, along with the remaining State Operations indicators in the FY 2011 Foreign Operations Congressional Budget Justification and FY 2009 joint Summary of Performance and Financial Information report published in February 2010.*

Please note that the chart is not intended to show a trend line. While the shift to a set of more stable performance indicators will result in year-to-year comparability in the future, ratings shown in the bar chart include a set of indicators used for the first time in FY 2009. Therefore, there is limited ratings comparability from FY 2008 to 2009.

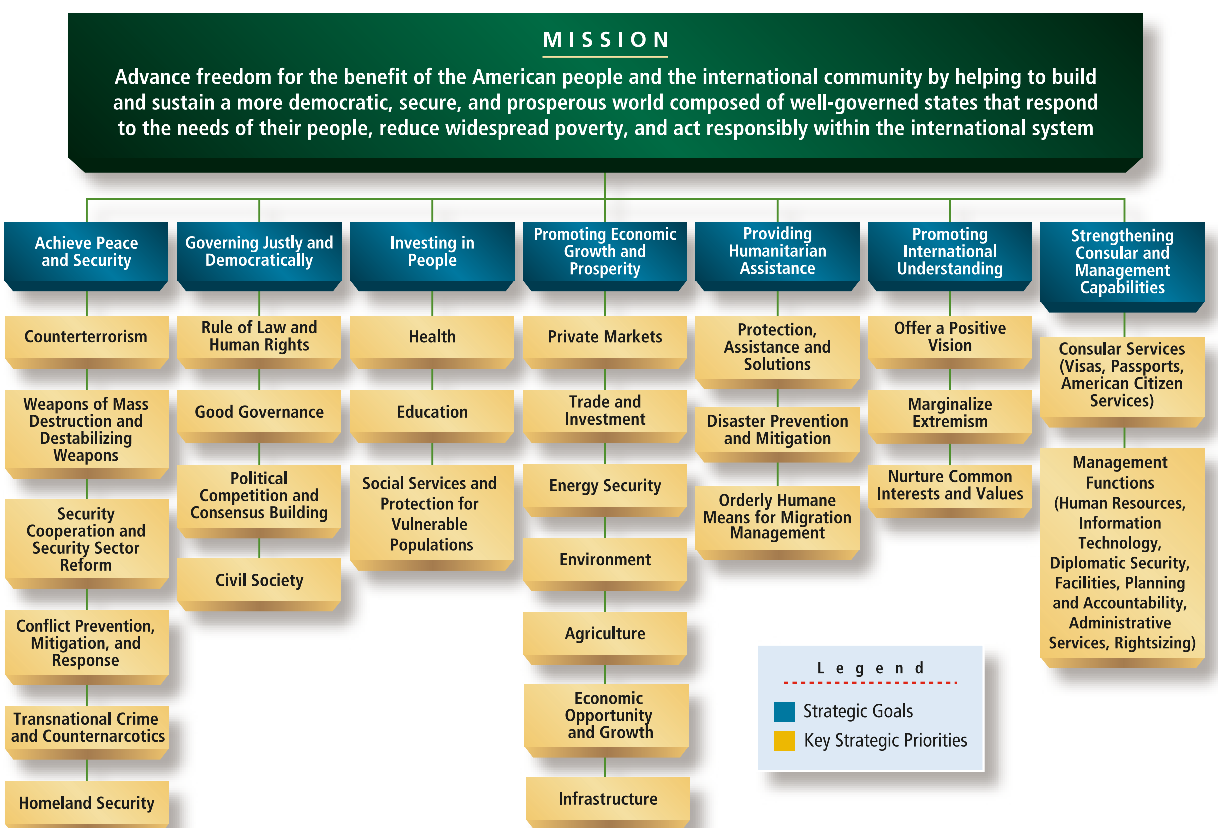
In addition, ratings are not yet available for new State Operations indicators for which targets have not yet been set. Furthermore, ratings for all Foreign Assistance indicators will not be available until data are reported. For this reason, indicators which did not have ratings at the time of publication are not included in the chart. The Department's FY 2009 Summary of Performance and Financial Information will feature a more complete set of performance information when it is released in February 2010.

Performance Summary and Highlights

Strategic Framework for Performance Management

The Department 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. Here, 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 and evaluation 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: achieve greater accountability of federal funds, align budget requests with demonstrated results, and make informed policy and management decisions based on reported results. The Department's performance management is guided by a high-level Joint Strategic Plan, shared by both the Department and USAID. The Department and USAID established a Joint Strategic Goal Framework organized by seven strategic goals and 39 strategic priorities. The Department's Annual Planning Cycle engages diplomatic missions and Washington-based bureaus in outcome-oriented planning activities that articulate policy and establish programmatic direction by country, region, strategic goal, and strategic priority. At all levels of annual performance planning, the Mission Strategic Plan (MSP), the Bureau Strategic Plan (BSP), and the Senior Policy, Performance and Resource Reviews ("Senior Reviews") integrate sustainable planning and budgeting leadership to enhance performance results. Further, missions and bureaus incorporate program evaluation as a best practice to determine the impact of our policies, understand better what is effective in our programs, and increase accountability to our stakeholders. The figure below depicts the goal framework that links the Department-wide goals to bureau and mission level goals and programs and performance information.



Using Performance to Achieve Results

At the Department we manage for results. We collect performance data and use this data to strategically focus the organization's efforts and improve governance. We monitor incremental progress and measure effectiveness through the collection and analysis of various performance indicators that link our activities to broader agency strategic goals and performance targets.

The Department uses performance management best practices to mitigate management challenges, benchmark program results, develop better data collection tools, comply with legislative requirements, and learn where to adjust course reflecting performance successes and short-comings. Applying *smart power* solutions will continue to improve the Department's ability to support resource requests with reliable data, proven efficiency, and program results.

The use of performance management is influential in many areas throughout the Department. The Department's senior leadership recognizes the importance of performance transparency and effective agency management. Our approach towards managing for results values the inclusion of other government entities, yielding a holistic, interagency scope of performance management. Additionally, performance information at the Department has advanced communication between and among other federal agencies invested in foreign affairs. Policy discussions, program collaborations, and resource management have been improved because of performance management and the Department's concentration on sound outcome measures.

Budgetary effects from performance management at the Department are most evident in building budget justifications; making decisions about the allocation, management, and monitoring of resources; reducing duplicative services; and increasing program cost-savings. The Department strives to make specific performance linkages between costs, activities, and results. In FY 2009, the Department increased analytical rigor in performance planning by focusing on outcome-oriented performance measures and resources at the strategic priority level, rather than at the broader strategic goal level, in order to better align performance with resource trends and strategic priorities. At the same time, the agency shifted to more quantitative measures of performance to increase validity and reliability of results. Finally, we increased focus on evidence-based policy decisions, linking investments in program evaluation with the Department's planning and performance management framework. We use performance information to clarify the effect of changes in funding distributions, understanding that the case for resources is more compelling when performance implications are transparent.

The Department has a visible organizational and leadership commitment to performance management. Performance management is one avenue the Department uses to build consensus around organizational vision and direction, to support prioritizing investments, to facilitate interagency planning and coordination, and to institutionalize a culture of accountability and transparency.

At the Program Evaluation Conference, Stephen Kester, Director of Evaluation at the Office of the Inspector General for Foreign Affairs and International Trade of Canada, speaks at the podium as panelists and Treasury Board of Canada staffers Anne Routhier and Brian Moo Sang listen at right.

State Magazine July/August 2009

Program Evaluation

A program evaluation is a systematic and objective assessment of an ongoing or completed project, program or policy using systematic collection and analysis of qualitative and quantitative information. As the Department seeks to increase resources, it must justify these needs by demonstrating effective use of its current resources, showing results that directly link to Department goals. As the need for greater accountability increases, so does the need for effective program and performance management tools that produce high-quality data. The Department recognizes evaluation as a key activity to systematically capture reliable data.

A robust, coordinated evaluation function is essential to the Department's ability to document program impact, identify best practices, assess return on investment, provide evidence for policy and planning decisions, and strengthen accountability to the American people. From an internal perspective, evaluations help program managers justify the Department's program and project resource requests. The Department's evaluation work is supported by legislation that states that federal agencies should report on the extent to which programs achieve stated goals and how effective programs are as compared to their cost. Evaluation supports the goal of aligning performance data with budget requests, so that resource decisions can be made based on program impact and results.

The Department's goal is to help managers understand how programs are working and provide them with tools to do so. The Department supports evaluation activities through workshops and conferences, works with USAID on joint evaluation guidelines and definitions, and requests bureaus to focus on program assessment related to strategic goals. In FY 2009, the Department worked with USAID and other evaluation partners to provide training to raise the importance of evaluation through a draft policy statement, and collect baseline evaluation information. Bureaus reported on foreign assistance and Department operations-funded evaluations in the Country Operational Plans and State Bureau Strategic Plans.

In addition to ongoing workshops, the Department hosted an international evaluation conference at which Deputy Secretary Lew spoke and Secretary Clinton provided a video message about the value of evaluation for affecting change in foreign

SECRETARY'S LIST OF CULTURALLY SIGNIFICANT PROPERTIES:

The American Center in Alexandria, Egypt reflects the city's rich cultural heritage and its cosmopolitan character. The former residence now houses the Thomas Jefferson Library and an American Cultural Center, enabling Egyptian citizens to borrow books, learn English and exchange views on regional and international issues. Although the U.S. Embassy closed its consulate in Alexandria in 1993 (the embassy is in Cairo), the center remains open to promote mutual understanding between the peoples of Egypt and the United States through a full range of programs.

The center was designed in Palladian Neo-Renaissance style by Architect Victor Erlanger in 1922 and purchased by the United States in 1962 to house the Library. Erlanger's design incorporates classical decorative elements into the square symmetrical house; downstairs rooms open onto a central hall with a marble staircase dividing into two separate flights.

Department of State/OBO

affairs. The conference also served as an exchange for ideas and best practices through panel discussions with Canadian and British government representatives. This allows the Department to better understand and assess more clearly the effects of policy or program outcomes. Data are collected and then assessed, and that assessment better informs decisions about program and performance management on a regular recurring basis. An outcome of this conference was the development of a draft Department policy on evaluation and an understanding that the Department is using evaluation to improve its performance-based budgeting.

In the next fiscal year, the Department will pursue these and other avenues to enhance existing activities and support bureaus in demonstrating program effectiveness.

DEPARTMENT OVERVIEW

Congress established the U.S. Department of State in 1789, replacing the Department of Foreign Affairs, which was established in 1781. The Department is the oldest and most senior executive agency of the federal government. Please visit *http://history.state.gov* and browse through the Department's renowned Foreign Relations of the United States series, explore the history of diplomatic relations country by country, and read biographies of famous diplomatic figures. The mission of the Department, working closely with the U.S. Agency for International Development (USAID), is to "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 responsibility within the international system." Both the current State/USAID Joint Strategic Plan for 2007-2012 and prior plans can be found at *http://www.state.gov/s/d/rm/rls/dosstrat/index.htm.*

LOOKING AHEAD AND ADDRESSING CHALLENGES

The United States and the world face great perils and urgent foreign policy challenges, including ongoing wars and regional conflicts, the global economic crisis, terrorism, weapons of mass destruction, climate change, worldwide poverty, food insecurity, and pandemic disease.

Multilateral institutions leverage greater global resources and complement bilateral assistance. The U.S. will invest in and encourage contributions to multilateral institutions. The U.S. is committed to working as part of a collaborative global effort centered around country-led processes to improve food security. The U.S. will work with other governments, multinational institutions, NGOs, private companies, and the poor themselves to reduce hunger sustainability, raise the incomes of the rural poor, and reduce the number of children suffering from under-nutrition.

In 2009, Secretary Clinton announced the Quadrennial Diplomacy and Development Review (QDDR), which is

U.S. President Barack Obama and Secretary of State Hillary Rodham Clinton address the employees of the Department of State in Washington, D.C. in January 2009. AFP Image both visionary and operational. The QDDR is the beginning of a longer-term process to institutionalize an ethic of review, analysis, and responsiveness within our diplomatic and development agencies. Five areas of strategic focus have been identified to address the essence of how the Department must modernize for 21st century challenges.

The Department will be disciplined in evaluating foreign policy choices; weighing the costs and consequences of our action or inaction; gauging the probability of success; and insisting on measurable results. Senior-level experts from the Department, USAID, and outside the government have developed the scope and design of an inclusive, analytical, rigorous review process. It is a comprehensive effort aimed at identifying the impact the Department desires to achieve in the changing global environment as well as the capabilities and mechanisms required to do so. The Department is making important progress in ensuring that public diplomacy is part of a total diplomatic effort.

The Department is addressing both the Office of the Inspector General's (OIG) management challenges and the Government Accountability Office's (GAO) recommendations. According to the OIG, the Department's greatest challenge is protecting people, facilities, and information. The Department has undertaken a vigorous program to replace overseas facilities

GREENING DIPLOMACY

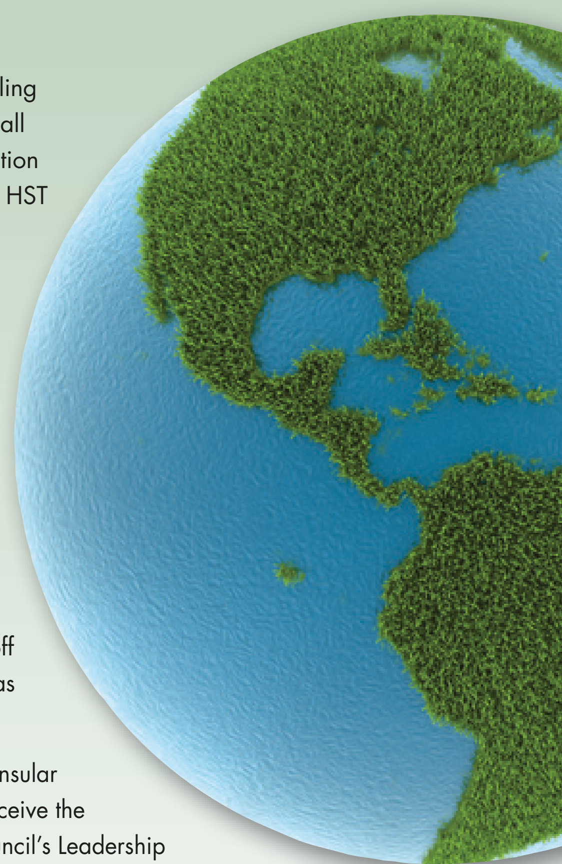
The United States and other countries that have been the biggest historic emitters of greenhouse gases should shoulder the biggest burden for cleaning up the environment and reducing our carbon footprint. On Earth Day, April 22, 2009, Secretary Clinton launched the Greening Diplomacy Initiative (GDI), a new commitment to lead by example, and improve the sustainability of the State Department's facilities and operations. The GDI will harness the Department's policy, management, and public diplomacy to advance our greening efforts and incorporate greening and sustainability into the Department's everyday operations.

Objectives:

- Develop and implement strategies that reduce the Department's carbon footprint.
- Empower employees to contribute to and participate in greening efforts.
- Leverage best practices internally and externally, and monitor progress of ongoing Department greening efforts.
- Connect the management of the Department with the work we do in diplomacy and development.

Greening in Action:

- There are now 104 solar panels located on the Department of State's main building, the Harry S Truman (HST) building roof.
- The HST building recycles nearly 250 tons of waste annually and on August 1, the cafeteria completely phased out styrofoam cups, trays, and dishes.
- The Department is recycling or reusing over 75% of all construction and demolition waste from the ongoing HST renovations.
- To help reduce energy costs and lower carbon dioxide emissions, the Department's Bureau of Information Resource Management currently has consolidation and virtualization efforts underway and continues to deploy desktop computers that operate off a central server, known as thin-clients.
- All new embassy and consular building projects must receive the U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED) certification.
- Members of the League of Green Embassies are working with both the Departments of State and Energy toward a goal of cutting energy usage at their embassies by 30 percent by 2015.



GLOBAL SECURITY

A New Course

The new course for U.S. nuclear weapons policy that President Obama set out in his April 5, 2009, Prague address has significantly realigned the top priorities for the United States and the Department. In his Prague speech, the President committed the United States to take concrete steps towards a world without nuclear weapons. He called for: (1) reducing the role of nuclear weapons in our national security strategy and urging others to do the same; (2) negotiating a new Strategic Arms Reduction Treaty with Russia and seeking the participation of all nuclear weapons states in follow-on reduction efforts; (3) pursuing U.S. ratification of the Comprehensive Nuclear Test-Ban Treaty (CTBT) and entry into force of the CTBT; and (4) seeking a new treaty that verifiably ends the production of fissile materials for nuclear weapons. He also committed that, as long as nuclear weapons exist, the United States will maintain a safe, secure, and effective arsenal to deter any adversary and to guarantee that defense to our allies.

Iraq

In 2009, the United States government announced a plan to responsibly end the war in Iraq. By the end of 2010 the U.S. combat mission in Iraq will end and Iraqi Security Forces will have full responsibility for major combat missions. After August 2010, the mission of United States forces in Iraq will fundamentally change. Our forces will have three tasks: train, equip, and advise the Iraqi Security Forces; conduct targeted counterterrorism operations; and provide force protection for military and civilian personnel. The President intends to keep the U.S. commitment under the Status of Forces Agreement to remove all U.S. troops from Iraq by the end of 2011.

Secretary of State Hillary Rodham Clinton with members of the Office of Military Cooperation Kuwait prior to boarding the plane from Kuwait to Iraq in Kuwait City, Kuwait on April 25, 2009. Department of State

and needs another decade or more to fully complete this program. In the interim, the Department is identifying and implementing temporary measures that can mitigate the threats to people, facilities, and information until the planned facilities can be fully secured. The Department has also made significant strides to protect personal identifiable information (PII). The Department's Passport Information Electronic Records System contains PII on more than 210 million passports for approximately 139 million passport holders and meets federal government requirements to encrypt and safeguard PII contained on laptop computers.

During FY 2009, GAO issued 63 reports and testimonies relating to the Department of State. In examining the role of performance at State, the GAO found that staffing and foreign language gaps compromise diplomatic readiness. The Department and America's diplomats face major challenges in coordinating and managing foreign assistance. The Department should focus on enhancing the ability to evaluate and report on progress towards its stated goals and objectives, in particular assistance to Iraqi refugees. The process for integrating strategic planning and budgeting of foreign assistance into the strategic planning of the U.S. Government's other foreign policy goals remains a challenge for the future.

For 2010, the Department's critical process of analysis, review, and change will:

- strengthen and elevate diplomacy and development as key pillars of our national security strategy;
- make our diplomacy and development tools and institutions more agile, responsive and complementary; and
- set institutional priorities and provide strategic guidance on the capabilities we need in the 21st century, the organizational structures best suited to our objectives, the most efficient and effective allocation of resources, and the best deployment models to maximize our impact on the range of challenges we face.

American democracy continues to inspire people worldwide, and U.S. influence is greatest when we live up to our own ideals. The Obama Administration aims to make the United States an exemplar of our own values.

Strategic Goals and Results

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 faces a broad set of dangers that know no borders and threaten our national security, including the grave danger of weapons of mass destruction (WMD); falling into the wrong hands, terrorism and violent extremism, transnational crime, and persistent conflict in geostrategic states whose repercussions are felt well beyond those states' borders.

The U.S. Government responds to these challenges using *smart power* – the deliberate and balanced application of the three pillars of U.S. foreign policy – diplomacy, development, and defense. In the U.S. Government's efforts to build a safer and more secure world, our priorities include: seeking the peace and security of a world without nuclear weapons through reducing the role of nuclear weapons in our own national security strategy and through bilateral and multilateral arms control efforts; combating weapons of mass destruction through cooperative efforts with friends and allies; countering terrorism, including the potential for terrorists to acquire WMD, fighting transnational crime; supporting stabilization operations activities and security sector reforms; supporting counternarcotics activities; sponsoring conflict mitigation and reconciliation; and ensuring homeland security.

The challenges are daunting, but we have made some notable progress. President Obama and Russian President Medvedev agreed on the broad outlines for a treaty that would reduce significantly their strategic nuclear arsenals and set the stage for even deeper reductions and the inclusion of other nuclear weapons states. Additionally, after 10 years of delay, the international community agreed to start negotiations in Geneva to ban the production of the nuclear material that is the building block for nuclear weapons, although this consensus will need to be reaffirmed in January 2010 when the Conference on Disarmament reconvenes.

Secretary of State Hillary Rodham Clinton speaks at the Brookings Institution in Washington, D.C., September 18, 2009. AFP Image

The United States, in partnership with its P5+1 allies (UK, France, Germany, China, and Russia), remains committed to the dual track policy of engagement and pressure as a means to persuade Iran to comply with its obligations. The U.S. and the international community are committed to meaningful negotiations with Iran to resolve the concerns about Iran's nuclear program. The U.S. and the international community will continue to pressure Iran to make a choice between complying with its international nuclear obligations or face increasing isolation.

In early 2009, Secretary Clinton appointed a Special Representative for North Korea Policy who will lead the Department's efforts to address the full range of concerns with respect to North Korea, including its nuclear ambitions and its proliferation of sensitive weapons technology, as well as its human rights and humanitarian problems. The U.S. continues to seek the verifiable denuclearization of the Korean Peninsula in a peaceful manner and the Democratic People's Republic of Korea's (DPRK) return to the Non-Proliferation Treaty (NPT) and International Atomic Energy Agency (IAEA).

Key Achievements

- Resumed negotiations with Russia to replace the expiring Strategic Arms Reduction Treaty (START) with an agreement to reduce and limit strategic offensive arms to levels lower than those in the Moscow Treaty, while including effective verification measures drawn from START.
- Initiated negotiations in the Conference on Disarmament on a global treaty banning the production of fissile material for use in nuclear weapons.
- Maintained an international coalition which condemned North Korea's missile and nuclear tests through the adoption of UN Security Council Resolution 1874.
- Held first round of the U.S.-China Strategic and Economic Dialogue, engaging China on regional security concerns, non-proliferation, and military-to-military relations.
- Surpassed goal to train and equip 75,000 new peacekeepers to be able to participate in peacekeeping operations worldwide by 2010.

2009 INTERNATIONAL WOMEN OF COURAGE AWARDEES

In March 2009, the State Department celebrated the achievements of extraordinary women, demonstrating its support to women and girls around the globe. For the past three years, our embassies have sent us stories of extraordinary women who work every day, often against great odds, to advance the rights of all human beings to fulfill their potential.

In Niger, one woman worked with a local non-governmental organization (NGO) and later with the British NGO Anti-Slavery International, to bring a case to the Economic Community of West African States (ECOWAS) charging that the Government of Niger had not successfully protected her rights under its anti-slavery laws. Her bravery is a ray of hope to send a strong message to the government of Niger and other countries in the region that anti-slavery laws must be more than words on paper.

In a country with a potentially volatile religious and ethnic mix, one woman courageously persevered in seeking answers from within the rule of law, and worked relentlessly and energetically for that legal and governing structure to be made more transparent, accessible, and equitable to all.

Another brave woman in Russia set an example of a grass-roots endeavor that began with little more than a commitment to social justice, and evolved into an influential and powerful group. The NGO she established is a whistleblower

First Lady Michelle Obama and Secretary of State Hillary Rodham Clinton at the Department of State ceremony honoring recipients of the International Women of Courage Award, Washington D.C., March 11, 2009. AP Image

organization that brings public scrutiny of human rights abuses to a large and opaque bureaucracy, giving vindication and sustenance to families, and support and improved conditions to young men serving their country.

In Yemen, judges hesitant to grant divorces to pre-teens have been exposed to international pressure by multiple cases of the plight of child brides within forced marriages that robs girls of their childhood. The personal bravery of one woman expanded that focus to more complex and difficult cases of enduring paternal complicity, and challenged the Yemeni legal system to put an unequivocal end to this crime that robs girls of their childhood.

STRATEGIC GOAL 2: GOVERNING JUSTLY AND DEMOCRATICALLY

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

Public Benefit. Respect for human rights and democratic principles has long been central to U.S. foreign policy. The U.S. Government supports just and representative democracies 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. Representative democracies that ensure greater governmental accountability and transparency through rule of law, free and fair electoral processes, a vibrant civil society, and independent media, are more likely to respect human rights, value fundamental freedoms, and act peacefully and responsibly toward other nations and in accordance with international law. Democratic states contribute to sustainable development, economic growth with open markets, better-educated citizens, and global peace and stability.

The Department is working bilaterally and multilaterally and with civil society and corporate community partners, to ensure that U.S. foreign policy promotes human rights and democratic principles. We also are implementing foreign assistance programs targeted toward priority countries where egregious human rights violations occur, where democracy and human rights advocates are under review, where governments are not democratic or are in transition, and/or where the demand for human rights and democracy is growing.

Human rights and fundamental freedoms are most accepted, respected, and protected in countries that have the electoral, institutional, and societal elements characteristic of representative democracies. These essential elements include: (1) free and fair electoral processes that include not only a democratic casting and honest counting of ballots on election day, but also a transparent adjudication of complaints and an electoral process that allows for real competition and full respect for the freedoms of expression, peaceful assembly, and association; (2) representative, accountable, transparent, democratic institutions of government, including independent judiciaries, under the rule of law to ensure that leaders who win elections democratically also govern democratically and are responsive to the will and needs of the people; and (3) vibrant civil societies, including independent Non-Government Organizations (NGO) and free media.

Key Achievements

- The Department supports the work of more than 130 NGOs with democracy and human rights foreign assistance programs. In FY 2009, the majority of these programs – more than 70% – met or exceeded their program goals.
- As a result of Department engagement, the Government of Uzbekistan ratified International Labor Organization (ILO) Convention 138 on the Minimum Age of Employment, and after taking the necessary steps, became subject to the advisory bodies of the ILO beginning June 2009.
- In Vietnam, respect for religious freedom and practice continued to improve. In 2009, the Government granted national recognition to five Protestant denominations and four additional religions: the Bani Muslim Sect, the Threefold Enlightened Truth Path, the Threefold Southern Tradition, and the Baha'I Community.

Secretary of State Hillary Rodham Clinton meets with former South African President Nelson Mandela in Johannesburg, South Africa, August 7, 2009. Department of State

STRATEGIC GOAL 3: INVESTING IN PEOPLE

Ensure good health, improve access to education, and protect vulnerable populations to help recipient nations achieve sustainable improvements in the well-being and productivity of their citizens.

Public Benefit. The U.S. is the global leader in addressing global health needs, investing $8.2 billion in FY 2009 and $45 billion over the last decade. While progress has been made, urgent health challenges remain, in the following priority areas: HIV/AIDS, child mortality, maternal mortality, tuberculosis, malaria, tropical disease, unintended pregnancy, and undernourishment.

Bringing better health to people around the globe contributes to a more secure, stable, and prosperous world. As President Obama has said, "We will not be successful in our efforts to end deaths from AIDS, malaria, and tuberculosis unless we do more to improve health systems around the world, focus our efforts on child and maternal health, and ensure that best practices drive the funding for these programs."

Multilateral institutions leverage greater global resources and complement bilateral assistance. The Global Fund is a unique global public/private partnership dedicated to attracting and disbursing additional resources to prevent and treat HIV/AIDS, tuberculosis and malaria. The U.S. is the largest donor to the Global Fund, having contributed $3.5 billion since 2001. The President's Emergency Plan for AIDS Relief (PEPFAR) is an essential component of the Department's smart power approach. 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.

