UNITED STATES DEPARTMENT OF STATE
AND THE BROADCASTING BOARD OF GOVERNORS

*OFFICE OF INSPECTOR GENERAL*

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# Audit of U.S. Department of State Use of Short-Term Leases Overseas

United States Department of State
and the Broadcasting Board of Governors

*Office of Inspector General*

PREFACE

This report was prepared by the Office of Inspector General (OIG) pursuant to the Inspector General Act of 1978, as amended, and Section 209 of the Foreign Service Act of 1980, as amended. It is one of a series of audit, inspection, investigative, and special reports prepared by OIG periodically as part of its responsibility to promote effective management, accountability and positive change in the Department of State and the Broadcasting Board of Governors.

This report is the result of an assessment of the strengths and weaknesses of the office, post, or function under review. It is based on interviews with employees and officials of relevant agencies and institutions, direct observation, and a review of applicable documents.

The recommendations therein have been developed on the basis of the best knowledge available to the OIG and, as appropriate, have been discussed in draft with those responsible for implementation. It is my hope that these recommendations will result in more effective, efficient, and/or economical operations.

I express my appreciation to all of those who contributed to the preparation of this report.

Harold W. Geisel
Deputy Inspector General

## Acronyms

| | |
|---|---|
| CGFS | Bureau of the Comptroller and Global Financial Services |
| DS | Bureau of Diplomatic Security |
| FAH | *Foreign Affairs Handbook* |
| FAM | *Foreign Affairs Manual* |
| FASAB | Federal Accounting Standards Advisory Board |
| ICASS | International Cooperative Administrative Support Services |
| LTL | long-term lease |
| OBO | Bureau of Overseas Buildings Operations |
| OIG | Office of Inspector General |
| STL | short-term lease |

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## Executive Summary

As of September 30, 2011, about 97 percent of the Department of State's (Department) real property operating leases were leased on a short-term basis. Annual rental cost for these leases in FY 2011 totaled about $459 million. The full cost of leased property could also include make-ready costs[1] incurred while preparing a property for occupancy, as well as security and safety improvements and maintenance and repair costs. Because of the high percentage of short-term leases[2] (STL) and their associated annual costs, the Office of Inspector General (OIG) performed this audit to help Department decision makers manage a vital operation and optimize the use of scarce financial resources. OIG's Office of Audits conducted this performance audit to determine whether the Bureau of Overseas Buildings Operations (OBO) was utilizing STLs for overseas real property operating leases to fulfill the Department's long-term requirements rather than securing leases with longer durations.

OIG found that OBO and the audited posts in Rome, Mexico City, Tel Aviv, and Jerusalem rarely utilized real property operating leases with durations longer than 10 years. This occurred because neither OBO nor posts had an incentive to secure longer lease durations because of a Department-imposed regulation prohibiting the sharing of operating lease costs with other occupying Federal agencies when the lease duration is 10 years or longer. As a result, the duration of most of the Department's real property operating leases was less than 10 years, and the Department may be missing opportunities to secure more preferable lease durations and reduce the vulnerability of losing leased properties that could lead to higher lease costs.

OIG also found that personnel at the posts audited were not tracking and reporting make-ready costs specific to each property in our audit sample. This occurred because OBO had not established guidance and procedures that require posts to track and report costs associated with each property. Without adequate accounting and reporting of these property costs, the Department cannot (1) ensure that make-ready costs specific to a property do not exceed the *Foreign Affairs Manual* (FAM) limitation, (2) verify that funds were used for legitimate make-ready costs, and (3) determine the full cost of leasing overseas properties to make fully informed decisions about whether lease agreements should be renewed or terminated.

OIG made six recommendations that are intended to enhance real property leasing options and better control lease costs. Specifically, OIG recommended OBO revise volume 15 of the FAM and the *Foreign Affairs Handbook* (FAH) to designate all noncapital leases as