Key Achievements

- A partnership framework between the Government of the Republic of Angola and the U.S. Government was signed to combat HIV/AIDS for 2009-2013. The partnership framework provides a five-year joint strategic plan for cooperation among the Government of Angola, the U.S. Government, and other stakeholders to support achievement of the goals of Angola's HIV National Strategic plan for 2007-2010. In doing so, it contributes to PEPFAR's goals for prevention, care and treatment. Recognizing the importance of achieving sustainability, the U.S. Government, through PEPFAR, will continue to support health priorities laid out in Angola's HIV National Strategic Plan.
- Through PEPFAR's growing network of public-private partnerships (PPPs), we are working with businesses to bring their distinctive strengths to the fight. PEPFAR has committed to invest $85 million to leverage $134 million from the private sector, bringing specialized expertise and enhanced sustainability to HIV/AIDS programming. In FY 2009, PEPFAR established a number of new partnerships, including alliances with Becton Dickinson, MTV and General Mills.

A Bangladeshi child receives a medical exam during humanitarian relief efforts in Sarankhola, Bangladesh. AP Image

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's goal is to achieve rapid, sustained, and broad-based economic growth for the United States, its trading partners, and developing countries. 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. The latest global economic downturn, however, demonstrates how quickly growth can reverse into rapid decline and teaches us the importance of implementing economic policies that promote sustainability. The current economic environment is still fragile. Yet, with this global crisis comes the opportunity to chart a better course that is more balanced and less prone to volatility in the financial markets.

Economic growth creates a "domino effect" of positive scenarios and is, therefore, central to achieving numerous domestic and foreign policy priorities of the U.S. Government. Sustainable growth and development policies create the income and opportunity impoverished households need to raise their living standards, provide resources to expand access to basic services, and create hope for the future. Rising incomes enable households to send children to school rather than to work, families to be healthier and better fed, and countries to be peaceful and stable. With higher incomes, governments can generate revenue to provide basic services that strengthen trust in public institutions and enhance stability. Countries can more easily confront the effects of global climate change and weather food, financial, and other crises. U.S. foreign assistance investments in development perform better in countries that consider and nurture economic growth.

CLIMATE CHANGE

The United States is taking a leading role in addressing climate change by advancing an expanding suite of measures. We have initiated a number of polices and partnerships that span a wide range of initiatives, from reducing our emissions at home, to developing transformational low-carbon technologies, to improving observations systems that will help us better understand and address the possible impacts of climate change. Our efforts emphasize the importance of results-driven action both internationally and domestically.

The international community recognizes the importance of moving forward collaboratively in addressing climate change. The Bali Action Plan represents an important step in this global effort by recognizing that all countries that contribute to atmospheric emissions must undertake measurable, reportable, and verifiable mitigation actions in order to cut greenhouse gas emissions. The world community must work collaboratively to slow, stop, and reverse greenhouse gas (GHG) emissions in a way that promotes sustainable economic growth, increases energy security, and helps nations deliver greater prosperity for their people. As we move from Bali to Poznan to Copenhagen, the United States will continue to engage constructively to contribute to an agreed outcome on a post-2012 arrangement that is both environmentally effective and economically sustainable.

During FY 2009, the U.S. and world economies suffered the most severe global economic contraction in decades, one which eliminated millions of jobs in the U.S. and other countries, added significantly to world poverty, and led to a steep downturn in international trade and investment. In response, the U.S. led a concerted international effort to restore the global economy to health. This effort was highlighted most visibly in 2009 by the three G-20 Summit meetings – in Washington, London, and Pittsburgh – and countless other bilateral and multilateral discussions in which the U.S. engaged intensively with its international partners to forge a solution to the crisis.

The global economic downturn also made clear the need for a reformed and revitalized structure of global economic coordination and decision-making, one in keeping with the realities of the global economy of the 21st century. Accordingly, the U.S., in cooperation with its key international partners, has established the G-20 as the premier forum for international economic cooperation, one that brings to the table the key countries needed to build a stronger world economy. We are also working to reform the structure and governance of the global and regional international institutions in order to maintain their continued vitality and relevance.

The global economic crisis and the setback it has delivered to world prosperity has also underscored the need for a reinvigorated approach to global development and the fight against world poverty. As Secretary Clinton has explained, "We advance our security, our prosperity, and our values by improving the material conditions of people's lives around the world." Accordingly, the U.S. is elevating development to become a core pillar of American power. Moreover, through the Quadrennial Diplomacy and Development Review now under way, the Department is examining how to more effectively design, fund, and implement foreign assistance as part of broader U.S. foreign policy.

An important developmental effort that has already been launched is the Administration's new Global Hunger and Food Security Initiative, which the Department is leading. With one-sixth of the world's population – over one billion people – suffering from chronic hunger, the U.S. has committed itself to working as part of a collaborative global effort to improve food security. This effort will build on country-led plans, which will comprehensively address the underlying causes of hunger and under-nutrition and promote longer-term, sustainable agricultural development.

A successful World Pomegranate Fair in Kabul, Afghanistan, sponsored by USAID, enabled farmers to boost production and stimulate the Afghan economy with international exports. Here, a seller displays his produce at the fair, held in November, 2008. AFP Image

Looking ahead, just as the economic crisis has once again illustrated the interconnectedness of U.S. and world prosperity, it has also re-emphasized the close interrelationship between international economic issues and other foreign policy goals. Accordingly, the Department is working to reinvigorate its role in U.S. international economic policy as part of a whole-of-government approach to our interactions with the rest of the world.

Key Achievements

- Upgraded development as a foreign policy goal demonstrated by the launch of the specific and high-profile Food Security Initiative.
- Intensified U.S. dialogue with key emerging economies including Brazil, India, and Russia.
- Launched a global initiative to fight hunger and promote sustainable agricultural development.

- Appointed a Special Envoy for Climate Change, a Coordinator for International Energy Affairs, an Economic Envoy to Northern Ireland, and a Special Envoy for Eurasian Energy.

STRATEGIC GOAL 5: PROVIDING HUMANITARIAN ASSISTANCE

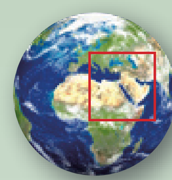
Save lives, alleviate suffering, and minimize the economic costs of conflict, disasters, and displacement.

Public Benefit. The Department and USAID are the lead U.S. Government agencies that respond 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. It requires urgent responses to emergencies, concerted efforts to address hunger and protracted crises, and planning to build the necessary capacity to prevent and mitigate the effects of conflict and disasters.

The U.S. Government's emergency response to population displacement and distress caused by natural and human-made disasters is tightly linked to all other foreign assistance goals, including the protection of civilian populations, programs to strengthen support for human rights, provision of health and basic education, and support for livelihoods of beneficiaries. 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.

At the end of 2008, some 42 million people were uprooted by conflict and persecution. This total includes 16 million refugees and 26 million internally displaced people (IDPs). A range of factors suggest that future humanitarian needs will be dire: increases in the incidence of natural disasters and other environmental conditions (e.g., cyclones, drought, earthquakes, tsunamis) that lead to displacement; greater urbanization, including among refugees and IDPs; and the impact of the global economic downturn on conflict- and

GLOBAL HEALTH



Prioritizing Gender in the Fight against HIV/AIDS: Mestawot's Story

Mestawot Wase's story is a prime example of how PEPFAR-supported gender programming is transforming lives.

Accustomed to verbal and physical abuse, the 33-year-old Ethiopian mother of three lived in constant fear of her husband's wrath. When her husband brought home a second wife, Mestawot's life became unbearable. She took her children, left her husband, and relocated to another village. But soon after the move, Mestawot heard that her husband had died and then she, herself, became ill. Suspecting the worst, Mestawot and her children visited a clinic to be tested for HIV and discovered that both she and her eldest son were HIV-positive.

Looking to her friends and neighbors for support, Mestawot found none. As a result of her status, the people she once trusted now avoided contact with her for fear of contracting HIV. Stigmatized and traumatized, Mestawot began to attend support meetings sponsored by the President's Emergency Plan for AIDS Relief (PEPFAR). Together, the group worked to find common strategies to combat stigma and discrimination, such as creating support networks and expanding HIV/AIDS awareness.

"These strangers welcomed me in a way that my relatives didn't," said Mestawot.

After becoming an outspoken community leader thanks to the strength she garnered at the PEPFAR-supported meetings, Mestawot decided to enter a line of work that would allow her to earn a living while raising HIV/AIDS awareness. With the 500 Birr (US $50) she was lent by the support group, Mestawot opened a barbershop. Today, her barbershop is thriving, and she has touched many customers with her story of resilience. Mestawot is just one of the many women who have benefited from PEPFAR-supported gender interventions. In fiscal year 2008, PEPFAR dedicated more than $1 billion to over 1,000 activities that included interventions to address one or more gender focus areas. For more information on PEPFAR's gender activities, please visit: *http://www.pepfar.gov/press/76365.htm*.

disaster-affected communities all are expected to contribute to the trend of growing humanitarian needs.

Refugee resettlement is an important solution and form of protection for some of the most vulnerable refugees, and a form of burden-sharing that can help unlock protracted refugee situations. The United States provides protection and durable solutions through its long-standing tradition of welcoming refugees to communities across the country. The U.S. Refugee Admissions Program has grown by over 50 percent in the past two years, admitting over 74,000 refugees in FY 2009, including almost 19,000 Iraqi refugees. Though the need for refugee resettlement remains great, new arrivals are facing challenges in the strained U.S. economy. With scarce job opportunities, it is becoming more difficult for newly resettled refugees to become self-sufficient. There is a growing need for the Department's support of refugees' initial reception, orientation and assistance as well as continued coordination with the Department of Health and Human Services, Office of Refugee Resettlement, which provides longer-term support to resettled refugees.

The United States promotes legal, orderly and humane international migration through policies and programs that respect the human rights of migrants and address the protection needs of vulnerable migrants, while preserving U.S. national security. In particular, the Department supports programs seeking to identify and provide protection for asylum seekers, refugees, stateless persons, victims of human trafficking, and others in need of international protection in the context of mixed migration flows, such as those in the Gulf of Aden and the Caribbean. For example, the Department supports programs that prevent human trafficking and provides return and reintegration assistance to survivors of trafficking in persons.

Key Achievements

- The 74,000 refugees resettled in the U.S. represents 99.5 percent of the regional ceilings established by the President, and a 25 percent increase over FY 2008 refugee admissions levels. This is the highest number of refugee admissions since 1999.
- In FY 2009, 83% 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 anti-trafficking projects funded through the Bureau of Population, Refugees and Migration.
- Since 2004, the Department has met or exceeded targets for combating trafficking in persons, demonstrating the value of its active diplomatic and programmatic engagement on these issues.

STRATEGIC GOAL 6: PROMOTING INTERNATIONAL UNDERSTANDING

Achieve foreign policy goals and objectives and enhance national security by fostering broad, mutually-respectful engagement and mutual understanding between American citizens and institutions, and their counterparts abroad.

Public Benefit. The President and Secretary of State have committed to renewing America's engagement with the people of the world by enhancing mutual respect and understanding and creating partnerships aimed at solving common problems. Public diplomacy must embrace and pursue this long-term objective even as it seeks in the short term to engage, understand, inform, and persuade foreign publics on issues of U.S. policies, society and values.

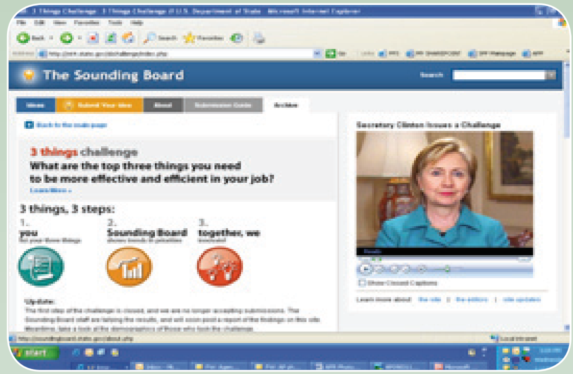
The communication revolution that has swept across the world has had a profound impact on the attitudes, behaviors and aspirations of people everywhere. Public opinion is influencing foreign governments and shaping world affairs to

Secretary of State Hillary Rodham Clinton during an interview by Suthichai Yoon and Veenarat Laohapakakul at Phyathai Palace in Bangkok, Thailand on July 22, 2009. Department of State an unprecedented degree. Young people, especially, see the world through new lenses that focus both on new aspirations and old resentments. Even in autocratic societies, leaders must increasingly respond to the opinions and passions of their people. Public diplomacy must thus develop new ways to communicate and engage with foreign publics at all levels of society. In doing so, we must do a better job of listening, learn how people in other countries and cultures listen to us, understand their desires and aspirations, provide them with context for our decisions, and offer them information and services of value to them.

The goal of person-to-person engagement has always been to form lasting relationships. This now must be a foundation of our communication strategy as well. In a crowded media environment, relationships offer a way to break through the clutter. The Department is expanding the scope of public diplomacy by engaging with broader and younger audiences around the world, with particular emphasis on Muslim communities. We are implementing a strategic approach to policy planning and resource allocations, tailoring messages and programs to reach new audiences, seeking to better coordinate interagency public diplomacy activities, and embracing new technologies, which if used creatively and in partnership with our posts overseas, hold the promise of dramatically scaling up many traditional public diplomacy outreach efforts.

Key Achievements

- In FY 2009, the Department engaged more than 27,000 foreign secondary school students, many from under-served communities, in its various programs.
- The Department is reaching out to foreign audiences worldwide through a mobile SMS messaging system, a team of online bloggers, the America.gov website, Twitter, publications, and Co.Nx, a multimedia interactive platform.
- To support Secretary Clinton's trip to Africa, America.gov produced more than 30 articles, eight podcasts, four photo galleries, Twitter feeds, and Flickr pages to amplify the trip's themes. Many of these items were used by news aggregators, local African media, and blogs, helping to shape the global conversation on democracy and good governance.



TOOLS OF DIPLOMACY

Secretary Clinton's travel itinerary is only one of a number of multimedia features on the Department's home page. It has an active feel, with videos, maps and news releases detailing officials' latest work. And those diplomatic professionals certainly have caught on to how to build good relationships in the era of Web 2.0. The agency's Web management team understands that it is not enough to keep up your own Web site, you must also maintain a presence on a wide range of social-networking sites.

Among the public services that the Department uses are Facebook, Twitter, YouTube for video, and Flickr for photos. The Department also publishes a blog of daily events, called DipNote. Using all those tools helps the agency get the word out about its activities.

"The Department of State has been doing a good job of exploring social media," said Larry Freed, president and chief executive officer of ForeSee Results, the organization that compiles the quarterly American Customer Satisfaction Index. That ongoing opt-in survey quizzes users about how satisfied they are with the sites they visit. The Department of State routinely tests near the top of government Web sites in the survey. The new navigation feature of the State.gov Web site increased search queries by 270% and more than doubled the page views from 22.5 million in April 2009 to approximately 50 million in July 2009.

The Department's use of social media is not focused on employee self-expression but rather on publicizing the Website's resources. "They really use it as distribution outreach so people can more easily get the information they are interested in," Freed said.

Secretary Clinton has invited all employees to contribute their ideas and suggestions about how to make the Department work in new, smarter, and more effective ways through a new website—the Sounding Board. This forum enables domestic and overseas employees to submit ideas for Department innovation and reform.

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 continues, in collaboration with the Department of Homeland Security and other agencies, to protect America's homeland in a variety of ways: improved technology and efficiency at ports of entry and in visa processing, more secure travel documents for the 21st century – both visas and passports, 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. The Department's Office of Children's Issues assists Americans whose children have been wrongfully taken to or kept in foreign countries – a problem of growing proportions. 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. We develop and maintain programs that enhance diplomatic capabilities, such as training in foreign language proficiency and other vital organizational skills, and exploit technology to make training more available to our global workforce. The Department provides and maintains secure, safe, and functional facilities for its employees in the United States, and overseas for both Department employees and those of other agencies. Our embassies overseas are the diplomatic platform for the entire U.S. Government. Our 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. Lastly, the Department provides grants and technical assistance to overseas schools to educate USG dependent children, assist schools in recruiting and retaining qualified U.S.-citizen staff, and encourage overseas schools to provide assistance to children with special needs.

Woven into the urban fabric of Beijing and symbolically combining Eastern and Western tradition, the new U.S. Embassy in Beijing infuses Chinese elements into a modern state of-the-art facility representing the best of 21st century American architecture. Department of State, Bureau of Overseas Buildings Operations

Key Achievements

- In FY 2009, Overseas Buildings Operations (OBO) completed seven major capital construction projects continuing to provide secure, safer, and more functional facilities. In addition, OBO completed ten major compound security upgrade projects and prepared the first Long-Range Overseas Maintenance Plan, submitted in support of the FY 2011 budget.
- The Bureau of Resource Management achieved international certification (ISO-9001:2008) for its Global Financial Services, putting in place internationally recognized and accepted management standards for corporate financial services with the goal of providing world-class financial services and continuous improvement for the Department and its other agency customers, worldwide.
- During FY 2009, the Office of Children's Issues in the Bureau of Consular Affairs assisted with the successful return of or access to more than 550 children wrongfully taken to or kept in another country.
- Improvements in the "Visas Mantis" program, which screens visa applicants who wish to enter the U.S. for purposes related to certain scientific or high-technology fields, has resulted in a reduction in processing time from more than 90 days in February to under two weeks in June.
- The Foreign Service Institute expanded distance learning to its global audience by 43%, reaching more Department employees with greater resource efficiency and timeliness.
- Using lessons learned in Iraq and Afghanistan, the Bureau of Diplomatic Security established protective operations and emergency response teams to protect Americans assigned to Peshawar, Pakistan – a post now considered among the most dangerous posts in the Foreign Service.
- Twenty-six Department-assisted schools participated in the Virtual School program, which provides the means for support and communication of U.S. Government dependents via the Internet while they are in evacuation status from dangerous posts, disaster areas, or war zones. Additionally, 138 Department-assisted overseas schools offered special needs programs.

ENGAGING THE NEXT GENERATION

In countries where young people have traditionally struggled to find a voice under oppressive regimes, state media, and the threat of violence, they are now finding a voice online—sharing their opinions on politics, exposing the abuses of regimes through video and images, and creating a digital democracy where every voice is heard and every vote is counted. Online social networking has become a tool by which civil society can be scaled to include millions of young people, not just in the freest of nations, but in some of the most oppressive regimes on earth.

The Alliance of Youth Movements was initially inspired by the success of Colombia's grassroots "No Mas FARC" movement. Aided by social networking technologies like Facebook.com, the organization inspired 12 million people in 190 cities around the world to take to the streets in protest against the FARC–an extremist group that has been terrorizing Colombia for more than 40 years.

In the same way that millions of young people–who had never met face-to-face–formed the largest movement against the FARC (or any other terror organization in history), the U.S. Department of State saw hints of similar developments in other high priority regions. The Department of State developed the hypothesis that social networking technologies provided a crucial realm for youth empowerment to promote freedom and justice and oppose violence, extremism and oppression that had previously been missing.

American and Lebanese students visit the Ottoman-period Beiteddine Palace in the Shouf Mountains of Lebanon. State Magazine, July/August 2009

Secretary of State Hillary Rodham Clinton participates in a town hall meeting with young leaders at the European Parliament in Brussels, Belgium, March 6, 2009. AP Image

APPROACH

In December 2008, leaders of pioneering youth movements from 15 countries launched a global network that empowers young people to mobilize against violence and oppression through the use of social media and the latest online tools. Brought together by Howcast, Facebook, Google, YouTube, MTV, the U.S. Department of State, Columbia Law School and Access 360 Media, the youth leaders met in New York City, shared their experiences, and crafted Creating Grassroots Movements for Change: A Field Manual in order to demonstrate how to effect social change using online tools.

RESULTS

- Convened the most successful online movements against violence, extremism, and oppression that have successfully transcended the digital/real world divide.
- Synthesized best practices and developed a public, multimedia online field manual for other potential individuals and organizations to use.
- Built a central hub around the field manual–which combines Howcast, Facebook, and other platforms– and serves as a one-stop shop for best practices to be utilized by other movements.
- Established a global youth movement which will serve as an advisory board to groups around the world looking to create movements against violence, extremism, and oppression.

Summary Analysis of Financial Condition

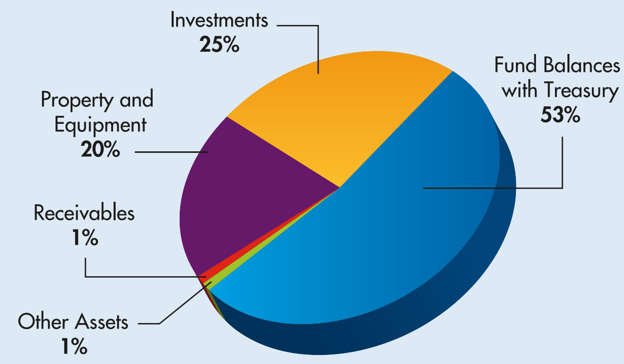
Overview of Financial Position

Assets. The Department's total assets were $60 billion at September 30, 2009, an increase of $8.1 billion, 16 percent, over the 2008 total. Fund balances with Treasury were up $6.6 billion. Investments were up $481 million because contributions and appropriations received to support the Foreign Service Retirement and Disability Fund (FSRDF) were greater than benefit payments; the excess is required to be invested for future benefit payments. Property and equipment increased $998 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 2009 and 2008. Investments consist almost entirely of U.S. government securities held in the FSRDF; 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.

Assets by Type

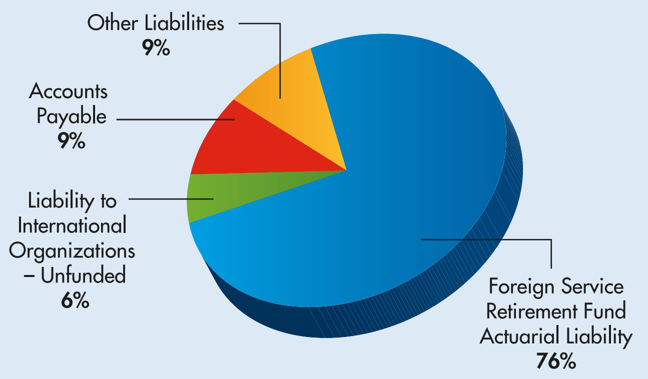


Assets as of September 30, 2009 and 2008

(Dollars in Millions)	2009	2008 (Restated)
Fund Balances with Treasury	$ 31,738	$ 25,151
Investments, Net	15,372	14,891
Property and Equipment, Net	11,676	10,678
Receivables, Net	687	671
Other Assets	382	326
Total Assets	$ 59,855	$ 51,717

Liabilities. The Department's total liabilities were up $1.4 billion, 6.5 percent between 2009 and 2008. The liability for future benefits payments to retired foreign service officers shown as the Foreign Service Retirement Actuarial Liability, 76 percent of the total, was up $1.8 billion, 12 percent, due to increasing participation in the benefit plan and changes in cost assumptions. Accounts Payable decreased by 28 percent, $802 million, primarily due to supplemental funding received in support of international organizations. This funding was used to reduce accounts payable to International Organizations.

Liabilities by Type



Liabilities as of September 30, 2009 and 2008

(Dollars in Millions)	2009	2008 (Restated)
Foreign Service Retirement Actuarial Liability	$ 16,983	$ 15,139
Liability to International Organizations	1,451	1,507
Accounts Payable	2,076	2,878
Other Liabilities	1,972	1,578
Total Liabilities	$ 22,482	$ 21,102

Ending Net Position. The Department's net position, comprised of both unexpended appropriations and the cumulative results of operations, increased 22 percent between 2008 and 2009. Unexpended appropriations was up by 31 percent, $5.6 billion, primarily due to increases in appropriations still available in the Global Health and Child Survival fund, up $3 billion, and the Embassy Security, Construction and Maintenance fund, up $1.4 billion. Cumulative Results of Operations was up $1.2 billion, primarily due to resources used to purchase property and equipment, $1.7 billion, which are capitalized on the Balance Sheet rather than presented in Net Cost as expenses.

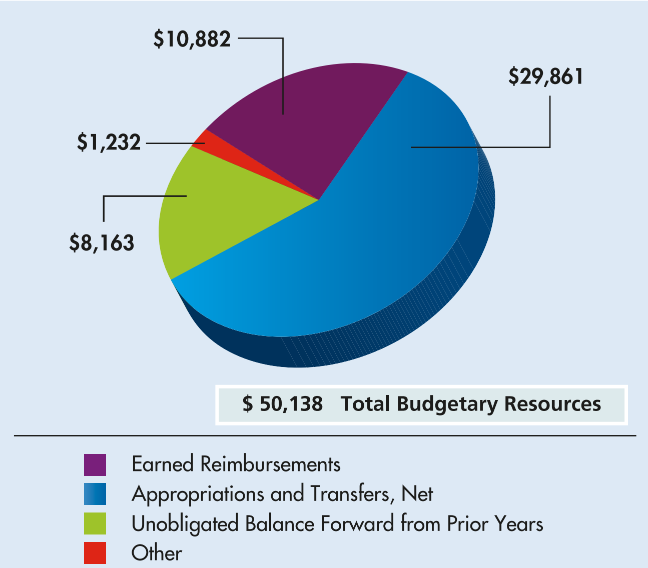
Results of Operations

The following two charts illustrate the sources of funds received by the Department in 2009 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 $11.3 billion, 29 percent, in 2009 over 2008. Most of that increase, $9.2 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 82 percent of year-end resources. The remainder was transfers, recoveries of prior-year unpaid obligations, and unobligated balances brought forward. The Department obligated $38.2 billion of the $50.1 billion total resources in 2009, an increase of $7.5 billion, 24 percent, over 2008. Percent of total resources obligated remained stable at 76 percent in 2009 versus 79 percent in 2008.

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,

Sources of Funds
(Dollars in Millions)



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 $21.6 billion is an increase of 22 percent or $3.9 billion over 2008. The goal of Investing in People and Executive Direction costs account for most of this increase. As seen in the Net Cost by Strategic Goal chart, the goal of Achieving Peace and Security is the largest representing 27 percent of 2009 net costs. Our second largest goal, Investing in People, accounted for $1.8 billion of the net costs increase. This was primarily the result of initiatives this year with the fund established in 2008 for Global Health and Child Survival.

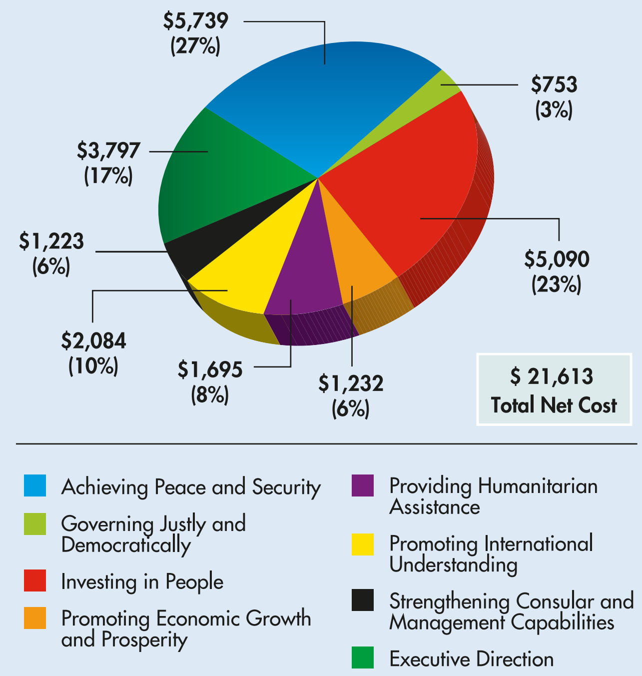
The increase in Executive Direction and other costs not assigned is a result of increases in the actuarial liability for the Foreign Service Retirement and Disability Fund (FSRDF). We performed an experience study to determine if the assumptions used still reflect actual experience within the retiree population. The results reflected that the population of FSRDF participants is living longer. The Department and our actuaries agreed that for the first time in the plan's history, it was necessary to depart from using the assumptions of the OPM's Board of Actuaries. The assumption revisions, both demographic and economic, resulted in an increase of $1.5 billion in pension costs in the FSRDF for 2009.

Additionally, contributions to the United Nations (UN) High Commissions on the Near East and Africa in the goal of Providing Humanitarian Assistance increased in 2009 contributing to $145 million of the net costs increase attributable to this goal.

Budgetary Position

The FY 2009 appropriated budget for the Department of State operations totaled $15.4 billion, including appropriations for Administration of Foreign Affairs ($10.9 billion), contributions to international organizations and international peacekeeping activities ($4.0 billion), international commissions ($337 million), and related

Net Cost by Strategic Goal
(Dollars in Millions)



programs ($153.7 million). These amounts do not include foreign assistance funding, which was provided through Foreign Operations appropriations.

The Department's FY 2009 budget was funded by the *FY 2009 Omnibus Appropriations Act under Division H – The Department of State, Foreign Operations, and Related Programs Appropriation Act*. The budget also included supplemental funding for FY 2009 requirements provided through the Supplemental Appropriations Act, 2008, as well as the Supplemental Appropriations Act, 2009. 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 full U.S. share of costs for United Nations peacekeeping missions. In addition, funding of $564 million (net of 38 million of transfers to USAID) was provided through the American Recovery and Reinvestment Act of 2009.

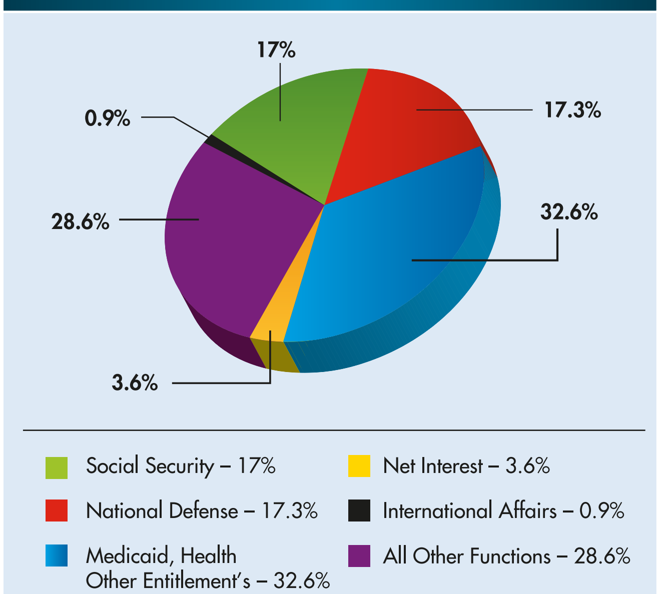
In addition to appropriated funds, the Department continued to rely on revenue from user fees – Machine Readable Visa fees, Enhanced Border Security Program fees, the Western Hemisphere Travel Surcharge, and other fees – for the Border

Security Program. The revenue from these fees supported program requirements to protect American citizens and safeguard the nation's borders. FY 2009 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 operational funding. They support the people and programs that 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. These funds also build, maintain, and secure the infrastructure of the American diplomatic platform, from which most U.S. Government agencies operate overseas.

For FY 2009, the Department's principal operating appropriation – Diplomatic and Consular Programs (D&CP) – was funded at $7.1 billion. Total D&CP funding included $1 billion to support operations of the U.S. Mission in Iraq, $1.3 billion for the Worldwide Security Protection program to strengthen security for diplomatic personnel and facilities under threat from terrorism, and $402 million for vigorous public diplomacy to counter extremist misinformation and

The Federal Government Dollar – Outlays in 2009



Source: FY 2010 Mid-Session Review, Budget of the U.S. Government, Estimates for FY 2009

secure support for U.S. policies abroad. The funding also included resources to further 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 2009 investments in information technology totaled $439 million. The Fund total included $323 million from the Capital Investment Fund (CIF) appropriation and $116 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. The Embassy Security, Construction, and Maintenance (ESCM) appropriation was funded at $2.7 billion. This funding helped provide U.S. missions overseas with secure, safe, and functional facilities. The funding also supported maintenance and repairs of the Department's real estate portfolio, which exceeds $14 billion in value and includes over 15,000 properties. The ESCM funding included $900 million to support capital security construction and compound security projects and $1 billion in supplemental funds for Afghanistan/Pakistan. Other agencies with overseas staff under Chief of Mission authority also contributed $480 million to capital security cost-sharing for the construction of new diplomatic facilities.

The Educational and Cultural Exchange Programs (ECE) appropriation was funded at $538 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 $311 million for academic programs of proven value, such as the J. William Fulbright Scholarship Program and English language teaching. It also included $168 million for professional and cultural exchanges, notably the International Visitor Leadership Program and Citizen Exchange Program.

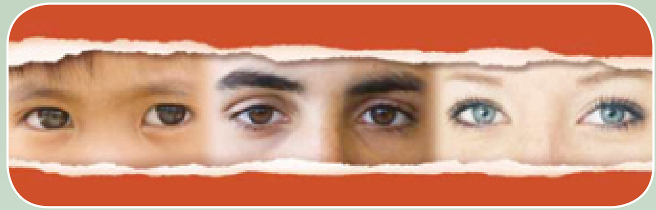
For FY 2010, the Department's budget request (at this date still pending before the Congress) totals $16.4 billion. It includes resources to address ongoing national security and foreign policy priorities. The request for D&CP is $9 billion, including $1.6 billion for Worldwide Security Protection to meet new demands in all regions. The centerpiece of the

FY 2010 budget is the request for a 700-position increase in the Foreign Service, part of an ongoing long-range request to increase Foreign Service staff by 25% over FY 2009 – 2013. The request provides $160 million for CIF for further investments in IT infrastructure and collaborative tools. The request for ESCM totals $1.8 billion, including $938 million for design and/or construction of secure facilities, additional site acquisitions, and compound security projects. Further, the request provides $633 million for ECE to strengthen the exchanges component of public diplomacy, expand the National Security Language Initiative, and bring key influencers to America.

Diplomatic capacity is built over time yet continuously "deployed," frequently called upon in times of great national need. However, diplomatic efforts cannot be effective unless the ground work and foundation are firmly established and institutionalized before a crisis arises. Effective global engagement is achieved only through continuous presence and requires a level of resources commensurate with unrelenting vigilance. Therefore, the leading objective of the FY 2010 Department of State Operations request is to build the capacity to advance diplomatic solutions to the most challenging issues of our time.

The Department remains focused towards positioning the right people – with the appropriate training and resources – in the right locations. These diplomats will concentrate on the critical national security efforts of our day, combating terrorism, and promoting freedom. The timing and location of these efforts will often not be of our choosing. Therefore it is critical that the Department be able to conduct diplomacy and deliver assistance in a flexible and dynamic manner. This requires a concerted and long-term focus on recruiting, hiring, training and retaining the most capable and motivated personnel while providing those stationed overseas the critical equipment and resources necessary.

Diplomatic activities must also be seamlessly coordinated with the rest of the U.S. government's agencies, particularly those that have critical foreign policy roles, in addition to our allies and international partners. Leveraging multi-agency, bi-lateral and multi-lateral organizational efforts is the most effective way of achieving the results that best serve our national interest.



USG ACTIVITIES TO COMBAT TRAFFICKING IN PERSONS

The U.S. Government is committed to combating modern-day slavery in all of its forms. The fight against human trafficking—which stems from the Constitution's prohibition against involuntary servitude and slavery—is one of our highest priorities for ensuring justice in the United States and around the world. The United States is aided by the modern tools created by the Trafficking Victims Protection Act and its reauthorizations to address trafficking in persons with a renewed and intensified vigor.

- Enhance recognition, and ability to meet the needs of all trafficking victims, regardless of national origin, including exploration of intensive case management practices for both foreign national and U.S. citizens, as appropriate.
- Develop policies to ensure that diplomatic immunity does not result in impunity for human trafficking crimes.
- Make intra-agency cooperation a priority on human trafficking cases by, for example, increasing U.S. Attorney involvement with human trafficking task forces in their districts.
- Increase efforts to exchange best practices, lessons learned, and research with UN agencies and international organizations (UN Office on Drugs and Crime, International Labor Organization, International Organization for Migration, UNICEF, etc.) that provide technical assistance to combat human trafficking.

FOOD SECURITY

Secretary of State Hillary Rodham Clinton and U.S. Agriculture Secretary Tom Vilsack provide remarks in a corn field near Nairobi, Kenya. Department of State

Over the past three years, Rwanda has experienced tremendous growth in agricultural production, which has precipitated a marked improvement in the country's national food security. The country's President conveyed this success in remarks at an event on Global Food Security co-hosted by Secretary of State Clinton and U.N. Secretary General Ban-Ki Moon during the United Nations General Assembly on September 26th. President Kagame discussed several key principles that have underpinned his country's recent progress in combating hunger: 1) Rwanda's leading role in the development of a food security strategy; 2) a comprehensive approach to food security that addresses the underlying causes of hunger; 3) robust coordination and partnership between donor countries, regional and international organizations, and the private sector; 4) leveraging the comparative advantages of multilateral institutions such as the World Bank. Looking to the future, President Kagame joined Secretary Clinton and Secretary General Ban in emphasizing the need for 5) a sustained and accountable commitment from all stakeholders.

The same five principles that underpin Rwanda's progress toward achieving national food security are endorsed in the L'Aquila Joint Statement on Food Security, which was signed by President Barack Obama on July 10, 2009. In this historic agreement, world leaders pledged to devote $20 billion over the next 3 years to the fight against global hunger. Of that sum, the United States has pledged a minimum of $3.5 billion, which represents an increase in American funding for food security as compared to the previous three years.

Building on the momentum of the L'Aquila Summit, the Department of State has established the Global Hunger and Food Security Initiative and has set the five principles of the L'Aquila Joint Statement as the foundation for this new enterprise. Through this Initiative, the Department will invest heavily in solutions throughout the agricultural supply chain and will seek to reduce undernutrition. The Department's priorities will also include enhancing the effectiveness of American food aid and empowering women, who constitute the majority of the world's farmers.

The FY 2010 budget requests the necessary resources to further increase diplomatic capacity, providing the critical tools and funding that our diplomats require to pursue the most challenging national security issues, now and in the future.

The FY 2010 budget request will enable the Department to meet the following critical goals: Strengthen Capacity to Pursue Diplomatic Solutions to National Security Issues; Coordinate Stabilization and Reconstruction Efforts; Further Assist Transition to Iraqi Responsibility; Strengthen Public Diplomacy and Exchanges; and Support Multilateral Engagement.

Budgetary Position for Foreign Assistance

The FY 2009 budget for the Department's Foreign Assistance programs totaled $12.2 billion and were funded by the Omnibus Appropriations Act, 2009, under Division H—The Department of State, Foreign Operations, and Related Programs Appropriations Act, 2009 (P.L. 111-8). The budget also included bridge funding from the Supplemental Appropriations Act, 2008 (P.L. 110-239) and supplemental funding provided through the Supplemental Appropriations Act, 2009 (P.L. 111-32). Foreign Assistance programs provide the tools by which the United States can promote stability in key countries and regions, confront security challenges, advance economic transformation, respond to humanitarian crises, and encourage better governance, policies, and institutions.

Foreign Assistance related programs under the purview of the Department included Foreign Military Financing; International Military Education and Training; the International Narcotics Control and Law Enforcement and Andean Counterdrug Program; the Migration and Refugee Assistance and Emergency Refugee and Migration Assistance programs; International Organizations and Programs; Nonproliferation, Antiterrorism, Demining and Related Programs; Democracy Fund; and Peacekeeping Operations.

The Foreign Military Financing (FMF) appropriation for FY 2009 was funded at $6.2 billion. The funds provided through FMF further U.S. interests around the world by ensuring that coalition partners and friendly foreign governments are equipped and trained to work toward common security goals and share burdens in joint missions. FMF promoted U.S. national security by contributing to regional and global stability, strengthening military support for democratically-elected governments, and containing transnational threats including terrorism and trafficking in narcotics, weapons, and persons. FMF was allocated strategically within regions; the vast majority of funds directed to our sustaining partners and a significant proportion to developing countries to support their advancement.

The International Military Education &Training (IMET) appropriation was funded at $93 million. IMET is a key component of U.S. security assistance that promotes regional stability and defense capabilities through professional military training and education. Through professionalization, technical courses, and specialized instruction, IMET provided students from allied and friendly nations valuable training and education on U.S. military practices and standards, including exposure to democratic values and respect for internationally recognized standards of human rights. IMET served as an effective means to strengthen military alliances and international coalitions critical to the global fight against terrorism.

The International Organizations and Programs (IO&P) was funded at $352.5 million. It provided voluntary contributions to international organizations that advanced U.S. strategic goals by supporting and enhancing international consultation and coordination. This approach is required in transnational areas, such as protecting the ozone layer or safeguarding international air traffic, where solutions to problems are best addressed globally. In other areas, such as in development programs, the United States can multiply the influence and effectiveness of its contributions through support for international programs.

For FY 2009, the International Narcotics Control and Law Enforcement (INCLE) appropriation was funded at $1.9 billion. INCLE supports bilateral and global programs critical to combat transnational crime and illicit threats, including efforts against terrorist networks in the illegal drug trade and illicit enterprises. Programs supported with INCLE funds sought to close existing gaps between law enforcement jurisdictions and to strengthen law enforcement institutions that are weak or corrupt. Many INCLE resources were focused where security situations are most dire and where U.S. resources are used in tandem with host country government strategies in order to maximize impact.

The UN peacekeeping mission MONUC Air Support Operations Base in GOMA, Democratic Republic of the Congo. Department of State

Resources were also targeted in countries that have specific challenges to establish a secure and stable environment, such as Mexico, Afghanistan, the Democratic Republic of Congo, Haiti and Indonesia.

Within the INCLE appropriation is the Andean Counterdrug Program (ACP), which was funded at $315 million to support counterdrug programs in seven countries, especially the three source countries for cocaine (Colombia, Peru and Bolivia). Support helped reduce the flow of drugs to the United States, addressed instability in the Andean region and strengthened the ability of both source and transit countries to investigate and prosecute major drug trafficking organizations and their leaders and to block and seize their assets.

The Nonproliferation, Anti-terrorism, Demining and Related Programs (NADR) appropriation was funded at $631.5 million to support critical security and humanitarian-related priority interventions. The FY 2009 NADR funds supported U.S. efforts in nonproliferation and disarmament, export control and other border security assistance, global threat reduction programs, anti-terrorism programs, humanitarian demining, and small arms and light weapon destruction.

Migration and Refugee Assistance (MRA) appropriation was funded at $1.7 billion. It is through the MRA account that the United States provides humanitarian assistance and resettlement opportunities for refugees and conflict victims around the globe, an essential component of U.S. foreign policy that reflects the American people's dedication to assisting those in need. In FY 2009, MRA contributed to key international humanitarian organizations as well as to non-governmental organizations to address pressing humanitarian needs overseas and to resettle refugees in the United States. These funds supported programs that met basic needs to sustain life; protected refugees and conflict victims; assisted refugees with voluntary repatriation, local integration, or permanent resettlement in a third country; and fostered the humane and effective management of international migration.

The U.S. Emergency Refugee and Migration Assistance Fund (ERMA) was funded at $40 million in FY 2009. ERMA serves as a contingency fund from which the President can draw in order to respond effectively to humanitarian crises in an ever-changing international environment. The FY 2009 funds ensured that the United States was able to respond quickly to urgent and unexpected refugee and migration needs.

The Democracy Fund was funded at $116 million for FY 2009. These resources promoted democracy in priority countries where egregious human rights violations occur, democracy and human rights advocates are under pressure, governments are not democratic or are in transition, and where the demand for human rights and democracy is growing.

Secretary of State Hillary Rodham Clinton speaks with staff of the United States Agency of International Development (USAID) in Washington, D.C., January 23, 2009. AP Image

The Peacekeeping Operations (PKO) appropriation was funded at $530.2 million to enhance international support for voluntary multi-national stabilization efforts, including international missions that are not supported by the United Nations, and U.S. conflict resolution activities. PKO funding was used to provide security assistance to help diminish and resolve conflict, enhance the ability of states to participate in peacekeeping and stability operations and address counter-terrorism threats, and in the aftermath of conflict, reform military establishments into professional military forces with respect for the rule of law. In FY 2009, the PKO program supported ongoing funding requirements for the Global Peace Operations Initiative, the Trans-Sahara Counterterrorism Partnership, a new counter-terrorism program in East Africa, and multi-lateral peacekeeping and regional stability operations, as well as security sector reform programs in Somalia.

For FY 2010, the Department's budget request for Foreign Assistance (at this date still pending before Congress) totals $12.3 billion. The request provides $5.7 billion for International Security Assistance programs, such as FMF ($5.3 billion), peacekeeping operations ($300 million), and IMET ($100 million). The request provides $1.9 billion for INCLE to meet commitments especially for Afghanistan, the Merida Initiative, Andean counterdrug programs, and other global programs. The requests for MRA ($1.5 billion) and ERMA ($75 million) will support overseas humanitarian assistance and programs to admit refugees into the United States. Further, the request provides $765.4 million in NADR for its non-proliferation, anti-terrorism, and stability assistance programs and another $356.6 million for voluntary contributions to international organizations.

Challenges in Foreign Assistance

The Department's Office of the Inspector General identified "Coordinating Foreign Assistance" as a Management and Performance Challenge, specifically citing redundant assistance programs and insufficient awareness in the field of assistance programs funded and managed by the Department's functional bureaus. The Office of the Director of U.S. Foreign Assistance (F) was established in 2006 to address those exact issues, among others. To ensure better coordination of assistance programs within a country, F has changed the budget formulation process to require a jointly developed budget from the Department and the USAID, which F submits to the Office of

Management and Budget on the Secretary's behalf. F's budget databases provide an overarching view of the budget that helps eliminate redundant programming. Furthermore, once there is an appropriation, F requires each mission and Washington-based bureau to submit an Operational Plan, a joint Department/USAID document that describes how appropriated funds will be used. Because functional bureaus participate in this process and prepare Operational Plans, their programs are much better understood by the field missions in which they are implemented. The Department and USAID also develop and submit an annual joint Performance Report which describes their results and reports on standardized foreign assistance indicators developed by F. Many missions use this as an opportunity to jointly review the programs and make adjustments to improve effectiveness.

Another management challenge is better integrating the development of foreign assistance program resources with personnel and other administrative requirements. This is a particular challenge in the Department because of the iterative nature of the foreign assistance budgeting process. As adjustments to foreign assistance resources are made, it is difficult to continually adjust personnel and other administrative requirements. Under the leadership of the Deputy Secretary for Management and Resources, efforts are under way to better integrate the foreign assistance and Department operations budgeting processes so that personnel and administrative resources are optimally positioned for the effective management of foreign assistance.

Finally, measuring results for foreign assistance programs is a significant challenge. Unlike many kinds of federal programs, foreign assistance results can take years to accomplish. In addition, United States assistance funds are often only a small part of the resources being directed at a problem. Other donors may be contributing funds, as well as the host government and other partners. Therefore, attributing specific results to U.S. funding can be very difficult. Finding indicators that describe assistance results effectively and that can be collected at minimal cost and in a timely manner can pose significant challenges. Both the Department and USAID continue to enhance their capacity to better measure results. In fact, both agencies have recently reinvigorated their monitoring and evaluation capacities, including adding staff to these functions and putting in place training and technical resources to help with performance management.

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.

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.

In the wake of a disaster, youth gathers to get water from public and private support in Sri Lanka. State Magazine April 2009

U.S. MULTILATERAL ENGAGEMENT: BENEFITS TO AMERICAN CITIZENS

The United States is deeply engaged with the United Nations and other international organizations to promote U.S. national interests. While most Americans are familiar with U.S. leadership at the United Nations as part of the Security Council and as a leading voice in support of human rights, economic development, and humanitarian relief, fewer Americans are aware of the many benefits that stem from U.S. engagement with the many technical and specialized international organizations.

AVIATION SAFETY

Every day throughout the world, thousands of commercial, cargo, and other aircraft span the skies on international flights. As a result of standards and recommended practices established and governed by the International Civil Aviation Organization (ICAO), international flights are handled in a uniform manner from takeoff to landing. ICAO is dedicated to safe, secure, and sustainable development of civil aviation through cooperation among its 190 Member States, including the United States. ICAO's standardized procedures enhance technical and operational aspects of international civil aviation, including safety, security, air traffic services, training and technical assistance, and environmental matters.

CLIMATE AND WEATHER FORECASTING

U.S. support for the World Meteorological Organization (WMO) promotes international cooperation on improved hurricane forecasting, natural disaster preparedness, climate issues, and the exchange of vital atmospheric and oceanic data. These data allow the U.S. National Weather Service to better forecast severe weather and better serve the forecasting needs of civil aviation, marine navigation, industry, and agriculture. The United States has been a member of WMO for more than 60 years.

GLOBAL HEALTH

Today's major health challenges know no borders. Whether discussing pandemic influenza, malaria, HIV/AIDS, polio, improving child and maternal health, or strengthening health systems around the world, the World Health Organization (WHO) has a crucial role to play. Established in 1948, WHO provides leadership on global health matters by establishing norms and standards, monitoring and assessing health trends, and providing technical assistance when and where needed. The United States works closely with WHO to support effective responses to public health challenges and WHO's International Health Regulations, which provide an improved and coordinated framework for dealing with global public health events.

GLOBAL COMMUNICATIONS

Since the first International Telegraph Convention was signed in 1865, the world community has adapted a cooperative approach to the development and coordination of new communication tools. The International Telecommunication Union (ITU) coordinates international standards of electronic communication. The ITU manages global radio frequencies for broadcasting, mobile phones, satellites, wireless internet and disaster operations.

INTELLECTUAL PROPERTY

The World Intellectual Property Organization (WIPO) is a specialized UN agency charged with developing and maintaining the international intellectual property system under a regime of several international treaties. This system supports the protection of intellectual property rights, which in turn encourages creativity, innovation, and economic development. WIPO's services include facilitating applications for international patents, copyrights, and registration of trademarks and designs, as well as technical assistance and training. The United States is an active member of WIPO, and believes its services are of significant benefit to Americans and American business.

SHIPPING AND MARITIME SAFETY

More than 45,000 merchant ships currently ply the seas, carrying the vast bulk of products and commodities traded in the world economy. Guiding the shipping industry is the International Maritime Organization (IMO), which is responsible for the industry's regulatory framework including safety and environmental standards, security, legal issues, and efficiency. IMO treaties, standards, and guidelines have significant benefits for American business, and directly serve U.S. national security by applying security requirements to foreign vessels entering U.S. ports.

INTERNATIONAL MAIL

Every year, post offices around the world handle in excess of 400 billion letters and packages. The legal and procedural framework for the global postal system is provided and overseen by the Universal Postal Union (UPU). This UN specialized agency, now more than 130 years old, sets the guidelines for international mail exchanges and makes recommendations to stimulate growth in mail volume and to improve the quality of service for customers. The global network of mail service governed by the UPU ensures that Americans can communicate by mail with friends, family, customers, and colleagues in all corners of the world.

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, 2009.

In addition, management is 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, 2009, was operating effectively and the Department found no material weaknesses in the design or operation of the internal control over financial reporting. The Department appreciates that the independent auditors reported material weaknesses related to the accounting for property and financial reporting. The Department, in our assessments and evaluations of internal controls, identified similar weaknesses but classified them as significant deficiencies versus material weaknesses. We will continue to work with them to resolve these issues.

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 the preparation and presentation of financial statements. 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.

These systems of internal controls are also being used to support our stewardship over the American Recovery and Reinvestment Act (Recovery Act) spending made by the Department. Our assessments of internal controls, along with senior managers' assurance statements and our review for improper payments for Recovery Act activities, allow the Department to provide reasonable assurance that the key accountability objectives of the Recovery Act are being met and that significant risks to meeting Recovery Act accountability objectives are being mitigated.

Hillary Rodham Clinton
Secretary of State
December 15, 2009

Departmental Governance

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:

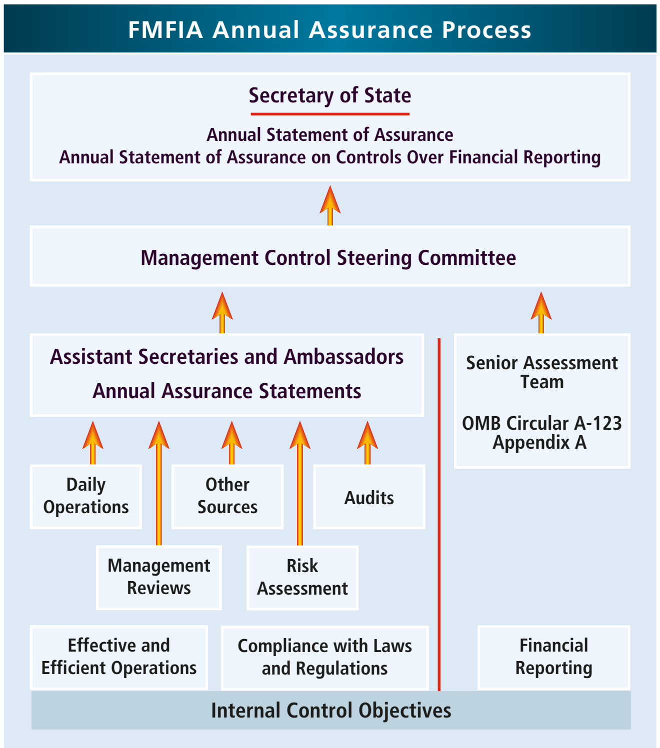
- Effectiveness and efficiency of operations,
- Compliance with applicable laws and regulations, and
- Reliability of financial reporting.

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 2009 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. At the close of FY 2009, the Department reported four program-related significant deficiencies. Following is a summary of the FY 2009 results.



Program Issue	Significant Deficiency Description	Beginning	New	Resolved	Ending
Federal financial assistance leadership, policy and training	Lack of coordinated Department leadership, policy framework, and training on Federal financial assistance.	1	0	1	0
Federal financial assistance systems	Lack of comprehensive and reliable information on Federal financial assistance available due to the Department's use of disparate information systems.	1	0	0	1
PIERS	Unauthorized access to the Passport Information Electronic Records System.	1	0	0	1
ECA Visitor Program Oversight	Insufficient oversight to ensure these programs (which bring foreign nationals to the U.S.) are operated in accordance with regulatory requirements.	1	0	0	1
ECA Youth Program Oversight	Insufficient oversight to ensure these programs (which bring foreign nationals to the U.S.) are operated in accordance with regulatory requirements.	0	1	0	1
Total Program Significant Deficiencies		4	1	1	4

The Senior Assessment Team (SAT) provided oversight during 2009 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. Due to the extensive knowledge of management involved with the Appendix A assessment, the Department evaluated issues on a detailed level. The findings that resulted from the FY 2009 Appendix A assessment included several significant deficiencies in internal control financial reporting. At the close of FY 2009, the Department reported four financial reporting-related significant deficiencies. Following is a summary of the FY 2009 results.

Financial Reporting Issue	Significant Deficiency Description	Beginning	New	Resolved	Ending
Unliquidated obligations (ULOs)	ULOs were not timely de-obligated during the year, as routine reviews were not conducted by all offices throughout the Department.	1	0	0	1
Personal Property	Various conditions existed including insufficient supporting documentation, data integrity issues, delays in recording acquisitions and dispositions of assets, and cut-off issues.	1	0	0	1
Intragovernmental financial reporting	Various conditions existed including transactions not accurately classified as Federal versus Public, inaccurate trading partner classification, accruals not adequately supported, and variances between our amounts compared to those recorded by our trading partners.	1	0	0	1
Budgetary financial reporting – Statement of Budgetary Resources (SBR)	Significant summary level adjustments were required to prepare the quarterly SF-133s and SBR.	1	0	0	1
Deferred revenues	Earned revenue recognized at the time the reimbursable agreement is approved, rather than at the time the services or goods are provided.	1	0	1	0
Total Financial Reporting Significant Deficiencies		5	0	1	4

The Independent Auditors Report on Internal Controls cites three material weaknesses. The material weaknesses relate to 1) the accounting for property, which includes issues related to both real and personal property; 2) financial reporting, primarily (but not solely) relating to the statement of budgetary resources; and 3) the need to restate previously reported amounts for the International Boundary and Water Commission. In regards to the material weaknesses, we agree to the issues identified. However, the Department disagrees with the severity at which they are categorized. With the exception of the IBWC Restatement, the Department reports similar weaknesses in our A-123 Appendix A program but classify them as significant deficiencies versus material weaknesses. While identifying and reporting significant deficiencies of our own, management recognizes the issues identified and reported as material weaknesses by the auditors, but believes the internal control over these areas provided reasonable (but not absolute) assurance that the objectives of internal control were met during FY 2009. The Department will work with the OIG and the Independent Auditors in FY 2010 to ensure we include their recommendations for improvements for these areas in our corrective action plans.

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. Management will continue to channel focused efforts to resolve issues with property, financial reporting, and matters related to IBWC that the auditor identified as material weaknesses, as well as for all other significant deficiencies in internal control over financial reporting that were identified by management.

During fiscal year 2009, the Office of Management Controls successfully integrated 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 that complies with Federal system requirements, 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.

Three USIBWC engineers, (l to r) John Merino, Gabriel Duran and Rod Dunlap, inspect the site of the levee rehabilitation financed by the ARRA. *IBWC Image*

AMERICAN RECOVERY AND REINVESTMENT ACT

State Department Role in the American Recovery and Reinvestment Act

Of the total $787 billion appropriated for the American Recovery and Reinvestment Act (ARRA), the Department received $564 million. The Department will use ARRA funds to create and save jobs, repair and modernize domestic infrastructure crucial to the safety of American citizens, and expand consular services offered to American taxpayers.

Construction Projects - A Hard Skills Training Center ($70 million) for Diplomatic Security will be built within 150 miles of Washington, D.C., and provide a centralized location to support all security-related training that is currently conducted at 19 locations throughout the United States. Passport Facilities ($15 million) will fund five new start-up sites and the renovation and expansion of two existing sites. The National Foreign Affairs Training Center ($5 million) will expand existing training capacity to ensure personnel assigned overseas have the necessary language training and information technology training. Projects include upgrading facility and grounds, updating orientation signage for the 72-acre campus, and upgrading infrastructure wiring and public address systems. An enterprise Data Center ($120 million) will be established in the western United States and consolidate all domestic servers into four enterprise data centers. The program will provide a highly available, scalable, and redundant data center infrastructure that will substantially reduce the Department's risk and provide for future information technology (IT) growth.

Information Technology Platform and Cyber Security - Funding ($132 million) will provide for new telephone systems, IT equipment, mobile communications for emergency situations, and projects to guard against and track cyber attacks, improve hardware security and testing, safeguard U.S. citizens' cyber security, and expand cyber education.

International Boundary and Water Commission (IBWC) - These projects ($220 million) will evaluate and repair portions of the flood control systems for 495 miles of the upper and lower Rio Grande River, protecting about 3 million U.S. citizens in New Mexico and Texas. The projects consist of $213 million for the construction and repair of levees, $6 million to rehabilitate contaminated soil and groundwater, and $1 million for other related projects.

Office of Inspector General - Funding ($2 million) to provide oversight of use of ARRA funds and ARRA projects by the Department.

Federal Information Security Management Act

The Department of State 2009 Federal Information Security Management Act (FISMA) and Privacy Management Report reflects a continuation of the Department's endeavor to advance and improve IT security. The Department has sustained its effort to integrate and leverage people, processes, and technology to promote an effective, comprehensive, risk-based information security program. This comprehensive information security program encourages a collaborative approach to protecting information, information systems and other critical assets through prioritizing security initiatives, standardizing processes, and making streamlined security tools available to our diplomats operating around the world. In doing so, the Department is soundly positioned to engage in vital continuous monitoring activities which will further strengthen its security posture.

Building on significant progress made in FY 2008 through identifying, categorizing, and assessing systems, the Department has institutionalized the certification and accreditation (C&A) process and has graduated to a more vigorous, risk-based, continuous monitoring methodology. To facilitate in this effort, the Department's Information Assurance and Enterprise Network Management offices collaborated with Diplomatic Security's Computer Security office to establish new metrics for measuring Information Technology (IT) security vulnerabilities and risks at the site level. During FY 2009, the iPost application, which provides sites with the ability to monitor aspects of their entire Information Technology infrastructure, was enhanced to provide the Department with an improved way of measuring risk through the Site Risk Scoring (SRS) program. The SRS program analyzes the data collected during the automated verification of the 20 most important controls also known as the Consensus Audit Guidelines (CAG) and measures the total risk present. This information aids both technicians and managers with identifying and implementing plausible cost-effective solutions and prioritizing resources.

In FY 2009, the Department continued to strengthen its IT security program through improving and concentrating resources on risk management internal processes, effectively leveraging network monitoring and compliance tools and furthering continuous monitoring efforts. With the continuous evolution of security threats, the Department's emphasis on identifying new methods and approaches such as the SRS program for targeting vulnerabilities that have an enterprise-wide impact has resulted in a 90% reduction in overall risk during the past year.

Financial Section

Message from the Chief Financial Officer

The Agency Financial Report (AFR) is the cornerstone of our efforts to disclose the Department's financial status and provide transparency and accountability to the American people; both our successes and challenges. It is a comprehensive view of the Department's financial activities set against the backdrop of global issues and engagements we face as an institution working to carry out U.S. foreign policy and advance U.S. interests abroad. It is also a snapshot in time of the immense financial work that occurs behind the scenes every day by Department financial personnel as we operate in more than 260 locations, 172 countries, and in over 150 currencies and foreign languages, often in the most challenging environments.

As the Acting Assistant Secretary for Resource Management, I would like to thank the Department's financial professionals, first and foremost, whose efforts on a daily basis to plan, execute, and account for the Department's global resources is the foundation of our stewardship of our public dollars in support of our foreign policy goals. It is a privilege for me to be a part of such a dedicated group of individuals as we all, both the Bureau of Resource Management and the Department's extended financial team, strive to deliver the highest standard of financial accountability and reporting.

FY 2009 was a year of transition to a new Administration. Secretary Clinton has squarely challenged the Department to increase our capacity to utilize "Smart Power" by intelligently leveraging and coordinating our diplomatic and development tools in order to meet the calling of a "New Era of Engagement." For the Department's financial community, this means providing the flexible financial platform that allows us to plan, manage, and account for resources in a way that supports our mission success.


James Millette

The scale and complexity of the Department's activities and corresponding financial management requirements have grown significantly to address a wide range of global issues, whether in support of humanitarian assistance, capital construction of secure diplomatic facilities, or carrying out crucial diplomatic and reconstruction programs in war zones. Over the last five years, total dollars under direct Department management has doubled from $21 billion in FY 2005 to $41.3 billion for FY 2009. We know that strong financial management and internal controls provide the building blocks to support the transparency of operations and accountability to effectively manage these resources. As a result, we have worked diligently to embrace the broadening landscape of financial compliance and reporting requirements and proactively incorporate them into our ongoing budgetary and financial operations. We recognize that the Annual Financial Reporting process is an essential discipline that has provided invaluable benefit over the past several years and in the future. At the same time, we will need to continue to be cognizant to strike the right balance between data driven compliance and reasoned practice tied to outcomes. The ultimate goal of course is to provide transparent, accurate, and timely financial data that translates into high-value financial information for decision-makers in furtherance of the Department's mission and financial transparency and confidence for the American public.

This year's annual audit process was extremely difficult, as we engaged a new audit firm to conduct our annual review. Our experience told us that the worldwide operations and complexities of the Department in carrying out the President's foreign policy agenda were going to be a large challenge for a new firm to comprehend in the tight time frame required by the process. Unfortunately this proved to be true resulting in an outcome that I believe does not truly reflect the full status of the Department's financial program.

Coming into this year, the Department faced no previously identified material weaknesses in its internal controls, and significant work was done to address the FY 2008-cited significant deficiencies in accounting for personal property, management of unliquidated obligations, reporting unfunded actuarial liability for defined benefit supplemental pension plans for overseas locally employed staff, and strengthening interface logic between our systems. In addition, I am pleased to report that the Department maintains a robust system of internal controls overseen by senior leadership and administered by the Bureau of Resource Management. For FY 2009, the Secretary was able to provide an overall unqualified statement of assurance about the Department's internal controls in accordance with the Federal Managers' Financial Integrity Act, as well as an unqualified statement of assurance for internal controls over financial reporting.

Nevertheless, for FY 2009 we did not receive an unqualified opinion on this year's financial statements. The Independent Auditor disclaimed an opinion on the Statement of Budgetary Resources, citing difficulties obtaining timely information requested, and qualified the opinion on the Balance Sheet, citing concerns about the accuracy of property reporting. While we are extremely disappointed with the results of the audit, we are committed to addressing the items cited and improving the audit process and result for FY 2010.

I am confident that the Department's dedicated financial professionals will support this new era of engagement as they continue to plan for and garner vitally needed resources; budget, manage and account for the Department's funds on behalf of America's taxpayers; and assist posts in the field as they conduct our nation's diplomatic affairs. Accountability remains our paramount priority.

James L. Millette

James L. Millette
Assistant Secretary for Resource Management and Chief Financial Officer
December 15, 2009

United States Department of State
and the Broadcasting Board of Governors

Office of Inspector General

DEC 15 2009

INFORMATION MEMO FOR THE SECRETARY

FROM: OIG/DIG – Harold W. Geisel

SUBJECT: Independent Auditor's Report on the U.S. Department of State 2009 and 2008 Financial Statements (AUD/FM-10-03)

An independent certified public accounting firm, Kearney & Company, P.C., was engaged to audit the financial statements of the U.S. Department of State (Department) as of September 30, 2009, and for the year then ended, to provide a report on internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations, to report on whether the Department's financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA), and to report any reportable noncompliance with laws and regulations it tested. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards; Office of Management and Budget audit guidance; and the *Financial Audit Manual*, issued by the Government Accountability Office and the President's Council on Integrity and Efficiency.

In its audit of the Department, Kearney & Company, P.C., was unable to obtain sufficient evidential support for the amounts presented in the FY 2009 Combined Statement of Budgetary Resources. Because of this limitation on its scope of work, Kearney & Company, P.C., was unable to give an opinion on the Combined Statement of Budgetary Resources.

In addition, Kearney & Company, P.C., was unable to obtain sufficient evidential support for property and equipment amounts presented in the FY 2009 Consolidated Balance Sheet and Consolidated Statement of Changes in Net Position.

UNCLASSIFIED

UNCLASSIFIED

Except for the effects of such adjustments, if any, as might have been determined to be necessary had Kearney & Company, P.C., been able to obtain evidential material to enable it to perform audit procedures to satisfy itself that property and equipment were free of material misstatement, Kearney & Company, P.C., found

- the Consolidated Balance Sheet, Consolidated Statement of Net Cost, and Consolidated Statement of Changes in Net Position were presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles,
- material weaknesses[1] in internal control, and
- instances of reportable noncompliance with laws and regulations tested, including instances in which the Department's financial management systems did not substantially comply with FFMIA.

Kearney & Company, P.C., is responsible for the attached auditor's report, which includes the Report of Independent Auditors, the Independent Auditor's Report on Internal Control, and the Independent Auditor's Report on Compliance and Other Matters, dated December 14, 2009, and the conclusions expressed in the report. The Office of Inspector General (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 substantially complied with FFMIA.

Comments on the auditor's report from the Bureau of Resource Management are also attached to this memorandum.

OIG appreciates the cooperation extended to it and Kearney & Company, P.C., by Department managers and staff during the conduct of this audit.

Attachments: As stated.

[1] A material weakness is a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

KEARNEY& COMPANY
Certified Public Accountants and Consultants
4501 Ford Avenue, Suite 1400, Alexandria, VA 22302
PH: 703.931.5600, FX: 703.931.3655, www.kearneyco.com

REPORT OF INDEPENDENT AUDITORS

To the Secretary and Inspector General of the U.S. Department of State

We have audited the accompanying consolidated balance sheet of the U.S. Department of State (Department) as of September 30, 2009, and the related consolidated statements of net cost and changes in net position for the year then ended. We were also engaged to audit the combined statement of budgetary resources for the year ended September 30, 2009. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

The Department's financial statements as of September 30, 2008, were audited by other auditors, whose report, dated December 12, 2008, expressed an unqualified opinion on those statements. We audited the adjustments described in Note 20 that were applied to restate the 2008 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

Except as described in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, as amended, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion on the consolidated balance sheet and statements of net cost and changes in net position.

The Department was unable to provide timely and competent evidential material to enable us to perform audit procedures to satisfy ourselves that the combined statement of budgetary resources for the year ended September 30, 2009, was free of material misstatements within the timeframes established by OMB. Our audit work identified issues related to the systems, processes, and internal controls supporting financial reporting and related processes, as well as key account balances. As a result of these limitations, we were unable to obtain sufficient evidential support for the amounts presented in the FY 2009 combined statement of budgetary resources.

The Department was also unable to provide timely and complete evidential material to enable us to perform audit procedures to satisfy ourselves that the property and equipment balance was free of material misstatements. Our work identified issues related to land valuation; identification and valuation of assets and liabilities under capital leases; completeness and accuracy of real property;

KEARNEY&
COMPANY

and existence, completeness, and valuation of personal property. As a result of these limitations, we were unable to obtain sufficient evidential support for property and equipment amounts presented in the FY 2009 consolidated balance sheet and consolidated statement of net position.

As discussed in Note 20 to the FY 2009 financial statements, the Department restated its FY 2008 financial statements to correct errors identified during the course of the FY 2009 financial statement audit related to classification and amounts reported as environmental liabilities and the valuation of two specific land holdings received from host governments in the mid 1900s.

Because of the matters discussed in the preceding paragraphs, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the combined statement of budgetary resources. We were unable to obtain sufficient and competent evidential matter related to the Department's property and equipment balance as of September 30, 2009. We cannot determine if the consolidated balance sheet and statement of changes in net position presented are free from material misstatement. In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence related to the property and equipment balance, the consolidated balance sheet as of September 30, 2009, and the related statements of net cost and changes in net position for the year then ended, including the accompanying notes, present fairly, in all material respects, the financial position of the Department as of September 30, 2009, and its net cost of operations and changes in net position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Department's Management's Discussion and Analysis, Required Supplementary Information (including stewardship information), and other accompanying information contain a wide range of information, some of which is not directly related to the financial statements. Such information has not been subjected to auditing procedures, and accordingly, we express no opinion on it. We were unable to apply certain procedures prescribed by professional standards to the information within the timeframes established by OMB because of the limitations on the scope of our audit of the financial statements.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have also issued reports, dated December 14, 2009, on our consideration of the Department's internal control over financial reporting and compliance, and on our tests of its compliance with certain provisions of laws, regulations, and other matters for the year ended September 30, 2009. The purpose of the reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance and other matters. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, and should be considered in assessing the results of our audit.

Kearney & Company

December 14, 2009

KEARNEY& COMPANY
Certified Public Accountants and Consultants
4501 Ford Avenue, Suite 1400, Alexandria, VA 22302
PH: 703.931.5600, FX: 703.931.3655, www.kearneyco.com

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

To the Secretary and Inspector General of the U.S. Department of State

We were engaged to audit the financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2009, and have issued our report dated December 14, 2009. Our report on the consolidated balance sheet of the Department and the related consolidated statement of changes in net position for the year then ended was qualified due to the Department's inability to provide timely and competent evidential material to enable us to perform audit procedures to satisfy ourselves that the property and equipment (P&E) balance was free of material misstatement. In addition, the report states that because of the matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the combined statement of budgetary resources for the year ended September 30, 2009.

The management of the Department is responsible for establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met.

In planning and performing our work, we considered the Department's internal control over financial reporting and compliance by obtaining an understanding of the design effectiveness of the Department's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of the Department's controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal controls. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting and compliance or on management's assertion on internal control included in Management's Discussion and Analysis.

We limited our internal control testing to those controls necessary to achieve the control objectives of Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended, control objectives that provide reasonable, but not absolute assurance, that: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP), and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in compliance with laws governing the use of budget authority, government-wide policies and laws identified in Appendix E of OMB Bulletin No. 07-04, as amended, and other laws and regulations that could have a direct and material effect on financial statements. We did not test all internal controls relevant to operating objectives, as broadly defined by FMFIA, such as those controls relevant to ensuring efficient operations.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraphs and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the following deficiencies in the Department's internal control to be material weaknesses.

Material Weaknesses

I. Environmental Liability Restatement

The Department consolidates the International Boundary and Water Commission, United States and Mexico, U.S. Section (USIBWC), into its financial statements. For the year ended September 30, 2008, USIBWC reported an environmental remediation liability of approximately $381 million. The Department did not have a process in place to analyze and evaluate USIBWC's financial information prior to its incorporation in the consolidated financial statements. During the course of our FY 2009 audit, we questioned the appropriateness of this recognition in relation to GAAP. As a result of our inquiries, the Department restated its prior year financial statements and eliminated the environmental liability initially reported by USIBWC.

The recorded liabilities resulted from two court cases requiring the USIBWC to either construct a new sanitary treatment facility or upgrade an existing treatment facility. Neither court case identified the existence of environmental contamination that required cleanup or removal. Additionally, neither ruling assessed fines, penalties, or damages. Both rulings required USIBWC to expend funds for construction of an asset, which would then be reported as P&E. In one case, USIBWC executed a Memorandum of Understanding with a local jurisdiction in which the local jurisdiction would be responsible for construction of the plant, would obtain funding for the plant's construction, and would own the plant. The local jurisdiction obtained a grant to fund construction, and construction was approaching substantial completion at September 30, 2008.

KEARNEY& COMPANY

The Department submitted a Technical Inquiry regarding this issue to the Federal Accounting Standards Advisory Board (FASAB). FASAB concluded that a liability did not exist in either case.

II. Property and Equipment

The Department reported approximately $12 billion in net P&E on its FY 2009 financial statements, about 20 percent of total assets. The Department's internal control structure exhibited several deficiencies that negatively affect the Department's ability to account for real and personal property in a complete, accurate, and timely manner. Weaknesses in property were initially reported in the audit of the Department's FY 2005 financial statements, and subsequent audits. Based on the pervasiveness of the deficiencies in internal control identified, and the related risk of a material misstatement in the financial statements, we assess the Department's property accounting challenges as a material weakness in FY 2009. The combination of these control deficiencies results in more than a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. The individual deficiencies we identified are discussed below:

- Land Valuation – The Department reported $2.2 billion of land and land improvements in FY 2008. As part of our audit of reconciliation procedures and controls in the area of real property, we identified errors in the calculation of the value of land owned by the Department. The Department estimated values for older land parcels because historical cost records were incomplete or missing. The estimation method consisted of obtaining appraisals and discounting the appraisal values back to the date of acquisition using local general inflation factors and currency exchange fluctuations. The Department applied this method regardless of the method of acquisition, i.e., purchase, gift, construction, or trade.

  Included in the Department's land balance, carried forward from years prior to 2008, were nine individual parcels of land with a combined value of $456 million. The nine parcels related to two specific prior period transactions. The Department had erroneously recorded these parcels without discounting estimated values back to the year of acquisition consistent with the Department's stated policy. Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, requires fair market valuation at the time of the gift. The Department processed a restatement to write-down the value of these land parcels to a combined value of $58 million.

- Capital Leases – The Department manages approximately 7,500 real property leases. SFFAS No. 6 requires an analysis of leases for capitalization based on four criteria. In determining leases that qualify as capital leases under GAAP, the Department did not apply one of the four capital lease evaluation criteria – net present value of minimum lease payments in excess of 90 percent of fair market value. If this criterion is met, the Department would record an asset under capital lease, typically for the net present value of the minimum lease payments. The lack of analysis of capital leases in accordance with

KEARNEY& COMPANY

SFFAS No. 6 produced an uncertainty as to the Department's accurate valuation of assets under capital leases.

- Completeness and Accuracy of Real Property – The Department reported a net value of $11 billion in real property assets as of September 30, 2009. Real property primarily consisted of facilities used for U.S. diplomatic missions abroad. The Department has not completed a reconciliation of the overseas real property listed in its general ledger to the properties tracked in its overseas real property management system. Efforts to reconcile real property records for a sample of international posts identified numerous errors and reconciling items. The lack of reconciliation increases the risk that errors may occur and remain undetected and uncorrected for extended periods of time.

- Accounting for Personal Property – The Department reported over $700 million in net personal property as of September 30, 2009. The Department's internal control structure contained several deficiencies related to the timeliness and accuracy of accounting for acquisitions and disposals, the adequacy of physical inventory controls, and the completeness and accuracy of contractor-held property inventories. The combination of these deficiencies contributed to the uncertainty of the Department's personal property balances.

- Accounting for Construction-in-Progress (CIP) – The Department processed approximately $1.8 billion in CIP activity during FY 2009. The Department's internal control structure did not ensure that only valid project costs were capitalized. In addition, the internal control structure did not ensure accurate recording of contractor retainage or identification of lagging costs at the time of a project's substantial completion and transfer into service.

III. Financial Reporting

The Department does not have adequate systems, processes, or controls in place to support the completion of a financial statement audit to meet OMB deadlines. For the FY 2009 audit, we disclaimed an opinion on the statement of budgetary resources because the Department was unable to provide timely and competent documentation prior to OMB's deadline. The FY 2009 audit also identified material adjustments and uncertainties related to Environmental Liabilities and P&E. Combined with the Department's non-automated, manually intensive financial statement process and lack of support for journal entries generated by that manual process, this resulted in a material weakness. In addition, key year-end financial reporting deadlines were not met for the production of draft financial statements, supporting journal vouchers, trial balances, and crosswalks. The Department issued multiple versions of the draft financial statements within four days, and the final statement of budgetary resources and supporting detail was submitted 11 days late during the 30-day extension period. Accordingly, this led to delays in conducting audit procedures and ultimately the inability to render an opinion on the statement of budgetary resources.

KEARNEY& COMPANY

The Department compiles its financial statements through a multi-step process using a combination of manual and automated procedures. The existing accounting system does not have the ability to fully compile the required financial statements and related reports. The necessary data is extracted from multiple systems and source files and sometimes manually keyed into crosswalk templates (i.e., Excel spreadsheets), which ultimately populate the financial statements. To prepare the balance sheet and the consolidated statements of net costs and net position, over 100 manual journal vouchers containing over 1,100 debit/credit combinations with a value of approximately $80.4 billion were recorded.

The non-automated, manually intensive nature of the financial statement compilation process, particularly for the statement of net cost and statement of budgetary resources, resulted in further delays in the production of final financial statements due to the identification of additional adjustments. The lack of a budgetary financial reporting system that is integrated with the financial management system general ledger forces the Department to use an extremely manual, labor-intensive process to develop the statement of budgetary resources. During the compilation process, multiple manual adjustments are required to be posted. A total of 2,602 manual adjustments with a net negative value of $1.4 billion and an absolute value of $202.4 billion were required to reconcile the statement of budgetary resources with the Report on Budget Execution and Budgetary Resources (SF-133). Despite these adjustments, $28.2 million (absolute value) of differences remained between the statement of budgetary resources and the SF-133s.

When accounting for financial transactions, the Department processes an excessive amount of data manually. Manual adjustments are prone to human error, require an increased measure of internal control and review, and increase the likelihood of errors in the statements.

* * * * * * * * *

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Department's internal control to be significant deficiencies.

Significant Deficiencies

I. Accounts Payable Accruals

The Department does not have adequate internal controls in place to ensure that accounts payable accruals are reasonably estimated. GAAP requires an estimate of goods and services received before year-end for which an invoice was not recorded in the accounting records at year-end. The Department uses two different methodologies to estimate domestic and international non-Federal accounts payable accruals. The Department did not prepare an accrual for Federal accounts payable. The Department had no methodology for estimating an accrual for Federal goods and services received but not billed, and could not provide support to demonstrate that an accrual was unnecessary. The audit produced an estimated adjustment of approximately $80

KEARNEY& COMPANY

million based on an analysis of recorded transactions and posting types. The Department recorded this audit adjustment in the financial statements.

In addition, our audit procedures identified anomalies within the Department's overseas accrual methodology. The revised estimate resulted in an audit adjustment of approximately $28 million based on an analysis of the subsequent year's transactions, invoice descriptions, and transaction dates.

The Department does not validate the domestic and international accrual models with actual transaction data to determine the accuracy of the models' outputs. This lack of formal validation limits the Department's ability to ensure that its current methodology is consistent with actual events. Audit procedures identified errors in both the domestic and international accrual estimates.

II. Validity and Accuracy of Unliquidated Obligations

The Department's internal controls are not sufficient to ensure that unliquidated obligations (ULO) are consistently and systematically evaluated for validity and deobligation. Weaknesses in controls over ULOs were initially reported in the audit of the Department's FY 1997 financial statements and subsequent audits. ULOs represent the cumulative amount of orders, contracts, and other binding agreements not yet outlayed. The Department has over $13 billion in ULO balances as of year-end FY 2009 covering a broad spectrum of budgetary authority including annual, multi-year, and no-year appropriations. The Department's policies and procedures provide guidance related to the periodic review, analysis, and validation of the ULO balances posted to the general ledger. Existing Departmental accounting policy requires performing periodic reviews not less frequently than monthly to ensure that ULO balances and disbursements are valid. The current internal control structure is not operating effectively to comply with this policy or to facilitate the accurate reporting of ULO balances recorded in the financial statements. The current process is not systematically and timely identifying open obligations that require deobligation. Additionally, for ULOs identified for closure based on the Department's internal review, bureaus failed to complete deobligation procedures timely or completely and prior to the preparation of financial statements.

The audit process identified adjustments outside of the operation of the internal control structure of approximately $171 million related to ULOs that required deobligation. The Department recorded this audit adjustment in the financial statements.

III. Information Technology

The Department's information technology (IT) internal control structure, both for the general support systems and critical financial reporting applications, did not facilitate a comprehensive risk analysis, effective monitoring of design and performance, and an ability to identify and respond to changing risk profiles. Both the National Institute of Standards and Technology (NIST) and Government Accountability Office (GAO), in its *Federal Information System Controls Audit Manual* (FISCAM), provide control objectives and evaluation techniques. The

KEARNEY& COMPANY

Department's IT control structure exhibited design and operation weaknesses that, when combined, are considered to be a significant deficiency, as summarized below.

- The Department could not provide documentation and analysis of automated controls in nine critical financial applications. These automated controls related to data entry validation, management approvals, segregation of duties, and edit controls. Without this information, the Department could not support that data processing objectives regarding data completion, accuracy, and validity were achieved.

- The Department did not map existing IT security policies and procedures to the NIST 800-53 *(Recommended Security Controls for Federal Information Systems)* control families. Without this mapping, the Department could not determine that existing internal control structures, policies, and procedures effectively and adequately mitigated vulnerabilities and were comprehensive.

- The Department could not provide data regarding numerous controls in multiple applications demonstrating the implementation of effective IT control policies and procedures. Without documentation, the Department could not demonstrate that it complied with management's control requirements.

- The Department did not define user roles, responsibilities associated with each role, and/or procedures to assign roles for five key financial applications. The Department also did not compare existing application privileges with users' job responsibilities for two key financial applications. The Department could not demonstrate management's approvals of users' roles in five financial applications. User requests were improperly completed and approved in five applications. Without a comprehensive analysis of roles, the Department could not assess whether transactions were processed in accordance with instructions, and whether adequate segregation of duties was maintained.

- The Department did not maintain adequate segregation of duties in three financial applications. Approximately 50 users had the ability to affect changes to system databases without leaving an audit trail or could perform incompatible functions. Proper access and audit trails help ensure the accuracy, validity, and integrity of data and transactions.

- The Department did not revise system security plans for multiple financial applications. System security plans did not reflect current password practices in three other applications. Accurate and updated system security plans support system certification and internal control effectiveness.

- The Department could not demonstrate that it had a formal, well-documented oversight process to ensure that all systems users successfully completed annual security awareness training. Security awareness and training helps support data integrity and validity.

* * * * * * * * *

KEARNEY&
COMPANY

The three material weaknesses identified during our audit were not reported by the Department in its FY 2009 FMFIA Assurance Statement. The Department's internal evaluations identified weaknesses in the areas of property and financial reporting. However, the Department did not consider these challenges to be material, and it classified them as significant deficiencies.

This report is intended solely for the information and use of Department management, those charged with governance and others within the Department, and the Inspector General of the U.S. Department of State, OMB, GAO, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Kearney & Company

December 14, 2009

KEARNEY& COMPANY
Certified Public Accountants and Consultants

4501 Ford Avenue, Suite 1400, Alexandria, VA 22302
PH: 703.931.5600, FX: 703.931.3655, www.kearneyco.com

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND OTHER MATTERS

To the Secretary and Inspector General of the U.S. Department of State

We were engaged to audit the financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2009, and have issued our report dated December 14, 2009. Our report on the consolidated balance sheet of the Department and the related consolidated statement of changes in net position for the year then ended was qualified due to the Department's inability to provide timely and competent evidential material to enable us to perform audit procedures to satisfy ourselves that the property and equipment balance was free of material misstatement. In addition, the report states that because of the matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the combined statement of budgetary resources for the year ended September 30, 2009. The management of the Department is responsible for complying with laws and regulations applicable to the Department.

As part of obtaining reasonable assurance about whether the Department's 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 Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. As part of our work, we performed tests of compliance with the Federal Financial Management Improvement Act (FFMIA), Section 803(a) requirements. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982. Providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion.

The results of our testing disclosed instances of noncompliance or other matters exclusive of FFMIA that are required to be reported under *Government Auditing Standards* and the requirements of OMB Bulletin No. 07-04, and which are summarized in the following paragraphs:

- *Antideficiency Act*. This act prohibits the Department from completing the following: (1) Making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law; (2) Involving the Government in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law; and (3) Making obligations or expenditures in excess of an apportionment or reapportionment, or in excess of the amount permitted by agency regulations. Our audit

KEARNEY& COMPANY

procedures identified Treasury fund symbols with negative balances potentially in violation of the Antideficiency Act. The Department had previously identified some of the potential violations and was researching others as of the end of our fieldwork.

- *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 in our report on internal controls, we found that the Department does not have effective controls over property, unliquidated obligations, and financial reporting.

- *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 fully integrate accounting and budgeting information to 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 property, unliquidated obligations, and financial reporting.

- *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. We found that the Department's financial system does not provide effective control over personal property, does not manage unliquidated obligations effectively, and is unable to issue year-end financial data in a timely manner.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with Federal financial management systems requirements,

KEARNEY&
COMPANY

applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level. We noted certain instances, described below, in which the Department's financial management systems did not substantially comply with certain Federal system requirements, Federal accounting standards, and the Standard General Ledger at the transaction level.

Federal Financial Management Systems Requirements:

- A reconciliation of budgetary and proprietary accounts was not part of the Department's routine control structure. A reconciliation as of September 30, 2009, noted differences requiring further research by the Department.
- The Department's core accounting system does not produce complete and timely financial statements. The Department's financial statements are subject to numerous adjustments made outside of the core accounting system. The Department's statement of budgetary resources could not be traced to adequate supporting documentation.
- Certain subsidiary systems, including property systems, are not integrated with the core accounting system. An audit trail from data in the core financial system to detailed source transactions in feeder systems is not always readily available.
- User access and authorization controls were not documented in all cases. Adequate segregation of duties was not maintained in certain financial systems.
- The Department's financial system allows transactions to exceed funds availability at the obligation level in certain instances.

Applicable Federal Accounting Standards:

- We noted certain non-compliances with Federal Accounting Standards in the Department's property accounting practices.
- The audit identified three material weaknesses.

Standard General Ledger at the Transaction Level:

- Financial data could not be appropriately and directly matched to financial statements and OMB and Treasury reports from standard general ledger codes.

Because we could not complete our audit work related to the statement of budgetary resources and property and equipment reported on the balance sheet and statement of changes in net position, we were unable to determine whether there were other instances of noncompliance with laws and regulations related to these areas that are required to be reported.

Kearney & Company

December 14, 2009

United States Department of State

Washington, D.C. 20520

UNCLASSIFIED

MEMORANDUM

TO: OIG – Harry W. Geisel

FROM: RM – James L. Millette

SUBJECT: Draft Audit Report on the Department of State's 2009 and 2008 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 2009 and 2008 Financial Statements" (Report).

The 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 of State (Department) face daily. Despite these complexities, the Department pursues a commitment to financial integrity, transparency, and accountability that is the equal of any large multi-national corporation. Working closely with the previous Independent Auditor and your office, the Department has a proud tradition of unqualified opinions on our financial statements for the past decade. Therefore, we are disappointed that we were unable to achieve an unqualified opinion on our financial statements.

It has been and continues to be a challenge for the Department to complete the audit and meet OMB's reporting deadline given the complexity of our financial operations. This year's annual audit process was extremely difficult, as we engaged a new audit firm, Kearney & Company (Kearney), to conduct our annual review. Our experience told us that the worldwide operations and complexities of the Department in carrying out the President's foreign policy agenda were going to be a large challenge for a new firm to comprehend in the tight time frame required by the process. Unfortunately, this proved to be true resulting in an outcome that we believe does not truly reflect the full status of the Department's financial program. We will work collaboratively and constructively with Kearney and your office on the issues identified in the Report to implement improvements and ensure their resolution.

The Report on Internal Controls cites three material weaknesses and three significant deficiencies. In regards to the material weaknesses, we agree to the issues identified. However, we disagree with the severity at which they are categorized. With the exception of the IBWC Restatement, the Department reports similar weaknesses in our A-123 Appendix A program but classify them as significant deficiencies versus material weaknesses. While identifying and reporting significant deficiencies of our own, management recognizes the issues identified and reported by the auditors regarding the financial statement restatement, property and equipment, and financial reporting issues, but believes the internal control over these areas provided reasonable (but not absolute) assurance that the objectives of internal control were met during FY 2009.

MATERIAL WEAKNESSES

Environmental Liability Restatement

The Report cites a material weakness that the Department did not have a process in place to analyze and evaluate the International Boundary and Water Commission's (IBWC) financial information prior to its incorporation in the Department's consolidated financial statements. As noted, the Department consolidates financial amounts for the IBWC into our financial statements.

For over a decade, in addition to having their amounts included in our Departmentwide financial statements, IBWC has issued separate audited component financial statements that have received unqualified opinions for a number of years. The audits are conducted by an independent CPA-firm engaged and overseen by the Office of Inspector General (OIG). It is these audited amounts that the Department has incorporated into our financial statements with the environmental liability first recorded in FY 2004. In our Appendix A program, we strive to integrate control related activities within the control framework and leverage the internal reviews already being performed such as the separately audited and issued IBWC financial statements. We saw no reason to question the amounts reported based on the issuance of the unqualified audit opinions on the IBWC financial statements by the OIG and independent auditor.

Further, we believe the accounting treatment and reporting of this item is difficult as to whether the cases involved should follow guidance in SFFAS No. 5, either as Government related events or specifically as contingent liabilities; or as environmental liabilities following guidance in SFFAS No. 6. These cases involve treaty provisions and court orders, decrees, and to quote FASAB "findings that are complex." The Department requested, and the OIG convened, a meeting with the two independent auditors. Unfortunately, no consensus was reached in the meeting. Consequently, the Department submitted a technical inquiry to the Federal Accounting Standards Advisory Board (FASAB) with the understanding that it would follow FASAB's guidance. FASAB's determination was that no accounting liability exists or existed as an immediate result of either case. The Department adopted this guidance and recorded the IBWC restatement accordingly as recommended by our new Independent Auditor.

We appreciate that Kearney concludes that a restatement is an "automatic" material weakness. We understand that the restatement of previously issued financial statements to reflect the correction of a material misstatement is an indicator of a control deficiency that should be regarded as at least a significant deficiency, and a strong indicator of a material weakness in internal control. However, in light of the above, we do not believe that this item represents a material weakness in our current and existing internal control processes. Further, we believe that the determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. We are unaware of any adverse impact on users of our or the USG financial statements, or on IBWC and Department operations, as a result of the reporting of the environmental liability. The restatements had no effect on the Department's or IBWC's reporting of budgetary resources.

Property and Equipment

Based on the pervasiveness of the deficiencies in internal control identified, and the related risk of a material misstatement in the financial statements, Kearney assessed the Department's property accounting challenges as a material weakness in FY 2009. Kearney elected to combine all of their findings related to property and equipment rather than on an individual basis for real versus personal property. In regards to the material weaknesses, while we agree to the issues identified, we disagree with the severity at which they are categorized.

Land Valuation. The Department's restatement was to correct the valuation of two specific land holdings received from host governments in the mid 1900s. The land acquisitions represented the fair market value of gifts of real property to the Department from other countries. The Department first valued these properties in 1996 at the inception of our accounting for property under the CFO Act. These two properties were part of our valuation of all real property, representing over 3,400 assets. The methodology, developed by a leading CPA firm, and agreed to by the previous Independent Auditor, OIG, OMB and GAO, was to estimate the fair market value of the gifts using reasonable and consistent parameters such as comparable purchases, equivalent square footage, and CPI inflation indices. The methodology erred in that it presented FMV as of 1996 instead of as of the date of the gift. In the intervening 12 years, we are unaware of any adverse impact on users of our financial statements, or on Department operations, as a result of the reporting of the overstated estimated values. The restatements had no effect on the Department's reporting of budgetary resources.

Capital Leases. We agree that we need to expand our processes to analyze property leases, and will work with Kearney to improve these processes.

Completeness and Accuracy of Real Property. The Department agrees that it has not completed a full reconciliation between the Department's real property management system (RPA/BMIS) and the Global Financial Management System's (GFMS) Fixed Assets (FA) module. These two systems serve different and multiple purposes, some of which intersect but many of which do not. Overseas buildings make up the largest balance of overseas real property assets -- totaling $6.4 billion (nearly 73%) net book value (NBV) of the $8.8 billion total NBV for overseas real property (excluding $1.5 billion of construction-in-process) at September 30, 2009. As a result of ongoing discussions on the audit, a reconciliation was completed by the Department between RPA/BMIS and GFMS-FA for all government-owned Chancery and Consulate Buildings. These buildings comprise $5.5 billion (86%) of the total overseas buildings NBV of $6.4 billion. The reconciliation identified a variance of $12.2 million (NBV), a .22% (i.e., less than ¼ of 1%) discrepancy rate. In addition, the Department completed reconciliations on twenty (20) posts. In doing so, the Department identified several other immaterial differences and the need to strengthen the controls and procedures for the accounting for disposals and retirements of buildings. We will take actions to improve these processes and complete the reconciliations over the remaining balances in FY 2010.

Accounting for Personal Property. The Department acknowledges that our internal control structure contains several deficiencies related to the timeliness and accuracy of accounting for personal property. This past year we have continued to improve controls. We established personal property points of contact for each post who work directly with the property accountability officer at post to improve the timeliness of recording acquisitions and disposals. The points of contact also assist the posts with various issues in recording personal property, such as proper fiscal data. The post GSO is now required to provide the ILMS screen print that supports the cost, vehicle receipt and fiscal data accuracy to the FMO as part of the supporting documentation for vehicle payments. The FMO reviews the documentation to ensure accuracy prior to certifying payment. Information regarding all payments for vehicles that have not been entered in ILMS is sent to the posts via the Property Accounting POC. The POC contacts the posts regarding the payment and assists them in data entry of the asset if necessary. Also, the frequency of the review of the asset detail by RM was increased from the prior year. A listing of assets that appeared to be entered improperly, based on various parameters, was sent to Property Accounting for review and post or bureau follow up as necessary. Corrections not processed by year end were captured in the analysis of personal property adjustments completed for yearend reporting. We will continue our efforts in FY 2010 to improve the accounting for personal property.

Accounting for Construction-In-Process (CIP). Kearney selected a statistical sample of current year CIP additions through March 31, 2009 and tested proper capitalization, accuracy of the amounts recorded, and the internal controls surrounding the process. The exceptions identified resulted in a $2.5 million net overstatement of the Department's interim general PP&E balance of approximately $1.5 billion. The Department will work to strengthen controls and oversight to ensure that CIP transactions are recorded accurately in those instances where the benefits of such additional oversight and controls exceed the cost to develop, implement and operate the improvements.

Financial Reporting

As noted by Kearney, the Department compiles its financial statements through a multi-step process using a combination of manual and automated procedures. The existing accounting system does not fully compile the required financial statements for several reasons including the receipt of information to include in the statements from external sources. For example, Kearney reported journal vouchers totaling over $80.4 billion (which treats all debits and credits as absolute amounts) were recorded. Of this amount, about $40 billion (i.e., one-half) is to include financial information received in mid-to-late October (after we have closed for the year) from other agencies that have allocations of the Department's budget authority. There are other similar type activities areas for large portions of the remaining balances where it is more effective to record the amounts to the agencywide financial statement level (e.g., accounts payable accrual estimates) then to attempt to record it to the detailed level that our financial system requires. The same is true for our SF-133 and Statement of Budgetary Resource preparation process. Regardless, the Department agrees that these processes can be improved, and will work with Kearney to do so in FY 2010.

SIGNIFICANT DEFICENCIES

Accounts Payable Accruals

The preparation of financial statements in conformity with GAAP requires the Department to make estimates and assumptions, and exercise judgment that affects the reported amounts of liabilities as of the date of the financial statements. These estimates are based on our best knowledge of historical experience 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. The Department believes our estimation process for our domestic accounts payable of about $825 million is reasonably accurate. Our estimation process for our overseas accounts payable of about $140 million could be improved, and we agree that we need to establish a process to record intragovernmental accounts payable. Accordingly, we recorded Kearney's estimated adjustment for intragovernmental accounts payable of $80 million. We appreciate the collaborative and professional manner in which this area of the FY 2009 financial statement audit was conducted, and plan to work closely in FY 2010 with Kearney to improve the accrual process.

Validity and Accuracy of Unliquidated Obligations

The Report cites a significant deficiency for the management of unliquidated obligations. Improvements in the management of undelivered orders will continue to be a priority for the Department in FY 2010. By way of reference, the audit adjustment of $171 million recorded by the Department for FY 2009 is about $27 million less than FY 2008 auditor recommended adjustment, and our total undelivered orders at September 30, 2009 ($13.8 billion) were $1.8 billion greater than the balances at September 30, 2008. Regardless, we agree that further corrective actions are needed and are already underway including the distribution of aging reports, and using recently developed enhancements to our Global Financial Management System capabilities to automate deobligations. In addition, actions to improve contract and grant closeout procedures relative to undelivered orders are being enhanced, and the Senior Assessment Team will be actively engaged with the implementation and oversight of these corrective actions. We appreciate the collaborative and professional manner in which this area of the FY 2009 financial statement audit was conducted, and plan to work closely in FY 2010 with Kearney to improve management of unliquidated obligations.

Information Technology

Kearney reported that the Department's information technology (IT) internal control structure, both for the general support systems and critical financial reporting applications, did not facilitate a comprehensive risk analysis, effective monitoring of design and performance, and an ability to identify and respond to changing risk profiles. While the Department did not completely concur with Kearney's notifications of findings and recommendations, the Department will work to fully understand the weaknesses identified by Kearney and address them in priority order according to the level of risk they present to the Department's operations.

In regards to the report on Compliance and Other Matters, we acknowledge that Kearney concluded that the Department's systems do not substantially comply with Federal financial management systems requirements, Federal accounting standards (GAAP), and the USSGL at the transaction level as of September 30, 2009. While we agree that significant deficiencies exist in certain capabilities within the Department's financial systems, we do not concur with the full extent of the auditor's assessment. We will work with Kearney over the next several months to reconcile our differences of opinion and develop corrective actions to any agreed upon shortcomings.

We thank you for the opportunity to comment on the draft Report. While we may not agree on the severity of issues identified in the Report, we remain fully committed to improving the management of the Department and its financial reporting. To that end, while this year's audit process has been difficult, we would like to extend our appreciation to Kearney & Company for their dedicated efforts on this year's audit.

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 2008 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 Deferred Maintenance.

CONSOLIDATED BALANCE SHEET

(Dollars in Millions)

As of September 30,	Notes	2009	2008 Restated (Note 20)
ASSETS	2		
Intragovernmental Assets:			
Fund Balances With Treasury	3	$ 31,738	$ 25,151
Investments, Net	4	15,372	14,891
Interest Receivable		191	194
Accounts Receivable, Net	5	458	401
Other Assets	8	—	2
Total Intragovernmental Assets		47,759	40,639
Accounts and Loans Receivable, Net	5	38	76
Cash and Other Monetary Assets	6	84	70
Property and Equipment, Net	7	11,676	10,678
Other Assets	8	298	254
Total Assets		$ 59,855	$ 51,717
Stewardship Property and Equipment; Heritage Assets	7		
LIABILITIES	9		
Intragovernmental Liabilities:			
Accounts Payable		$ 157	$ 129
Other Liabilities		993	783
Total Intragovernmental Liabilities		1,150	912
Accounts Payable		1,919	2,749
Foreign Service Retirement Actuarial Liability	10	16,983	15,139
Liability to International Organizations	11	1,451	1,507
Other Liabilities	9,12	979	795
Total Liabilities		22,482	21,102
Commitments and Contingencies	13		
NET POSITION			
Unexpended Appropriations—Other Funds		23,546	17,979
Cumulative Results of Operations—Earmarked Funds	14	(910)	231
Cumulative Results of Operations—Other Funds		14,737	12,405
Total Net Position		37,373	30,615
Total Liabilities and Net Position		$ 59,855	$ 51,717

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,	2009	2008 Restated (Note 20)
Achieve Peace and Security		
Total Cost	$ 6,479	$ 6,880
Earned Revenue	(740)	(1,032)
Net Program Costs	5,739	5,848
Governing Justly and Democratically		
Total Cost	794	808
Earned Revenue	(41)	(66)
Net Program Costs	753	742
Investing in People		
Total Cost	5,110	3,267
Earned Revenue	(20)	(30)
Net Program Costs	5,090	3,237
Promoting Economic Growth and Prosperity		
Total Cost	1,298	1,321
Earned Revenue	(66)	(108)
Net Program Costs	1,232	1,213
Providing Humanitarian Assistance		
Total Cost	1,695	1,158
Earned Revenue	–	(5)
Net Program Costs	1,695	1,153
Promoting International Understanding		
Total Cost	2,363	2,301
Earned Revenue	(279)	(219)
Net Program Costs	2,084	2,082
Strengthening Consular and Management Capabilities		
Total Cost	3,831	3,674
Earned Revenue	(2,608)	(2,659)
Net Program Costs	1,223	1,015
Executive Direction and Other Costs Not Assigned		
Total Cost	5,596	4,097
Earned Revenue	(1,799)	(1,634)
Net Program Costs	3,797	2,463
Total Cost	**27,166**	**23,506**
Total Revenue	**(5,553)**	**(5,753)**
Total Net Cost	**$ 21,613**	**$ 17,753**

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,	2009			2008 Restated (Note 20)
	Earmarked Funds	All Other Funds	Consolidated Total	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$ 231	$ 12,405	$ 12,636	$ 10,787
Correction of Environmental Liability and Land Revaluation (Note 20)	—	—	—	(6)
Beginning Balances, as adjusted	231	12,405	12,636	10,781
Budgetary Financing Sources:				
Appropriations Used	—	23,176	23,176	20,083
Non-exchange Revenue	1	33	34	25
Donations	5	3	8	13
Transfers in(out) without Reimbursement	199	9	208	34
Accrued Earmarked Transfer In	32	—	32	—
Other Financing Sources:				
Donations	—	—	—	89
Imputed Financing From Costs Absorbed by Others	—	133	133	121
Non-entity Collections	—	(787)	(787)	(757)
Total Financing Sources	237	22,567	22,804	19,608
Net Revenue from (Cost of) Operations	(1,378)	(20,235)	(21,613)	(17,753)
Net Change	(1,141)	2,332	1,191	1,855
Total Cumulative Results of Operations	**(910)**	**14,737**	**13,827**	**12,636**
Unexpended Appropriations				
Beginning Balances	$ —	$ 17,979	$ 17,979	$ 14,553
Budgetary Financing Sources:				
Appropriations Received	—	28,939	28,939	23,601
Appropriations transferred in(out)	—	(8)	(8)	217
Rescissions and Canceling Funds	—	(188)	(188)	(309)
Appropriations Used	—	(23,176)	(23,176)	(20,083)
Total Budgetary Financing Sources	—	5,567	5,567	3,426
Total Unexpended Appropriations	**—**	**23,546**	**23,546**	**17,979**
Net Position	**$ (910)**	**$ 38,283**	**$ 37,373**	**$ 30,615**

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,	**2009**	**2008**
Budgetary Resources:		
Unobligated Balance, brought forward, October 1:	$ 8,163	$ 6,310
Recoveries of Prior Year Unpaid Obligations	702	779
Budget Authority:		
Appropriations	29,826	24,969
Spending authority from offsetting collections:		
Earned		
Collected	10,849	7,063
Change in receivable from Federal sources	33	(171)
Change in unfilled customer orders:		
Advance received	612	285
Without Advance from Federal sources	(2)	—
Nonexpenditure transfers, net	35	217
Temporarily not available pursuant to Public Law	—	(305)
Permanently not available	(80)	(322)
Total Budgetary Resources	**$ 50,138**	**$ 38,825**
Status of Budgetary Resources:		
Obligations Incurred:		
Direct	$ 26,226	$ 23,092
Reimbursable	11,942	7,570
Unobligated balance		
Apportioned	11,396	7,489
Unobligated balance not available	574	674
Total Status of Budgetary Resources	**$ 50,138**	**$ 38,825**
Change in Obligated Balance:		
Obligated Balance, net		
Unpaid Obligations, brought forward, October 1	$ 17,467	$ 13,986
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(456)	(627)
Obligations incurred, net	38,168	30,662
Less: Gross Outlays	(34,571)	(26,402)
Less: Recoveries of prior-year unpaid obligations, actual	(702)	(779)
Change in uncollected customer payments from Federal sources	(31)	171
Obligated balance, net, end of period:		
Unpaid obligations	20,362	17,467
Less: Uncollected customer payments from Federal sources	(487)	(456)
Net Outlays		
Gross outlays	34,571	26,402
Less: Offsetting collections	(11,460)	(7,348)
Less: Distributed Offsetting receipts	(337)	(352)
Net Outlays	**$ 22,774**	**$ 18,702**

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

NOTES TO PRINCIPAL FINANCIAL STATEMENTS

ORGANIZATION

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

The 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.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity and Basis of Consolidation

The accompanying principal financial statements present the financial activity and financial position of the Department of State. The statements include all General, Special, Revolving, Trust and Deposit funds established at the Department of the Treasury to account for the resources entrusted to Department of State management, or for which the Department acts as a fiscal agent or custodian, (except fiduciary funds, see Note 19). Included in the Department's reporting entity is the International Boundary and Water Commission (IBWC), established by treaty between Mexico and the United States in 1889 to facilitate negotiations for and maintenance of 1,200 miles of shared water along the Texas border.

Basis of Presentation and Accounting

The statements are prepared as required by the CFO Act of 1990 (requiring statements), as amended by the Government Management and Reform Act of 1994 (requiring audited statements). They are presented in accordance with form and content requirements of the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, as amended.

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.

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, the Department reports all activity relative to these allocation transfers in its 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 USAID.

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 Fund, 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, Thailand, and Charleston, South Carolina, and provide financial support for overseas operations for the Department and other Federal agencies. 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.

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 a rate established by Treasury annually. 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 only when related goods and services are received. Advances are made principally to Department employees for official travel and for salaries of Department employees transferring to overseas assignments. Advances to other entities secure future services. 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.

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 to the financial statements, and in the Heritage Assets section of Other Accompanying Information.

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 IBWC owns buildings and structures related to its boundary preservation, flood control, and sanitation programs.

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 Buildings Operations (OBO)

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 $1 million. The capitalization threshold for improvements to Department real property was changed from $250,000 to $1,000,000 effective October 1, 2008. 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 holds 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 involve routine inspection, as well as scheduled maintenance and replacements of certain parts after given hours of use. Host-country managed aircraft are maintained to host country requirements, which are less than FAA standards.

Department of State/Diplomatic Security

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. Additionally, 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 lesser of the useful life (not to exceed 30 years) or 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 normal business activities, unbilled payables are estimated based upon historical data.

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.

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 $133 million and $121 million in 2009 and 2008 for these benefits. The additional costs are not owed or paid to OPM, and thus are not reported on the Balance Sheet as a liability; instead, they are reported as an imputed financing source from costs absorbed by others on the Statement of Changes in Net Position.

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 Image/Paul J. Richards*

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 actuarial liability for which the Department is responsible totaled $72 million and $69 million as of September 30, 2009 and 2008.

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 Note 10 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:

Unexpended Appropriations — the sum of undelivered orders, delivered orders unpaid, 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.

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.

Net position of earmarked funds is separately disclosed. See Note 14.

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.

Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold. The Department's fiduciary activities are not recognized on the proprietary financial statements, but are reported on schedules as a note to the financial statements. The Department's fiduciary activities include receiving contributions from donors for the purpose of providing compensation for certain claims within the scope of an established agreement, investment of contributions into Treasury securities, and disbursement of contributions received within the scope of the established agreement.

Change in an Accounting Estimate

To determine the Actuarial Present Value of Projected Plan Benefits for the Foreign Service Retirement and Disability Program, the Department retains the services of a professional actuarial firm to determine these values. In FY 2009, the actuarial estimates increased significantly over the previous year. The cause of this increase is the result of a change in the underlying assumptions used to calculate the values. The underlying assumption changed as a result of the Foreign Service Retirement Plans Actuarial Experience Study 2003 -2008, dated September 22, 2009. As a result of the study, the valuation for the assumed investment return, the assumed general salary scale, and the assumed rate of inflation have decreased by 0.5% from the previous valuations reported from FY 2004 through FY2008. The decreases in these three economic indicators combined with changes in demographic assumptions such as withdrawal rates, active employee disability rates, and mortality rates has resulted in a significant increase, $1.8 billion, in the FSRDF reported Actuarial Liability between September 30, 2008 and 2009.

For detailed information of these changes and the Department's accounting policy for the FSRDF as of September 30, 2009, see separate Note 10 on the Foreign Service Retirement Actuarial Liability.

2 ASSETS

The Department's assets are classified as entity or non-entity. Entity assets are those assets that the Department has authority to use for its operations. Non-entity assets are those held by the Department that are not available for use in its operations. Total non-entity assets at September 30, 2009 and 2008, were $15 million and $15 million, respectively, for amounts in the Chancery Development Trust Account. These items are included in 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, 2009 and 2008, are summarized below *(Dollars in Millions)*.

Fund Balances	2009	2008
Appropriated Funds	$ 30,645	$ 24,387
Revolving Funds	669	541
Earmarked Funds	367	186
Special Funds	31	17
Deposit & Receipt Accounts	26	20
Total	$ 31,738	$ 25,151

Status of Fund Balances	2009	2008
Unobligated Balances Available	$ 11,396	$ 7,489
Unobligated Balances Unavailable	574	674
Obligated Balances not yet Disbursed	19,742	16,968
Total Unobligated and Obligated	31,712	25,131
Deposit and Receipt Funds	26	20
Total	$ 31,738	$ 25,151

4 Investments

SUMMARY OF INVESTMENTS

Investments at September 30, 2009 and 2008, are summarized below *(Dollars in Millions)*. All investments are classified as Intragovernmental.

At September 30, 2009:	Net Investment	Market Value	Maturity Dates	Interest Rates Range	Interest Receivable
Non-Marketable Special Issue Securities	$ 15,334	$ 15,334	2010-2024	3.125%-7%	$ 191
Notes, Israeli-Arab Scholarship Fund	5	5	2009-2010	2%-3.5%	—
Notes, Eisenhower Exchange Fellowship Fund	8	8	2010-2019	1.125%-8.875%	—
Notes, Middle Eastern-Western Dialogue Fund	18	18	2009-2010	2.875%-6.5%	—
Treasury Bills, Gift Funds	7	7	2010-2019	1.972%-3.5%	—
Total Investments	$ 15,372	$ 15,372			$ 191

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

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. The Government finances most expenditures in this way.

5 Accounts and Loans Receivable, Net

The Department's Accounts Receivable and Loans Receivable at September 30, 2009 and 2008, are summarized here *(Dollars in Millions)*. All are entity receivables.

	2009			2008		
	Entity Receivables	Allowance for Uncollectible	Net Receivables	Entity Receivables	Allowance for Uncollectible	Net Receivables
Intragovernmental Accounts Receivable	$ 458	$ —	$ 458	$ 441	$ (40)	$ 401
Non-Intragovernmental Accounts and Loans Receivable	91	(53)	38	85	(9)	76
Total Receivables	$ 549	$ (53)	$ 496	$ 526	$ (49)	$ 477

Included in Accounts and Loans Receivable, Net are $1 million and $2 million, in 2009 and 2008, 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, 2009 and 2008, are summarized below *(Dollars in Millions)*. There are no restrictions on entity cash. Non-Entity cash is restricted as discussed below.

	2009			2008		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Chancery Development						
Trust Account:						
Treasury Bills, at par	$ —	$ 15	$ 15	$ —	$ 15	$ 15
Cash-Imprest and Other Funds	69	—	69	55	—	55
Total	$ 69	$ 15	$ 84	$ 55	$ 15	$ 70

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 a 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, 2009 and 2008, are shown in the following table *(Dollars in Millions)*:

	2009			2008 (Restated)		
Major Classes	**Cost**	**Accumulated Depreciation**	**Net Value**	**Cost**	**Accumulated Depreciation**	**Net Value**
Real Property:						
Overseas —						
Land and Land Improvements	$ 1,886	$ (21)	$ 1,865	$ 1,830	$ (12)	$ 1,818
Buildings and Structures	10,362	(3,956)	6,406	9,304	(3,609)	5,695
Construction-in-Progress	1,827	—	1,827	1,735	—	1,735
Assets Under Capital Lease	89	(38)	51	86	(35)	51
Leasehold Improvements	362	(195)	167	368	(178)	190
Domestic —						
Structures, Facilities and Leaseholds	591	(272)	319	591	(257)	334
Construction-in-Progress	244	—	244	33	—	33
Land and Land Improvements	81	(6)	75	81	(6)	75
Total — Real Property	15,442	(4,488)	10,954	14,028	(4,097)	9,931
Personal Property:						
Aircraft	632	(400)	232	682	(407)	275
Vehicles	554	(311)	243	456	(264)	192
Communication Equipment	29	(25)	4	71	(59)	12
ADP Equipment	78	(59)	19	65	(50)	15
Reproduction Equipment	10	(8)	2	12	(10)	2
Security	92	(60)	32	95	(60)	35
Software	327	(225)	102	327	(198)	129
Software-in-Development	32	—	32	26	—	26
Other Equipment	218	(162)	56	215	(154)	61
Total — Personal Property	1,972	(1,250)	722	1,949	(1,202)	747
Total Property and Equipment, Net	$ 17,414	$ (5,738)	$ 11,676	$ 15,977	$ (5,299)	$ 10,678

STEWARDSHIP PROPERTY AND EQUIPMENT; HERITAGE ASSETS

The Department maintains collections of art, furnishings and real property (Culturally Significant Property) that are held for public exhibition, education and official functions for visiting chiefs of State, heads of government, foreign ministers and other distinguished foreign and American guests. As the lead institution conducting American diplomacy, the Department uses this property to promote national pride and the distinct cultural diversity of American artists, as well as to recognize the historical, architectural and cultural significance of America's holdings overseas.

There are 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, activity of which is shown in the following table and described more fully in the Other Accompanying Information section of this report, consist of items that were donated, purchased using donated or appropriated funds, or on loan from individuals, organizations and museums. The Department provides protection and preservation services to maintain all Heritage Assets in good condition forever as part of America's history.

HERITAGE ASSETS
For Year Ended September 30, 2009

	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 - 9/30/2007	3,440	2,203	979	4,819	1,033	17
Acquisitions	9	45	197	1,603		3
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
Acquisitions	14	39		5,075	27	
Adjustments		40	(210)			
Disposals	(16)			(662)	(1)	
Number of Items - 9/30/2009	3,443	2,327	966	10,829	1,059	20
Deferred Maintenance - 9/30/2009	N/A	N/A	N/A	N/A	N/A	$3,665,000

8 OTHER ASSETS

The Department's other assets at September 30, 2009 and 2008, include advances and prepayments in support of programs including HIV/AIDS, Child Health, Diplomatic and Consular, and Overseas Building Operations plus salary/travel advances to employees and inventory.

9 LIABILITIES

The Department's Other Liabilities at September 30, 2009 and 2008, are summarized below *(Dollars in Millions)*.

	2009			2008		
	Current	Non-Current	Total	Current	Non-Current	Total
Intragovernmental						
Deferred Revenue	$ 931	—	$ 931	$ 716	—	$ 716
Custodial Liability	20	—	20	36	—	36
Other Liabilities	42	—	42	31	—	31
Total Intragovernmental	993	—	993	783	—	783
Federal Employees Compensation Act Benefits	72	—	72	69	—	69
Capital Lease Liability	4	68	72	5	68	73
Accrued Salaries Payable	157	—	157	125	—	125
Contingent Liability	—	15	15	27	—	27
Pension Benefits Payable	56	—	56	52	—	52
Accrued Annual Leave	—	299	299	—	272	272
Funds Held in Trust and Deposit Accounts	—	15	15	—	15	15
Other Liabilities	243	31	274	155	2	157
Deferred Revenues	19	—	19	5	—	5
Subtotal	551	428	979	438	357	795
Total Other Liabilities	$ 1,544	$ 428	$ 1,972	$ 1,221	$ 357	$ 1,578

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, 2009 and 2008, are summarized to the right *(Dollars in Millions)*.

Liabilities Not Covered by Budgetary Resources	2009	2008 (Restated)
Intragovernmental Liabilities		
Unfunded FECA Liability	$ 18	$ 18
Total Intragovernmental Liabilities	18	18
Payable to International Organizations	1,451	$ 1,507
Foreign Service Retirement Actuarial Liability	1,513	142
Accrued Annual Leave	299	272
Contingent Liability	15	27
Other Liabilities	210	156
Total Liabilities Not Covered By Budgetary Resources	3,506	2,122
Total Liabilities Covered By Budgetary Resources	18,976	18,980
Total Liabilities	$ 22,482	$ 21,102

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 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.

As discussed in Note 1, *Change in an Accounting Estimate*, the economic and demographic assumptions used to estimate the actuarial liability changed as a result of an experience study conducted by the Department's actuaries in FY 2009. As a result of the study, the valuation for the assumed rate of investment return decreased from 6.25 percent to 5.75 percent; the assumed general salary scale decreased from 4.25 percent to 3.75 percent; and the assumed inflation rate decreased from 3.5 percent to 3.0 percent. Additionally, changes occurred in demographic assumptions such as employee withdrawal rates, retirement rates, and disability and mortality rates. As a result of these changes in the actuarial assumptions, the September 30, 2009, present value of accumulated plan benefits increased by $918.8 million. The table below presents the normal costs for FY 2009 and FY 2008 incorporating the changes for FY 2009.

Normal Cost:	FY 2009	FY 2008
FSRDS	32.36%	30.35%
FSPS	27.56%	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, 2009 and 2008 *(Dollars in Millions)*.

For the Year Ended September 30,	2009	2008
Pension Actuarial Liability, Beginning of Year	$ 15,139	$ 14,729
Pension Expense:		
Normal Cost	326	311
Interest on Pension Liability	931	906
Actuarial (Gains) or Losses	1,406	(16)
Total Pension Expense	2,663	1,201
Less Payments to Beneficiaries	(819)	(791)
Pension Actuarial Liability, End of Year	16,983	15,139
Less: Net Assets Available for Benefits	(15,470)	(14,997)
Actuarial Pension Liability - Unfunded	$ 1,513	$ 142
Actuarial Assumptions:		
Rate of Return on Investments	5.75%	6.25%
Rate of Inflation	3.00%	3.50%
Salary Increase	3.75%	4.25%

Net Assets Available for Benefits at September 30, 2009 and 2008, consist of the following *(Dollars in Millions)*:

At September 30,	2009	2008
Accounts and Interest Receivable	$ 205	$ 206
Investments in US government securities	15,334	14,855
Total Assets	15,539	15,061
Less: Liabilities Other Than Actuarial	(69)	(64)
Net Assets Available for Benefits	$ 15,470	$ 14,997

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. The amounts assessed that will never be 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. Certain other organizations and peace keeping efforts such as UNESCO which are supported by voluntary pledges and appropriations not in arrears are not included here *(Dollars in Millions)*.

As of September 30,	2009	2008
Regular Membership Assessments Payable to UN	$ 772	$ 772
Dues Payable to UN Peacekeeping Missions	441	1,602
Liabilities to Other International Organizations	1,030	1,033
	2,243	3,407
Less Amounts not Authorized to be Paid	(617)	(680)
Liabilities to International Organizations	$ 1,626	$ 2,727
Accounts Payable - Funded	$ 175	$ 1,220
Liabilities to International Organizations - Unfunded	1,451	1,507
Total Liabilities to International Organizations	$ 1,626	$ 2,727

12 Leases

The Department is committed to over 7,500 leases, which cover office and functional properties, and residential units at diplomatic missions overseas. The majority of these leases are short-term operating leases. In most cases, management expects that the leases will be renewed or replaced by other leases. Personnel from other U.S. Government agencies occupy some of the leased facilities (both residential and non-residential). These agencies reimburse the Department for the use of the properties. Reimbursements are received for leases approximately $73M 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, 2009 and 2008 *(Dollars in Millions)*:

	2009	2008
Net Assets Under Capital Leases:		
Land and Buildings	$ 89	$ 86
Accumulated Depreciation	(38)	(35)
Net Assets under Capital Leases	$ 51	$ 51

Future Minimum Lease Payments:

2009

Fiscal Year	Lease Payments
2010	$ 4
2011	5
2012	4
2013	4
2014	4
2015 and thereafter	315
Total Minimum Lease Payments	336
Less: Amount Representing Interest	(264)
Obligations under Capital Leases	$ 72

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

OPERATING LEASES

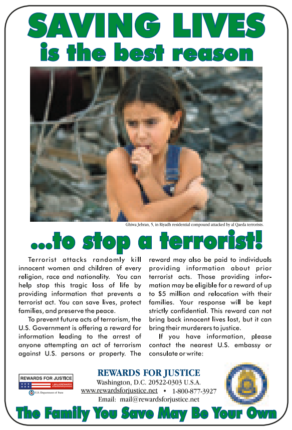
The Department leases real property in overseas locations under operating leases. These leases expire in various years. Minimum future rental payments under operating leases having remaining terms in excess of one year as of September 30, 2009, for each of the next 5 years and in aggregate are as follows *(Dollars in Millions)*:

Year Ended September 30,	Operating Lease Amounts
2010	$ 333
2011	239
2012	151
2013	95
2014	65
2015 and thereafter	139
Total Minimum Future Lease Payments	$ 1,022

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 involve contract disputes related to embassy construction, class action suits related to fees collected, foreign taxes, and international claims made against the United States being litigated by the Department. As a result of these reviews, the Department believes these claims could result in potential losses of $50 to $70 million if the outcomes were adverse to the Department, an amount 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 2009 and 2008 had a material effect on the financial position or results of operations of the Department.

As a part of our continuing evaluation of estimates required in the preparation of our financial statements, we recognize settlements of claims and lawsuits and revised other estimates in our contingent liabilities. Management and the Legal Advisor believe we have made adequate provision for the amounts that may become due under the suits, claims and proceedings we have discussed here.

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 reward offers under the three programs total $685 million. We have paid out $149 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.

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 fourteen earmarked funds as listed below. In 2009, based upon new information from the Department of the Treasury, we reclassified fund 19X5515 as Earmarked. For 2009, therefore, its results of operations were reported on the Statement of Net Position and in the Net Position section of the Balance Sheet as Earmarked. Its results in 2008 and in prior years were reported in the Other Funds sections of these statements. No amounts were changed in the reclassification. Future years will be reported as Earmarked.

Treasury Fund Symbol	Description	Statute
19X5497	Foreign Service National Defined Contribution Fund	22 USC 3968(a)(1)
19X5515	H1-B and L Visas Fraud Detection and Prevention	118 Stat. 3357
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

A brief description of the individually reported earmarked funds and their purposes follows.

FOREIGN SERVICE RETIREMENT AND DISABILITY FUND (19X8186)

The Foreign Service Retirement and Disability Fund (FSRDF) was established in 1924 to provide pensions to retired and disabled members of the Foreign Service. The FSRDF's revenues consist of contributions from active participants and their U.S. Government agency employers; appropriations; and interest on investments. Monthly annuity payments are made to eligible retired employees or their survivors. Separated employees without title to an annuity may take a refund of their contributions. P.L. 96-465 limits the amount of administrative expense that can be charged to the fund to $5,000. The total cost for administering FSRDF was $4.4 million in 2009 and $6.3 million in 2008. 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.

VISAS FRAUD DETECTION AND PREVENTION FUNDS (VFDPF) (19X5515)

Visas Fraud Detection and Prevention Funds are supported by fees paid by employers applying for foreign workers under the American Competitiveness and Workforce Improvement Act of 1998 and the Global War on Terrorism and Tsunami Relief (P.L. 109-13). Section 426 of the Consolidated Appropriations Act, 2005 (P.L. 108-447) authorizes one-third of the fees collected for H-1B, L, and H-2B visa applications to be available to the Department of State for fraud prevention and detection activities. These fees help finance the Department's Border Security Program.

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**	**VFDPF**	**GIFT**	**All Other Earmarked**	**Total Earmarked Funds**
Balance Sheet As of September 30, 2009:						
Assets:						
Fund Balances with Treasury	$ —	$ 168	$ 183	$ 14	$ 2	$ 367
Investments	15,334	—	—	7	31	15,372
Taxes and Interest Receivable	190	—	—	1	—	191
Other Assets	15	—	33	97	67	212
Total Assets	**$ 15,539**	**$ 168**	**$ 216**	**$ 119**	**$ 100**	**$ 16,142**
Liabilities:						
Actuarial Liability	$ 16,983	$ —	$ —	$ —	$ —	$ 16,983
Other Liabilities	69	—	—	—	—	69
Total Liabilities	**$ 17,052**	**$ —**	**$ —**	**$ —**	**$ —**	**$ 17,052**
Net Position:						
Unexpended Appropriations	$ —	$ —	$ —	$ —	$ —	$ —
Cumulative Results of Operations	(1,513)	168	216	119	100	(910)
Total Liabilities and Net Position	**$ 15,539**	**$ 168**	**$ 216**	**$ 119**	**$ 100**	**$ 16,142**
Statement of Net Cost for the Year Ended September 30, 2009:						
Gross Program Costs	$ —	$ 17	$ 15	$ 8	$ 5	$ 45
Less: Earned Revenues	1,292	19	—	—	19	1,330
Net Program Costs	(1,292)	(2)	15	8	(14)	(1,285)
Costs Not Attributable to Program Costs	2,663	—	—	—	—	2,663
Less Earned Revenues Not Attributable to Program Costs	—	—	—	—	—	—
Net Cost of Operations	**$ 1,371**	**$ (2)**	**$ 15**	**$ 8**	**$ (14)**	**$ 1,378**
Statement of Changes in Net Position for the Year Ended September 30, 2009:						
Net Position Beginning of Period	$ (142)	$ 166	$ —	$ 122	$ 85	$ 231
Non-Exchange Revenue	—	—	—	—	1	1
Other Financing Sources	—	—	231	5	—	236
Net Cost of Operations	(1,371)	2	(15)	(8)	14	(1,378)
Taxes and Other Nonexchange Revenue	—	—	—	—	—	—
Change in Net Position	(1,371)	2	216	(3)	15	(1,141)
Net Position End of Period	**$ (1,513)**	**$ 168**	**$ 216**	**$ 119**	**$ 100**	**$ (910)**

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**

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, 2009

(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	$ 468	$ 34	$ 2,106	$ 4,983	$ 1	$ —	$ (1,113)	$ 6,479
Earned Revenue	(165)	(11)	(559)	(1,118)	—	—	1,113	(740)
Net Program Costs	303	23	1,547	3,865	1	—	—	5,739
Governing Justly and Democratically								
Total Cost	84	6	39	863	—	—	(198)	794
Earned Revenue	(30)	(2)	(7)	(200)	—	—	198	(41)
Net Program Costs	54	4	32	663	—	—	—	753
Investing in People								
Total Cost	763	57	170	4,209	—	—	(89)	5,110
Earned Revenue	(14)	(1)	(3)	(91)	—	—	89	(20)
Net Program Costs	749	56	167	4,118	—	—	—	5,090
Promoting Economic Growth and Prosperity								
Total Cost	138	10	65	1,409	—	—	(324)	1,298
Earned Revenue	(49)	(3)	(12)	(326)	—	—	324	(66)
Net Program Costs	89	7	53	1,083	—	—	—	1,232
Providing Humanitarian Assistance								
Total Cost	—	—	1,696	—	—	—	(1)	1,695
Earned Revenue	—	—	(1)	—	—	—	1	—
Net Program Costs	—	—	1,695	—	—	—	—	1,695
Promoting International Understanding								
Total Cost	166	12	78	1,705	793	—	(391)	2,363
Earned Revenue	(59)	(4)	(14)	(394)	(199)	—	391	(279)
Net Program Costs	107	8	64	1,311	594	—	—	2,084
Strengthening Consular and Management Capabilities								
Total Cost	—	—	—	1,345	615	3,623	(1,752)	3,831
Earned Revenue	—	—	—	(511)	(281)	(3,568)	1,752	(2,608)
Net Program Costs	—	—	—	834	334	55	—	1,223
Executive Direction and Other Costs Not Assigned								
Total Cost	4	6	125	7,839	753	—	(3,131)	5,596
Earned Revenue	(2)	(3)	(68)	(4,378)	(464)	—	3,116	(1,799)
Net Program Costs	2	3	57	3,461	289	—	(15)	3,797
Total Cost	1,623	125	4,279	22,353	2,162	3,623	(6,999)	27,166
Total Revenue	(319)	(24)	(664)	(7,018)	(944)	(3,568)	6,984	(5,553)
Total Net Cost	$ 1,304	$ 101	$ 3,615	$ 15,335	$ 1,218	$ 55	$ (15)	$ 21,613

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, 2009 and 2008, these consist of costs and earned revenue summarized below *(Dollars in Millions)*:

	2009			2008 (Restated)		
Program	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**
Costs:						
Executive Direction & Other	$ 4,369	$ 1,460	$ 2,909	$ 3,478	$ 499	$ 2,979
FSRDF	2,663	472	2,191	1,201	557	644
ICASS	1,576	1,198	378	1,516	1,154	362
International Commissions	119	1	118	113	1	112
Total Costs	$ 8,727	$ 3,131	$ 5,596	6,308	2,211	4,097
Earned Revenue:						
Executive Direction & Other	1,960	1,460	500	1,010	604	406
FSRDF	1,292	457	835	1,268	436	832
ICASS	1,629	1,198	431	1,540	1,154	386
International Commissions	34	1	33	11	1	10
Total Earned Revenue	4,915	3,116	1,799	3,829	2,195	1,634
Total Net Cost for Executive Direction and Other Costs Not Assigned	$ 3,812	$ 15	$ 3,797	$ 2,479	$ 16	$ 2,463

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 2009 and 2008 under the Under Secretary for Management by the following organizations *(Dollars in Millions)*:

Bureau (or equivalent)	2009	2008
Bureau of Diplomatic Security	$ 2,401	$ 2,004
Office of Overseas Buildings Operations	1,111	971
Bureau of Administration	740	1,699
Bureau of Information Resource Management	340	302
Bureau of Personnel	558	524
Bureau of Resource Management	3,807	508
Foreign Service Institute	158	143
Medical Services and Other	237	232
Total Central Support Costs	$ 9,352	$ 6,383

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 2009 and 2008 was as follows *(Dollars in Millions)*:

Program Receiving Allocation	2009	2008
Achieving Peace and Security	$ 1,896	$ 1,354
Governing Justly and Democratically	335	240
Investing in People	151	108
Promoting Economic Growth and Prosperity	548	392
Providing Humanitarian Assistance	-	1
Promoting International Understanding	662	474
Strengthening Consular and Management Capabilities	3,012	1,849
Executive Direction and Other Costs Not Assigned	2,748	1,965
Total	$ 9,352	$ 6,383

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	2009	2008
Political Affairs	$ 13,334	$ 8,738
Public Diplomacy	1,507	1,102
Management (Consular Affairs)	2,331	1,612
Arms Control, International Security Affairs	1,201	348
Global Affairs	395	381
Economic, Business and Agriculture Affairs	93	72
Total	$ 18,861	$ 12,253

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, 2009 and 2008 *(Dollars in Millions)*:

Inter-Entity Cost	2009	2008
Other Post-Employment Benefits:		
Civil Service Retirement Program	$ 24	$ 24
Federal Employees Health Benefits Program	109	97
Subtotal – Imputed Financing Source	133	121
Future Workers' Compensation Benefits	17	18
Total Inter-Entity Costs	$ 150	$ 139

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, 2009 and 2008, consist of the following *(Dollars in Millions)*:

	2009			2008		
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	$ 712	$ —	$ 712	$ 764	$ —	$ 764
Machine Readable Visa	882	—	882	952	—	952
Expedited Passport	142	—	142	164	—	164
Passport, Visa and Other Surcharges	524	—	524	590	—	590
Fingerprint Processing, Diversity Lottery, and Affadavit of Support	22	—	22	23	—	23
Subtotal – Consular Fees	2,282	—	2,282	2,493	—	2,493
FSRDF	1,292	457	835	1,268	436	832
ICASS	1,629	1,198	431	1,540	1,154	386
Other Reimbursable Agreements	6,238	4,502	1,736	2,792	874	1,918
Working Capital Fund	945	789	156	1,046	941	105
Other	151	38	113	136	117	19
Total	$ 12,537	$ 6,984	$ 5,553	$ 9,275	$ 3,522	$ 5,753

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*

PRICING POLICIES

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

The FSRDF finances the operations of the Foreign Service Retirement and Disability System (FSRDS) and the Foreign Service Pension System (FSPS). The FSRDF receives revenue from employee/employer contributions, a U.S. Government contribution, and interest on investments. By law, FSRDS participants contribute 7.25% of their base salary, and each employing agency contributes 7.25%; FSPS participants contribute 1.35% of their base salary and each employing agency contributes 20.22%. Employing agencies report employee/employer contributions biweekly. Total employee/employer contributions for 2009 and 2008 were $263 million and $245 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 2009 and 2008 were $250 million and $242 million, respectively. FSRDF cash resources are invested in special non-marketable securities issued by the Treasury. Total interest earned on these investments for 2009 and 2008 was $778 million and $781 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.

DUTIES OF THE SECRETARY OF STATE

Under the Constitution, the President of the United States determines U.S. foreign policy. The Secretary of State, appointed by the President with the advice and consent of the Senate, is the President's chief foreign affairs adviser. The Secretary carries out the President's foreign policies through the State Department and the Foreign Service of the United States.

Created in 1789 by the Congress as the successor to the Department of Foreign Affairs, the Department of State is the senior executive Department of the U.S. Government. The Secretary of State's duties relating to foreign affairs include the following:

- Serves as the President's principal adviser on U.S. foreign policy;
- Conducts negotiations relating to U.S. foreign affairs;
- Grants and issues passports to American citizens and exequaturs to foreign consuls in the United States;
- Advises the President on the appointment of U.S. ambassadors, ministers, consuls, and other diplomatic representatives;
- Negotiates, interprets, and terminates treaties and agreements;
- Ensures the protection of the U.S. Government to American citizens, property, and interests in foreign countries;
- Supervises the administration of U.S. immigration laws abroad;
- Provides information to Congress and American citizens regarding the political, economic, social, cultural, and humanitarian conditions in foreign countries;
- Administers the Department of State and supervises the Foreign Service.

In addition, the Secretary of State retains domestic responsibilities that Congress entrusted to the State Department upon its creation. These include the custody of the Great Seal of the United States, the preparation of certain presidential proclamations and the custody of certain original treaties and international agreements.

The Secretary of State has retained custody of the Great Seal of the United States since the establishment of the Department of State in 1789. The elements of the seal have changed over the years. The current seal replicates an original designed by James H. Whitehouse of Tiffany & Company in 1885.

16 Statement of Budgetary Resources

The Statement of Budgetary Resources (SBR) reports information on how budgetary resources were made available and their status as of and for the years ended September 30, 2009 and 2008. 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 the years ended September 30, 2009 and 2008, the Department received approximately $50.1 billion and $38.8 billion in budgetary resources, respectively, primarily consisting of the following:

Source of Budgetary Resources *(Dollars in Billions)*	**2009**	**2008**
Budget Authority:		
Direct or related appropriations	$ 28.8	$ 23.6
Authority financed from Trust Funds	1.0	1.4
Spending authority from providing goods and services	11.5	7.2
Unobligated Balances – Beginning of Year	8.2	6.3
Other	0.6	0.3
Total Budgetary Resources	$ 50.1	$ 38.8

Apportionment Categories of Obligations Incurred:
(Dollars in Millions)

	Direct Obligations	**Reimbursable Obligations**	**Total Obligations Incurred**
For the Fiscal Year Ended September 30, 2009			
Obligations Apportioned Under			
Category A	$ 17,760	$ 11,124	$ 28,884
Category B	8,466	818	9,284
Total	$ 26,226	$ 11,942	$ 38,168

	Direct Obligations	**Reimbursable Obligations**	**Total Obligations Incurred**
For the Fiscal Year Ended September 30, 2008			
Obligations Apportioned Under			
Category A	$ 19,527	$ 7,530	$ 27,057
Category B	3,563	40	3,603
Exempt	2	—	2
Total	$ 23,092	$ 7,570	$ 30,662

Per OMB Circular A-11, Category A obligations represent resources apportioned for calendar quarters. Category B obligations represent resources apportioned for other time periods; for activities, projects, and objectives or for a combination thereof.

STATUS OF UNDELIVERED ORDERS:

Undelivered Orders (UDO) represents the amount of goods and/or services ordered, which have not been actually or constructively received. This amount includes any orders which may have been prepaid or advanced but for which delivery or performance has not yet occurred.

The amount of budgetary resources obligated for UDO for all activities as of September 30, 2009, and 2008 was approximately $17.7 billion and $16.0 billion, respectively. This includes amounts of $613 million for September 30, 2009, and $559 million for September 30, 2008, pertaining to revolving funds, trust funds, and substantial commercial activities.

PERMANENT INDEFINITE APPROPRIATIONS:

A permanent indefinite appropriation is open-ended as to both its period of availability (amount of time the agency has to spend the funds) and its amount. The Department received permanent indefinite appropriations of $92.6 million and $83 million, including the Foreign Service Pension portion, for 2009 and 2008. 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, Foreign Service Pension System, and disbursements attributable to liability from military service.

STATEMENT OF BUDGETARY RESOURCES VS BUDGET OF THE UNITED STATES GOVERNMENT:

The reconciliation as of September 30, 2008 is presented below. The reconciliation as of September 30, 2009 is not presented, because the submission of the Budget of the United States for FY 2011, which summarizes the execution of the FY 2009 Budget, occurs after publication of these financial statements. The Department of State Budget Appendix can be found on the OMB website (*http://www.whitehouse.gov/omb/budget)* and will be available in early February 2010.

For the Fiscal Year Ended September 30, 2008 ***(Dollars in Millions)***	**Budgetary Resources**	**Obligations Incurred**	**Distributed Offsetting Receipts**	**Net Outlays**
Statement of Budgetary Resources	$ 38,825	$ 30,662	$ 352	$ 18,702
Funds not Reported in the Budget:				
Expired Funds	(554)	19	—	352
International Assistance Program	(1,725)	(1,410)	—	(1,185)
Other and Rounding	6	(11)	9	(2)
Budget of the United States	$ 36,552	$ 29,260	$ 361	$ 17,867

International Assistance Program, included in these financial statements, is reported separately in the Budget of the United States. Other differences represent financial statement adjustments, timing differences and other immaterial differences between amounts reported in the Department SBR and the Budget of the United States.

17 CUSTODIAL ACTIVITY

The Department administers certain activities associated with the collection of non-exchange revenues that 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 2009 and 2008, the Department collected $34 million and $24 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.

(Dollars in Millions) **For the Year Ended September 30,**	**2009**	**2008 Restated (Note 20)**
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 38,168	$ 30,662
Spending Authority from Offsetting Collections and Recoveries	(12,194)	(7,956)
Offsetting Receipts	(337)	(352)
Net Obligations	25,637	22,354
Imputed Financing	133	124
Other Resources	26	42
Total Resources Used to Finance Activities	**25,796**	**22,636**
Resources Used to Finance Items not Part of Net Cost:		
Resources Obligated for Future Costs - goods ordered but not yet provided	(2,948)	(2,940)
Resources that Finance the Acquisition of Assets	(1,685)	(1,828)
Resources that Fund Expenses Recognized in Prior Periods	(42)	-
Other	(39)	(14)
Total Resources Used to Finance Items not Part of Net Cost	**(4,714)**	**(4,782)**
Total Resources Used to Finance the Net Cost of Operations	**21,082**	**17,854**
Components of the Net Cost of Operations that will not require or generate Resources in the Current Period:		
Increase in Actuarial Liability	1,371	410
Passport Fees Reported as Revenue Returned to Treasury General Fund	(787)	(738)
Depreciation and Amortization	599	571
Interest Income of Trust Funds	(778)	(784)
Other	126	440
Total Components of the Net Cost of Operation that will not require or generate Resources in the Current Period	**531**	**(101)**
Net Cost of Operations	**$ 21,613**	**$ 17,753**

19 Fiduciary Activities

The Resolution of Libyan Claims deposit fund 19X6224, and the Saudi Arabia Infrastructure support deposit fund 19X6225, are presented here, as fiduciary activities, in accordance with FASAB 31, *Accounting for Fiduciary Activities*, and OMB Circular A-136, *Financial Reporting Requirements*.

Deposit fund 19X6224 was authorized by a claims settlement agreement between The United State of America and The Government of Libya effective August 14, 2008. The agreement authorized the Department to collect contributions from donors for the purpose of providing compensation for certain claims within the scope of the agreement, investment of contributions into Treasury securities, and disbursement of contributions received in accordance with the agreement. As specified in the document, donors could include governments, institutions, entities, corporations, associations, and individuals. The Department manages this fund in a fiduciary capacity and does not have ownership rights against its contributions and investments; its assets and activities summarized here do not appear in the financial statements.

Deposit fund 19X6225 was authorized by a Project Specific Agreement between The Kingdom of Saudi Arabia and The United States of America effective May 16, 2008. This agreement authorized the United States to provide assistance to the Kingdom of Saudi Arabia in the development of its capacity in the areas of critical infrastructure protection and public security. The Kingdom of Saudi Arabia will pay all cost for services performed, equipment provided and expenses incurred by the United States under the agreement. Funds required by the United States for the agreed upon expenditures will be deposited by the Kingdom of Saudi Arabia in this fund. The Department manages this fund in a fiduciary capacity and does not have ownership rights against its deposited funds. Activities summarized here do not appear in the financial statements.

Schedule of Fiduciary Activity
As of September 30, 2009
(Dollars in Millions)

	2009 19-X-6224	2009 19-X-6225
Contributions	$ 1,500	$ 28
Disbursements to and on behalf of beneficiaries	(1,212)	(27)
Increases/(Decrease) in Fiduciary net assets	(1,212)	(27)
Fiduciary Net Assets, End of Year	$ 288	$ 1

Fiduciary Net Assets
As of September 30, 2009
(Dollars in Millions)

Fiduciary Assets	2009 19-X-6224	2009 19-X-6225
Investments	$ 288	$ 1
Total Fiduciary Net Assets	$ 288	$ 1

U.S. Agriculture Secretary Tom Vilsack, third from left last row, and Philippine Agriculture Secretary Arthur Yap, second from left in last row, pose with grade four pupils, teachers and aides in the flood-stricken city of Pasig, Philippines. Total U.S. Government aid to victims of the September 29,2009 floods reached $30 million by December. AP Image

20 RESTATEMENTS

The Department made two restatements to its financial statements as of September 30, 2008. The first was to correct the Environmental Liability of the IBWC. The Environmental Liability had represented the estimated cost to comply with court orders to bring wastewater treatment plants owned and operated by the IBWC into environmental compliance. The court mandates covered the upgraded construction of secondary wastewater treatment plants. The liability was first recorded in the FY 2005 financial statements with a restatement of the FY 2004 financial statements. During FY 2009 audit efforts, it was determined that the court mandates address the prevention of future environmental damage by upgrading the plants. The Department submitted a technical inquiry to FASAB on the matter. The advice of FASAB was that the Department had made a mistake in the application of accounting principles, and since the remedy addresses future events rather than past events, no recognition of a liability was required. The effect of the restatement was to decrease liabilities on the Balance Sheet by $381 million and increase net cost by $12 million on the Statement of Net Cost.

The second restatement was to correct the valuation of two specific prior period land acquisitions. The land acquisitions represented the fair market value (FMV) of gifts of real property to the Department from other countries. The gifts were received in the mid-1900's. The Department first valued these properties in 1996 at the inception of our accounting for property under the CFO Act. These two properties were part of our valuation of all real property, representing over 3,400 assets. The methodology, developed by a leading CPA firm, was to estimate the FMV of the gifts using reasonable and consistent parameters such as comparable purchases, equivalent square footage, and Consumer Price Index (CPI) inflation indices. The methodology erred in that it presented FMV as of 1996 instead of as of the date of the gift. The Department has examined all gifts estimated by this methodology and using the best information available that is consistent with the original methodology re-estimated their FMV as of the date of the gift. The effect of the restatement was to decrease assets on the Balance Sheet by $399 million. Cumulative Results of Operations at the beginning of 2008 on the Statement of Changes in Net Position has been adjusted for the effects of both restatements on prior years. The restatements had no effect on the Statement of Budgetary Resources.

Consolidated Balance Sheet:

	As of September 30, 2008			
	As Previously Reported	Adjustment #1	Adjustment #2	As Restated
Property and Equipment, Net	$ 11,077	$ —	$ (399)	$ 10,678
Total Assets	52,116	—	(399)	51,717
Environmental Liablity	381	(381)	—	—
Total Liabilities	21,483	(381)	—	21,102
Cumulative Results of Operations - Other Funds	12,423	381	(399)	12,405
Total Net Position	30,633	381	(399)	30,615

Consolidated Statement of Net Cost:

	As of September 30, 2008			
	As Previously Reported	Adjustment #1	Adjustment #2	As Restated
Total Cost	$ 23,494	$ 12	$ —	$ 23,506
Total Net Cost	17,741	12	—	17,753

Consolidated Statement of Changes in Net Position:

	As of September 30, 2008			
	As Previously Reported	**Adjustment #1**	**Adjustment #2**	**As Restated**
Cumulative Results of Operations				
Beginning Balances	$ 10,787	$ 393	$ (399)	$ 10,781
Net Cost of Operations	(17,741)	(12)	—	(17,753)
Ending Balances	12,654	381	(399)	12,636

Footnote 7, Property and Equipment, Net:

	For the Year Ended September 30, 2008			
	As Previously Reported	**Adjustment #1**	**Adjustment #2**	**As Restated**
Real Property - Overseas:				
Land and Land Improvements:				
Cost	$ 2,229	$ —	$ (399)	$ 1,830
Net Value	2,217	—	(399)	1,818
Total - Real Property				
Cost	14,427	—	(399)	14,028
Net Value	10,330	—	(399)	9,931
Total Property and Equipment, Net				
Cost	16,376	—	(399)	15,977
Net Value	11,077	—	(399)	10,678

Footnote 18, Reconciliation of Net Cost of Operations to Budget:

	For the Year Ended September 30, 2008			
	As Previously Reported	**Adjustment #1**	**Adjustment #2**	**As Restated**
Resources Used to Finance Items Not Part of Net Cost:				
Other	$ (26)	$ 12	$ —	$ (14)
Total Resources Used to Finance Items not Part of Net Cost	(4,794)	12	—	(4,782)
Net Cost of Operations	17,741	12	—	17,753

Required Supplementary Information

COMBINING SCHEDULE OF BUDGETARY RESOURCES
For the Year Ended September 30, 2009 ***(Dollars in Millions)***

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Budgetary Resources:						
Unobligated Balance, brought forward, October 1:	$ 4,939	$ 330	$ 111	$ 314	$ 2,469	$ 8,163
Recoveries of Prior Year Unpaid Obligations	527	1	1	63	110	702
Budget Authority:						
Appropriations	12,060	3,993	337	2,214	11,222	29,826
Spending authority from offsetting collections (gross):						
Earned						
Collected	10,546	1	12	31	259	10,849
Change in receivable from Federal sources	49	—	(2)	(2)	(12)	33
Change in unfilled customer orders:						
Advance received	154	—	—	3	455	612
Without Advance from Federal sources	—	—	(2)	—	—	(2)
Nonexpenditure transfers, net	(148)	—	—	(25)	208	35
Permanently not available	(58)	(2)	(1)	(14)	(5)	(80)
Total Budgetary Resources	**$28,069**	**$ 4,323**	**$ 456**	**$ 2,584**	**$14,706**	**$50,138**
Status of Budgetary Resources:						
Obligations Incurred:						
Direct	$ 11,215	$ 3,709	$ 220	$ 1,244	$ 9,838	$ 26,226
Reimbursable	10,739	—	8	20	1,175	11,942
Unobligated balance:						
Apportioned	5,720	604	226	1,185	3,661	11,396
Unobligated balance not available	395	10	2	135	32	574
Total Status of Budgetary Resources	**$28,069**	**$ 4,323**	**$ 456**	**$ 2,584**	**$14,706**	**$50,138**
Change in Obligated Balance:						
Obligated Balance, net						
Unpaid Obligations, brought forward, October 1	$ 6,568	$ 896	$ 36	$ 1,155	$ 8,812	$ 17,467
Less: Uncollected customer payments from Federal sources, brought forward, October 1	(436)	—	(7)	(2)	(11)	(456)
Obligations incurred, net	21,954	3,709	228	1,264	11,023	38,168
Less: Gross Outlays	(19,934)	(4,422)	(143)	(1,390)	(8,682)	(34,571)
Less: Recoveries of prior-year unpaid obligations, actual	(527)	(1)	(1)	(63)	(110)	(702)
Change in uncollected customer payments from Federal sources	(49)	—	4	2	12	(31)
Obligated balance, net, end of period:						
Unpaid obligations	8,061	182	120	966	11,033	20,362
Less: Uncollected customer payments from Federal sources	(485)	—	(3)	—	1	(487)
Net Outlays:						
Gross outlays	19,934	4,422	143	1,390	8,682	34,571
Less: Offsetting collections	(10,700)	—	(12)	(33)	(715)	(11,460)
Less: Distributed Offsetting receipts	(337)	—	—	—	—	(337)
Net Outlays	**$ 8,897**	**$ 4,422**	**$ 131**	**$ 1,357**	**$ 7,967**	**$22,774**

Deferred Maintenance for the Fiscal Year Ended September 30, 2009

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 backlogs of $84.3 million and $137 million in 2009 and 2008 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, which ran from March 2007 to March 2009, served 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 were pleased to participate in 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: Benjamin Franklin, the first U.S. diplomat, negotiated the first U.S. treaty with French Foreign Minister, the Comte de Vergennes, enabling the fledgling republic to continue its struggle for independence.

1783 — Treaty of Paris: John Jay, Benjamin Franklin, and John Adams negotiated a treaty of peace with Great Britain, obtaining British recognition of U.S. independence and U.S. possession of trans-Appalachian lands to the Mississippi River.

1803 — Louisiana Purchase: U.S. Minister James Monroe negotiated the purchase of the trans-Mississippi territory from Napoleon of France.

1823 — Monroe Doctrine: Responding to Latin America's wars for independence and Russia's expansion in northwest North America, President James Monroe declared the United States opposed to European intervention in Latin America's independence struggles and new European colonization in Western Hemisphere.

1848 — Treaty of Guadalupe-Hidalgo: Diplomat Nicholas Trist negotiated the treaty ending the 1846-1848 war with Mexico and cession of Texas and the Southwest to the United States.

1853 — Perry and Japan: Commodore Matthew Perry sailed into Edo (Tokyo) Bay in 1853, and later signed a treaty establishing the first diplomatic relations with Japan after Japan's 200 years of self-imposed isolation.

1893 — First U.S. Ambassador: President Grover Cleveland appoints the first U.S. Ambassador, Thomas F. Bayard to the Court of St. James (United Kingdom). Previously, the highest rank of a U.S. diplomat was Minister.

1898 — Treaty of Paris: The treaty ended the War of 1898 between Spain and United States, resulted in Cuban independence, and ceded Puerto Rico, the Philippines, and Guam to the United States. The treaty signified the emergence of the United States as a world power.

1906 — Secretary of State's First Official Trip: Secretary of State Elihu Root travelled to Río de Janeiro to attend the Third International Conference of American States. It was the first official overseas trip by a Secretary of State.

1918 — 14 Points: President Woodrow Wilson issued the 14 Points, and they were accepted by the European powers as the basis for peace negotiations to end World War I. Wilson travelled to Europe to conduct peace negotiations, leading to the 1919 Treaty of Versailles.

1941 — The Atlantic Charter: President Franklin Roosevelt and British Prime Minister Winston Churchill drafted the declaration of principles that served as the basis of the Allies' objectives during World War II. The principles included national self-determination, free trade, international cooperation, and freedom from fear and want.

1944 — Bretton Woods Agreement: Delegates from 44 nations created the post-WWII international monetary system. In addition to promoting free trade, the agreement created the International Monetary Fund (IMF) to fund national economic development projects and the International Bank of Reconstruction and Development (IBRD) to fund reconstruction of war-devastated nations. The IBRD is now known as the World Bank.

1947 — Truman Doctrine: President Harry Truman declared that the United States must provide economic and military aid to nations threatened by "armed minorities" and "outside pressure," namely Communism. The Truman Doctrine set containment as the basis of U.S. Cold War foreign policy.

1947 — Marshall Plan: Secretary of State George C. Marshall called for an extensive program to rebuild war-torn Europe. Funded by Congress, the reconstruction program for Western and Central Europe ultimately cost $12 billion.

1948 — North Atlantic Treaty: The United States, Canada and ten Western European nations signed the North Atlantic Treaty, a defensive alliance against Soviet military power. NATO, the treaty's organization, encouraged military cooperation, technical exchange, and standardization among the twelve allies.

1962 — Cuban Missile Crisis: President John F. Kennedy and Soviet Premier Nikita Khrushchev negotiate removal of Soviet missiles from Cuba over Fidel Castro's protests. Kennedy's diplomacy resolved the crisis that was the closest the two superpowers came to nuclear war.

1968 — Nuclear Nonproliferation Treaty: Signed by or acceded to by over 189 nations, the treaty bans the proliferation of nuclear weapons, urges nuclear disarmament, and allows for the transfer of nuclear technology for peaceful uses only.

1978 — Camp David Accords: Negotiated by President Jimmy Carter, the accords (two treaties) ended 30 years of conflict, led to normalization of relations between the two countries, and provided a framework for comprehensive peace in the Middle East.

1989 — Cold War Ends: In a May 1989 speech on U.S. policy at Texas A & M University, President George H.W. Bush acknowledged that the Cold War had ended.

1991 — Operation Desert Storm: In response to Iraq's invasion of Kuwait, the United States, under President George H.W. Bush, built an international coalition and, after United Nations approval, militarily pushed Iraq out of Kuwait.

1994 — The North American Free Trade Agreement (NAFTA): The agreement between the United States, Canada, and Mexico formed a free trade area to reduce barriers to trade and investment.

2001 — 9/11 Terrorism and Afghanistan: In the wake of al-Qaeda's attacks on the World Trade Center, the United States formed a global coalition against terrorism. Three weeks later, the coalition began Operation Enduring Freedom in Afghanistan to capture Osama bin Laden and al-Qaeda leaders and to remove the Taliban regime that gave safe harbor to al-Qaeda.

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

2004 — AIDS Relief: The United States budgets $2.5 billion to combat AIDS, tuberculosis, and malaria in the world. President George W. Bush's Emergency Plan against AIDS is the largest international health initiative ever against a single disease. Funding continued into 2009.

2004 — Indian Ocean Tsunami Disaster Relief: A seaquake off the coast of Sumatra generated large tsunamis that devastated coastal areas around the Indian Ocean. The United States led one of the largest public-private cooperative efforts — totaling more that $2.6 billion — to provide disaster relief and reconstruction assistance to the nations of the region.

2005 — Liberian Elections: After two civil wars, Liberia held elections, choosing Ellen Johnson-Sirleaf as President, the first woman head of state in Africa. The United States encouraged peace talks and landed a task force in Monrovia to protect the city until an accord was reached.

2006 — Central American Free Trade Agreement (CAFTA): The United States and the nations of Central America and the Caribbean joined to form CAFTA, which went into effect in March 2006. Like NAFTA, the agreement sought to reduce barriers to trade and investment.

2006 — Restoration of U.S-Libyan Relations: Secretary of State Condoleezza Rice announced the restoration of U.S.-Libyan relations after Libyan leader Muammar al-Gaddafi agreed to relinquish his weapons of mass destruction.

2007 — U.S.-Indian Nuclear Agreement: The United States and India signed an agreement for cooperation in nuclear energy technology.

2009 — Turkey-Armenia Accord: Secretary of State Hillary Clinton brokered an agreement between Turkey and Armenia, establishing diplomatic relations between them, opening their common border, and easing tensions that date back to World War I.

Other Accompanying Information

Financial Management Plans and Reports

Overview

INTRODUCTION

The Department of State's financial activities operate in approximately 260 locations in 172 countries. We conduct business transactions 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. Among the Department's customers are 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, is the Department's corporate financial manager and strategic planner. RM has overall responsibility for the preparation and execution of the budget; management of financial systems, reporting and internal controls; management of global financial operations and services; and directing the Department's strategic planning and performance reporting efforts; administering interagency administrative support cost sharing related to overseas missions and interagency resource planning efforts with the intelligence community. RM produces a number of essential documents including the Joint State/USAID Strategic Plan, Department Performance Plan, Agency Financial Report, Performance Report, Citizen's Report, Budget-in-Brief, and the Congressional Budget Justification Document.

RM employs over 500 people around the globe, primarily in Washington, Charleston, South Carolina and Bangkok, Thailand. RM's services to its customers are critical to carry out the Department's mission effectively.

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 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 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.

MISSION

To integrate strategic planning, budgeting, and performance, and to secure the resources necessary to accomplish the Department of State's mission.

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.

BUREAU OF RESOURCE MANAGEMENT GOAL STATEMENT

To establish world financial services, integrate budget, planning and performance, and ensure that all RM employees know they play a crucial role in the success of American foreign policy.

Performance measures for this goal 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, and build a first-rate finance team.

FY 2009 RESULTS

Providing World Class Customer Service.

Central to our vision of a premier, global financial system is the worldwide cadre of financial managers who rely on our financial systems to conduct the Department's business and support bureau missions. It is critical our systems meet the needs of this diverse customer base. Product review groups have been instituted to better enable us to work with our customer base, identifying priorities for improvements to systems, associated business processes, and support mechanisms.

Implementing Financial Systems and Processes that Meet Federal Requirements.

In FY 2008, we stabilized the Global Financial Management System after its major conversion in FY 2007. In September 2008, GFMS statistics across all interfaces established as baseline a 97% acceptance rate on 5.4 million transactions. As of August 2009, acceptance rate is 98% of 5.0 million transactions. Over the past year, 40 major software releases were implemented addressing over 1,000 software changes and enhancements across the Department's suite of financial systems. These changes and enhancements covered a wide array of systems including compensation, reporting and management information, and accounting and logistics. FY 2009 has also brought a new auditor to conduct the financial statement audit. It became clear early on that there is an increased emphasis on compliance with applicable Federal requirements and regulations – e.g., the Federal Information System Controls Audit Manual (FISCAM), the National Institute of Standards and Technology (NIST), the Financial Systems Integration Office (FSIO) – that will greatly influence our system priorities in FY 2010.

Leveraging Best Business Practices and E Government.

The deployment of e Travel worldwide continued unabated in FY 2009. Global e Travel, utilizing a web-based commercially available off-the-shelf system (COTS) solution is now in place at 80 missions overseas and 34 bureaus domestically. Overseas, we exceeded our goal of 66% of overseas travel vouchers being processed through the new system by implementing Global e Travel at those posts that generate 70% of overseas temporary duty travel vouchers.

The interface of our Regional Financial Management System with Global e Travel, implemented in early FY 2009, has an acceptance rate exceeding 98%.

The Department's effort of migrating to a Grant Management Line of Business solution continued throughout FY 2009. With the selection of GrantSolutions offered by the Department of Health and Human Services in FY 2008, the Department implemented its first pilot under our State Assistance Management System in January 2009 for the Global Monitoring and Combating Trafficking in Persons organization. GrantSolutions will automate the full range of assistance management activities, from solicitation through award, post-award monitoring and closeout. Requirements for the interface between Management System and GFMS were finalized in September 2009. Design of an interface between GrantSolutions and GFMS is in progress with an anticipated completion in 2010.

The Department selected a COTS solution for its payroll. The Global Foreign Affairs Compensation System will utilize this new payroll COTS platform to replace six legacy systems with a single system supporting the widely diverse global payroll requirements for the Department and the forty plus agencies it services. Payees will include locally engaged, civil service, and Foreign Service staff, as well as Foreign Service Annuitants.

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.

OMB continues its initiative to standardize government-wide business processes to address the Federal government's long-term need to improve financial management and assist agencies in substantially complying with the Federal Financial Management Improvement Act (FFMIA). Also, over the next several years, a number of new Federal accounting and information technology standards will become effective. These include government-wide projects to standardize business requirements and processes, establish and implement a government-wide accounting classification, and support the replacement of financial statement and budgetary reporting to the Department of the Treasury. The Department's implementation of new standards and government-wide reporting will strengthen both our financial and information technology management practices.

In FY 2010, RM will continue to expand its centralized processing services to support additional posts and wholesale systematic consolidation of some financial processes. For Global eTravel, we will complete full deployment domestically and anticipate reaching the goal of 90% of overseas temporary duty travel voucher volume being supported, network connections permitting. Next year will also bring focus on greater consolidation of financial and other administrative systems into RM's existing portfolio of systems, incorporating each into a disciplined and certified system development and maintenance organization.

With the selection of the Payroll COTS solution, work has begun in earnest to implement the Global Foreign Affairs Compensation System. FY 2010 will be focused on implementing components to generate annuitant payments to the Department's retired Foreign Service Officers and their qualified beneficiaries and migrating the Department's Foreign Service National payroll to the new platform.

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, the Department 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 programs or initiatives, with affordable cost alternatives and expected results, will be essential in maximizing the effectiveness of the Department's funding. This ability to better quantify costs with results will also bolster the Department's credibility with Congress and OMB.

FINANCIAL MANAGEMENT SYSTEMS

Through the Joint Financial Management System 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, Global eTravel, State Assistance Management System, and other domestic and post-level systems.

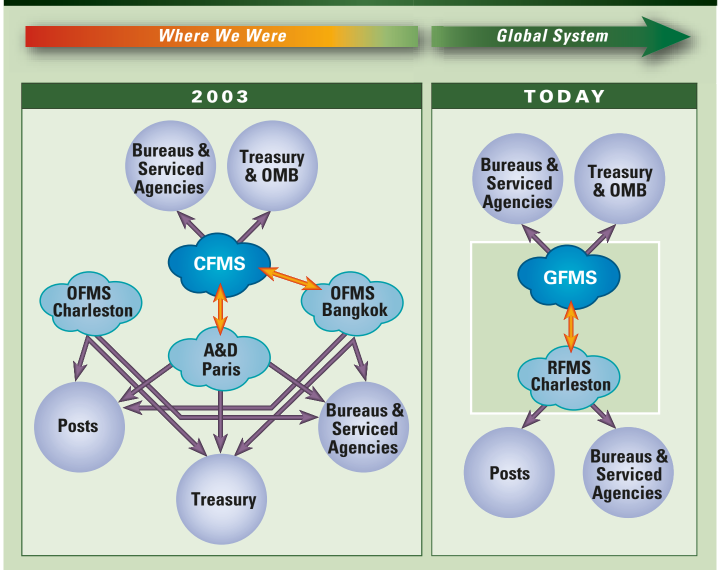
The diagram depicts the state of our vision, a virtual global financial management system.

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 and technical platform to support the Global Financial Management System domestically, the Regional Financial Management System 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.

In FY 2007, the Department implemented the GFMS as the next step in its multi-year effort to establish a global financial system. With the implementation of GFMS, we aligned our domestic financial management systems environment with the Department's enterprise architecture. The system 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. It includes data warehouse, fixed asset and cost allocation (for managerial cost accounting) modules and integrates the Department's acquisition and fixed asset systems into a single software application.

The Global Financial Management System (GFMS) Vision and Concept



Regional Financial Management System.

RFMS is the global accounting and disbursing system that has been implemented for posts around the world. RFMS includes a common accounting system for funds management, obligation and voucher processing; the RFMS/D system to provide disbursing services; and the Consolidated Overseas Accountability Support Toolbox (COAST) post-based system for analysis, reporting and other post-level activities. The system incorporates State's standard account structure and improves transaction standardization and timeliness between post and headquarters, which results in the consistent, timely processing and recording of financial data on a worldwide basis. Plans for FY 2010 include further improvements to the COAST offering, with continued rollout of a much improved encryption capability and initial deployment of cashiering capabilities.

Global Direct Connect.

Our Global Direct Connect initiative moves posts that have operationally practical and reliable network connections from their batch processing environment to a real time, on-line connection. As a result of our efforts to date, there are now over 145 (out of a possible 180) posts using Global Direct Connect. In FY 2009, we converted 14 posts to Global Direct Connect. Moving forward, our plan is to convert another 26 posts to Global Direct Connect in FY 2010 and then to convert the remaining 9 posts in FY 2011.

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 FY 2007. In FY 2008, improvements were added to provide information "drill down" and budget and planning versus actual reporting capabilities. 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.

Domestically, and in support of Department-wide reporting, RM implemented the GFMS Data Warehouse in FY 2007. Based on a modern, browser-based technology platform, the GFMS Data Warehouse 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. The GFMS Data Warehouse also provides, on a daily basis, critical financial information to the Department's Enterprise Data Warehouse. In addition to adding and improving reports and queries, managerial cost accounting and acquisitions reporting modules have been added to the GFMS Data Warehouse since its inception. Plans for FY 2010 include expanding available content and further enhancing management reporting capabilities, including executive-level dashboard reporting.

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 Departmental Obligations

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. The Department assesses civil fines and penalties on individuals for such infractions as violating the terms of munitions licenses, exporting unauthorized defense articles and services, and valuation of manufacturing license agreements. In FY 2009, the Department assessed $15.1 million of penalties against two companies, and collected $28.5 million of outstanding penalties from ten companies. Balance outstanding at September 30, 2009, was $19 million.

Debt Management

Total outstanding debt from non-federal sources (net of allowance) decreased from $76.5 million in FY 2008 to $37.9 million in FY 2009.

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.

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 $1,658,020 to Treasury for cross-servicing in FY 2009. Of the current and past debts referred to Treasury, $814,075 was collected in FY 2009.

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

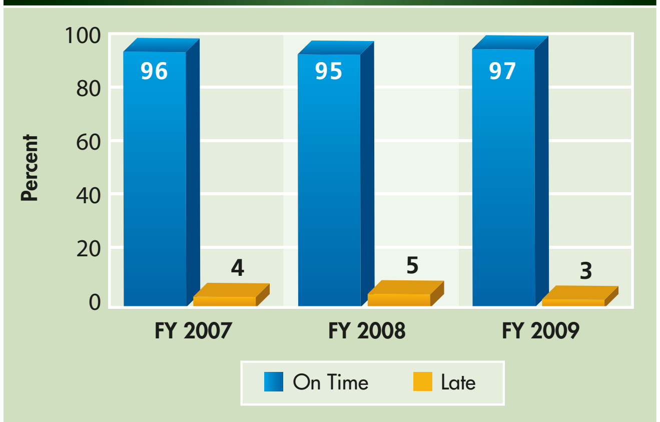
	FY 2009	FY 2008	FY 2007	FY 2006
Number of Accounts	1,006	864	884	1,044
Amounts Referred (In Millions)	$1.7	$1.7	$1.5	$1.7

Prompt Payment Act

Timeliness of Payments

The Prompt Payment Act requires federal agencies to pay bills on time or incur and pay an interest penalty to vendors. In FY 2009, the Department paid timely 97% of the almost 500,000 payments subject to prompt payment act regulations. The chart below reflects the timeliness of the Department's payments from FY 2007 through FY 2009.

Timeliness of DOS Payments
FY 2007 – FY 2009



During FY 2009, the Department paid $1.3 million in interest penalties, compared to $5.4 million in FY 2008, a 76 percent decrease. The Bureau of Resource Management (RM) was able to reduce domestic payment delays this year caused by the transition to a new accounting system in FY 2007.

Electronic Payments

Electronic Funds Transfer (EFT) accounted for 93 percent of the Department's total payments, domestic and overseas. Domestic operations accomplished 99 percent of its payments with EFT this year. Overseas operations have a lower EFT percentage than domestic operations due to the complexities of banking operations in some foreign countries. Each year, RM disburses about 3 million separate payments.

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 is scheduled to conduct its next full risk assessment of programs in FY 2010. In the interim, simplified annual assessments evaluating whether any significant legislative, programmatic, funding, and/or other changes have occurred showed that the Department continues to be 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

RM 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 and 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 FY 2009, the GFS domestic claims debt management process identified and validated 259 actual duplicate/erroneous payments, totaling $3.87 million, out of 133,400

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	133,400	133,400	259	219	1,259	1,518	1,295	223
Amount	$12.73 billion	$12.73 billion	$3.87 million	$3.75 million	$28.6 million	$32.47 million	$30.45 million	$2.02 million

CY=Current year, PY=Cumulative, FY 2005-2008

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*

total payments, totaling $12.73 billion. The claims office has collected or recovered 219 of the 259 erroneous payment debts, totaling $3.75 million (97 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.

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 1,518 duplicate/erroneous payments ($32.47 million), and collected 1,295 identified debts ($30.45 million or a collection rate of 94 percent).

SENSITIVE PAYMENTS

In addition to the annual required IPIA reviews, Departments are also encouraged to conduct reviews of programs and activities that are commonly prone to misinterpretation or misapplication of Federal guidelines and various sensitive payment areas. Sensitive payments are those where the dollar amounts involved are usually not significant, but the public disclosure of improper payments may result in significant criticism of the agency.

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 in fiscal year 2009 to determine if improper payments were made in association with three areas of sensitive payments: business class travel, representation expenses, and payments made from funding received for the American Recovery and Reinvestment Act (ARRA).

Business Class Travel Reviews

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.

Beginning with fiscal year 2006, the Department has annually selected a random sample and supporting documentation was reviewed. There were no instances where evidence was found that a business class travel payment was unapproved and needed to be recovered. For 2009, there were no instances where the travelers flying business class were found to be ineligible, but there were 4 instances where proper supporting documentation was not readily available. Those errors represent an error rate of 4 percent or $10,994 in FY 2009. Past error rates have been 1 percent or $5,385 in FY 2008; 4 percent or $17,038 in FY 2007; and 24 percent or $348,567 in FY 2006. The improvement shown in the sampling results demonstrates that the additional controls the Department put in place in 2006, along with continuous monitoring, have been effective in ensuring significant improper payments were not made for business class travel. Since the error rate is slightly higher in fiscal year 2009 (although well below the 2006 error rate), the Department will reinforce internal communication of the Department's policies regarding business class travel.

Representation Expense Reviews

The Department's mission is conducted throughout the world and requires that extensive diplomatic relationships be established and maintained. This necessarily requires the Department to expend funding on representing the United States' interests at foreign posts. A random sample of representation expenses was selected and supporting documentation was reviewed. In all instances, the expenses were found to be appropriate, in compliance with the Department's policies regarding limitations on representation activity, and supported by adequate documentation.

American Recovery and Reinvestment Act (ARRA) Reviews

The Department received $602 million in funding from the ARRA. The Department has placed emphasis during fiscal year 2009 in obligating and expending the monies as quickly as possible to positively contribute to the facilitation of the country's recovery from the current recession. A random sample of ARRA expenses was selected and supporting documentation was reviewed. In all instances the expenses were found to be appropriate, in compliance with the Department's policies regarding ARRA activity, and supported by adequate documentation.

Heritage Assets

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 the Bureau of Overseas Buildings Operations, Interiors & Furnishings Division, Program Management Branch, is responsible for identifying and maintaining cultural objects owned by the Department 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 that 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*

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 them. 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. Counterterrorism and Border Security
6. Public Diplomacy
7. Coordinating Foreign Assistance

1 Protection of People and Facilities

Protecting people, facilities, and information continues to be one of the Department's highest priorities and greatest challenges. The single most significant factor in this effort is having a safe and secure work environment. The Department has undertaken a vigorous program to replace overseas facilities that do not meet security standards with new, secure facilities, but a decade or more will be needed to fully complete this program. In the interim, the Department must identify and implement temporary measures that can mitigate the threats to people, facilities, and information.

The second most significant aspect in the protection of people, facilities, and information is the security personnel who manage and implement the Department's security programs. Staffing shortages, increasing security requirements, and the demands of high-threat posts have put an ever-increasing workload on Department security personnel. As a result, some security requirements are not being fully met. The Department needs to find ways to help security professionals become more efficient and effective in their work, and to be able to more closely scrutinize the demands being placed on them.

A critical factor in the protection of people, facilities, and information is the cost and the limited funds available for this purpose. Related to cost is the number of people to be protected—the more people protected, the higher the cost. For these reasons, close attention needs to be paid to National Security Decision Directive 38 requests for personnel increases, and Annex A of the chief of mission/combatant commander memorandum of agreement, which identifies those Department of Defense personnel for which the chief of mission has security responsibility. For non-Department personnel under chief of mission security responsibility, International Cooperative Administrative Support Services agreements are needed to cover the cost of the required security support. The Department needs to ensure that all personnel are adequately protected, and that the cost of providing this protection is being equitably distributed.

Other factors that need to be considered are ever-changing security threats and the implementation of measures to counter those threats. For example, lessons learned from past attacks on official facilities should be used as a basis for new security requirements that will provide better protection against future attacks. Similarly, as technology changes, security requirements should be revised to counter increased technical threats or identified vulnerabilities. These are being done, but at an extremely slow pace. In some cases, it has taken years to change the Department's security requirements in response to an identified vulnerability or an increased threat. It is crucial to find ways to streamline the process of updating security requirements to better keep pace with the ever-changing threat environment.

2 Information Security

The protection of personally identifiable information (PII) is a significant information security challenge for the Department. Safeguarding PII and preventing its breach are essential to ensuring the U.S. Government retains the trust of the American public. Enormous amounts of PII are used in many Department programs and operations and are stored and accessed via multiple mediums, which require multiple levels of control and protection. The Department has made strides in protecting PII and other sensitive data, but recently identified weaknesses demonstrate the need for continued focus and improvement.

The Department's Passport Information Electronic Records System (PIERS) contains PII on more than 210 million passports for approximately 139 million passport holders. In March 2008, media reports surfaced that the PII maintained in PIERS for three U.S. Senators, who were also presidential candidates, had been improperly accessed by Department employees and contract staff. OIG performed a review to identify the internal control weaknesses that allowed the improper access to occur, and made recommendations to address the internal control weaknesses found, including the development of policies and procedures to accurately identify the users of passport information, detect unauthorized access to passport and applicant information, and respond effectively when unauthorized access has been determined. As noted above, the Department has made significant strides in addressing these weaknesses.

Federal agencies are required to encrypt and safeguard PII contained on laptop computers. OIG found that as a result of various internal control weaknesses, the Department did not have an accurate inventory of all of its domestic and overseas classified and unclassified laptop computers. Specifically, bureaus and posts failed to enter newly acquired laptop computers into the official inventory system or to delete laptops from the inventory after disposal. In addition, bureaus and posts failed to report and investigate missing laptops or adequately document when a laptop was loaned to an individual for use outside of the assigned facility.

OIG also found that not all of the Department's laptop computers had been encrypted. This created a security vulnerability whereby PII or potentially sensitive information about Department operations contained on those computers could be compromised, should those computers be lost or stolen.

The Department's Computer Incident Response Team (CIRT) now automatically alerts OIG of every information security-related breach, including those concerning PII and laptops. Continued monitoring and protection of passports records and PII of Department employees, as well as other mission-critical information, is crucial if the Department is to maintain the public trust and effectively perform its responsibilities.

The Department continues working to satisfy the requirements of the Federal Information Security Management Act of 2002. During fiscal year 2009, the Department modified its systems inventory management approach and its certification and accreditation (C&A) toolkits, and updated its contingency plan policy. However, the Department continues to face challenges in implementing a fully effective information security management program. The Plans of Action and Milestones process must be strengthened by working with system owners to ensure timely reporting of security weaknesses during the C&A process; testing contingency plans; developing detailed standard operating procedures for addressing each IT security weakness and/or finding; and actively monitoring, validating, and implementing remediation steps to correct all security weaknesses within a reasonable time frame. Security awareness also must be strengthened. Specifically, the processes to identify the number of users with access to the network and the number of users who have taken the cyber security awareness have not been fully defined.

A recent OIG evaluation concluded that the Department's effort to consolidate IT desktop services found inadequate project planning and management, among other shortcomings. The number one priority for the IT Consolidation was customer service; however, the consolidation program to date has failed to deliver the level of customer service promised. In addition, the Department established a 2-year schedule to complete the consolidation of IT desktop services for 34 domestic bureaus and offices rather than abiding by the contractor-recommended 5-year timeframe. As a result, project requirements were not fully defined, cost savings cannot be documented, and security measures are inadequate.

3 Financial Management

Financial management continues to be a major challenge in the Department. In each of the past three years, the Department could not respond in a timely manner to requests for evidential material during the audit of the financial statements. As a result, the independent external auditor was unable to express an opinion on the financial statements by the mandated deadline. For the audit of the FY 2008 financial statements, the Department later provided additional information that supported the amounts in its financial statements, and the external auditor then issued an unqualified opinion.

The Department continues to take steps to improve internal controls over financial management. In 2008, its efforts allowed two material internal control weaknesses, related to personal property and undelivered orders (UDO), to be downgraded to significant internal control deficiencies. The external auditor also identified two other significant deficiencies related to the adequacy of the financial and accounting system, and to calculating the extent of the liability related to supplemental pension plans for locally employed staff that had been identified in prior audits. The Department believes that its plans to establish a virtual single global financial management system, which will include both domestic and overseas financial data, will address some of the internal control issues identified by the external auditor. The Department also is working to establish an accurate inventory of defined benefit supplemental pension plans for locally employed staff.

4 Contracting and Procurement

The Department spends about $4 billion annually on formal contracts and simplified acquisitions,[1] primarily on procurement activities that support overseas programs and operations. Between FY 2001 and FY 2006, the Department's primary acquisition organization, the Bureau of Administration's Office of Acquisitions Management (AQM), experienced a 41 percent increase in the number of procurement transactions processed and a 155 percent increase in the dollar value of procurement actions issued. This workload increase was not accompanied by a corresponding increase in AQM contracting office personnel.

OIG found several examples where contract administration and oversight were inadequate, including the more than $55 million in overpayments in contracts valued at $1 billion for personal protective services in Iraq. Other procurement issues the Department must focus on include adequate planning and transparency in the procurement process. Failure to plan adequately for the construction of the New Embassy Compound in Baghdad, Iraq, and failure to properly administer the contract resulted in more than $100 million in construction defects the Department was required to repair or replace, and the failure to collect liquidated damages and interest payments on contractor advances. With its multi-year plan to upgrade overseas facilities, the Department must ensure that contractors are properly chosen, work is properly conducted, and costs are contained.

5 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. The Department must adequately prepare for both new statutory requirements and new policy initiatives in order to effectively assist U.S. citizens, implement new policies, and provide effective oversight of funds. Examples of increased staffing, resource, and oversight demands include the implementation of the Western Hemisphere Travel Initiative, which requires travel documents for all land, sea, and air travelers in the region. Border crossing card replacement also is expected to add significantly to demand for visa adjudications in Mexico. The Merida Initiative, a historic development in the U.S.-Mexico bilateral relationship to fight transnational crime and corruption, will require significant resources, particularly at Embassy Mexico City. The Department must anticipate and adequately prepare for implementation of such changes.

1 A simplified acquisition is a purchase made from a private commercial business source totaling $100,000 or less (or $5.5 million for commercial items).

6 Public Diplomacy

The Department needs to better integrate public diplomacy into policy formation. In the Bureau of African Affairs, for example, the public diplomacy and public affairs office is not an active contributor to the bureau's policy goals. On the other hand, the Bureau of Western Hemisphere Affairs' successful program of embedding public diplomacy officers with the regional desk officers of the regions they serve is a useful model for ensuring better coordination that results in more effective daily press guidance as well as increased public diplomacy input to regional planning. This initiative needs to be developed further and implemented by other regional bureaus.

According to the Secretary of State, the Department needs to employ new social networking tools—including FaceBook, Twitter, YouTube, and blogging—to engage in dialogue with broader audiences. Challenges hampering the Department's efforts to support social networking include a lack of human, fiscal, and technical resources, IT security and policy concerns, and a lack of appropriate IT equipment and support. As the security climate deteriorates overseas and as new embassy compounds are established with impressive security enhancements, it becomes more difficult for public affairs offices to directly engage local residents. New ways of conducting public diplomacy must be found, including the possible use of virtual presence posts, digital videoconferences, and a further reliance on web sites.

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 afterthought to a particular policy, but further integration within the Department and interagency still remains an issue. The Department needs to ensure more mission-level integration of public diplomacy objectives in all mission goals.

7 Coordinating Foreign Assistance

Observers inside and outside the government recognize that the Department of State and America's diplomats face major challenges in coordinating and managing foreign assistance. Foreign assistance has grown in dollar value and scope, and now includes not only development assistance, but also economic, security, humanitarian, and law enforcement assistance.

As the number and variety of foreign assistance programs has grown, so has the number of agencies—and the number of bureaus in the Department—conducting the programs. The U.S. Government must deliver foreign assistance through grants, contracts, or cooperative agreements, but OIG found that some grants officers did not have the appropriate training to perform those responsibilities, and coordination and financial management of these funds must be improved.

In addition, U.S. embassies and the Department face the challenge of managing the Global HIV/AIDS, Tuberculosis, and Malaria program with a budget of nearly $10 billion a year. The Department established the position of Director of Foreign Assistance in 2006, and began to build a process for integrating strategic planning and budgeting of foreign assistance into the strategic planning of the U.S. Government's other foreign policy goals. Although this initiative responds to widely shared concerns about the modernization of the U.S. Government's management of foreign assistance, it remains a work in progress.

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 2009, the Department improved its ratings over 2009 in four categories. Our prompt payment interest per million of vendor payments fell to just $93, earning a green rating over red last year. Our rating did not change in five of the nine categories. We rank above the government-wide rating in one category, equal the rating in three categories and rank below the average in five categories. While our worldwide operations make it difficult to achieve certain metrics, we continue to achieve improvements as our new global financial management system phases in completely.

		State Sept 2009		State Sept 2008		Governmentwide Performance Standards			Governmentwide Sept 2009	
Measure and Frequency	Why Is It Important	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.	0.059%		0.30%		< = 2%	> 2% to < = 10%	> 10%	0.034%	
Percent of Amount in Suspense (Absolute) Greater than 60 Days Old [Quarterly]	Timely reconciliation supports clean audits and accurate financial information.	37.09%		36%		< = 5%	> 5% to < = 15%	> 15%	21.51%	
Percent of Accounts Receivable from Public Delinquent Over 180 Days [Quarterly]	Actively collecting debt improves management accountability and reduces Treasury borrowing.	34.60%		32%		< = 10%	> 10% to < = 20%	> 20%	11.12%	
Percent of Vendor Payments made Electronically [Monthly]	Use of electronic funds transfer saves money, reduces paperwork, and improves cash management.	92.91%		91%		> = 96%	> = 90% to < 96%	< 90%	97.76%	
Percent Non-Credit Card Invoices Paid On-Time [Monthly]	Timely payment reduces interest charges and reflects a high degree of accountability and integrity.	97.41%		81%		> = 98%	> = 97% to < 98%	< 97%	98.81%	
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.	$92.58 per million		$653 per million		< = $200.00	> $200.00 to $300.00	> $300.00	$84.19 per million	
Travel Card Delinquency Rates - Individually Billed Accounts [Monthly]	Reducing outstanding travel card balances helps increase rebates to agencies.	3.30%		2%		< = 2%	> 2% to < = 4%	> 4%	1.97%	
Travel Card Delinquency Rates - Centrally Billed Account [Monthly]	Reducing outstanding travel card balances helps increase rebates to agencies.	0.49%		2%		= 0%	> 0% to < = 1.5%	> 1.5%	1.52%	
Purchase Card Delinquency Rate [Monthly]	Reducing outstanding purchase card balances helps increase rebates to agencies and reduces interest payments.	0.56%		0.20%		= 0%	> 0% to < = 1.5%	> 1.5%	0.51%	

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: **Qualified Balance Sheet and Disclaimer on SBR**

Restatement: **Yes, for IBWC activity**

MATERIAL WEAKNESSES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
Accounting for Property	0	1	0	0	0	1
Financial Reporting	0	1	0	0	0	1
IBWC Restatement	0	1	0	0	0	1
Total Material Weaknesses	**0**	**3**	**0**	**0**	**0**	**3**

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**					
Total Material Weaknesses	0	0	0	0	0	0
EFFECTIVENESS OF INTERNAL CONTROL OVER OPERATIONS (FMFIA § 2)						
Statement of Assurance:	**Unqualified**					
Total Material Weaknesses	0	0	0	0	0	0
CONFORMANCE WITH FINANCIAL MANAGEMENT SYSTEM REQUIREMENTS (FMFIA § 4)						
Statement of Assurance:	**Systems conform to financial system management requirements**					
Total Non-conformances	0	0	0	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	No
3. USSGL at Transaction Level	Yes	No

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.

Appendix

Glossary of Acronyms

AFR	Agency Financial Report
AFP	Agence France Presse
AP	Associated Press
Appendix A	(Refers to) OMB Circular A-123, 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 Group Life Insurance Program
FEHB	Federal Employees Health Benefits Program
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FISMA	Federal Information Security Management Act
FMFIA	Federal Managers' Financial Integrity Act
FSC	Financial Services Center
FSN	Foreign Service National
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 Equivalent
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	The 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
LE Staff	Locally Employed Staff
NGO	Non-governmental Organization
OBO	Overseas Buildings Operations (DoS)
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
PSA	Personal Service Agreements
PSC	Personal Service Contractor
PSU	Post Support Unit
QDDR	Quadrennial Diplomacy and Development Review
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
UNESCO	United Nations Educational, Scientific and Cultural Organization
USAID	United States Agency for International Development
USG	U.S. Government
WCF	Working Capital Fund

◄ *Photovoltaic cells on roof generate power from sunlight, Geneva embassy.*

Images: Department of State/OBO

U.S. Embassy, Geneva, Switzerland ▲

BUILDING GREEN EMBASSIES

Our Embassies represent much more than diplomacy to their host nations – they are icons of American values. Therefore, the Bureau of Overseas Building Operations, responsible for the worldwide construction and maintenance of America's embassies abroad, has established a "Green Team" to ensure these buildings embody the U.S. commitment to global environmental stewardship.

The Green Team's technical experts incorporate energy- and water-saving technologies, work to improve indoor air quality and specify environmentally sustainable materials in the Department's overseas facilities. As a result, there are magnetic-levitation chillers cooling the U.S. Embassy in Tokyo, photovoltaic panels producing electricity for the U.S. Embassy in Geneva, co-generation systems saving energy for the U.S. Embassy in Stockholm and rainwater harvesting being designed for the U.S. Embassy in Freetown.

LEED (Leadership in Energy and Environmental Design) certification was awarded to the U.S. Embassy in Panama City in 2008 by the U.S. Green Building Council. The nine-year-old rating system grades projects' sustainability based upon their energy use, water efficiency, indoor air quality and other factors. LEED certification has become a status symbol, a label of environmental consciousness and responsibility. Every future new compound built by the Bureau will earn LEED certification.

U.S. Ambassador to Sweden Michael M. Woods launched a movement to support the goals of eco-diplomacy by establishing the League of Green U.S. Embassies. The 30 embassies in the league have committed to adopting environmentally responsible practices. Additionally, the Green Team is working to achieve climate-neutral operations. The actions of the Green Team and the League of Green U.S. Embassies will help create international models of sustainability as solid platforms for eco-diplomacy by greening U.S. embassies and consulates.

-from an article appearing in State Magazine, April, 2009 by Donna Mcintire and Melanie Berkemeyer, Architects with OBO and members of the Green Team.

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

Carol Gower, Director, Reporting & Analysis

Barbara Clark and Victoria Ashley, AFR Editors

Nadine Bradley, Harold Brown, Andrew Callihan, Kathy Chandra, Melissa Clark, Carole Clay, Melinda DeCorte, Tynesha Douglass, Nancy Durham, Kiana Elam, Dominique Foster, Vicki Gentry, Brian Gesinski, Michelle Green, Bethany Hart, Ashley Hawkins, Matthew Johnson, Mo Kohistani, Yen Le, Jeffrey Long, Frank Rosado, Troy Scaptura, Meredith Shears, Filia Sidarta, Mark Terman, David Weise, Matthew Williams, Sam Yang, Jennifer Yount.

Office of Strategic and Performance Planning:

Claudia Magdalena Abendroth, Thea C. Bruhn, Colleen Fisher, Alessandra Holland, and Yaropolk T. Kulchyckyj.

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 Kearney & Company for the professional manner in which they conducted the audit of the FY 2009 financial statements.

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

FY 2009 IMAGE CREDITS

Agence France Presse (AFP): *Table of Contents, Message from the Secretary, pages 7, 9, 16, 19, 23, 24, 81, 107*

Associated Press (AP): *Cover, Table of Contents, pages 20, 22, 30, 38, 103*

Department of State: *Pages 7, 9, 14, 15, 18, 21, 26, 29, 36, 37, 78, 79, 98, 113, 116, 118, 120, 128*

State Magazine: *Pages 14, 30, 39*

USIBWC: *Page 45*

Table of Contents Image Captions: Images (L) to (R): (1) Secretary of State Hillary Rodham Clinton in India, July 2009, AP Image; (2) Secretary Clinton meets with Russian Foreign Minister Sergei Lavrov in Moscow recently, AFP Image; (3) Secretary Clinton meets with Afghan President Hamid Karzai (L) and Pakistani President Asif Ali Zardari (R) at the Department of State in Washington, D.C., May 2009, AP Image; (4) Secretary Clinton chairs the UN Security Council Session on Women, Peace and Security in New York, September 2009, AFP Image; (5) President Obama (L) and Secretary Clinton (C) tour the Sultan Hassan Mosque in Cairo, June 2009, AFP Image.

The *Agency Financial Report for Fiscal Year 2009* 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 2009

Note: The Bureau of Public Affairs, Office of Electronic Information (PA/EI) assisted the Bureau of Resource Management with the production of the *FY 2009 Agency Financial Report*, including images from AP/Wide World.

2201 C Street, N.W.
Washington, D.C. 20520
(202) 647-4000

www.state.gov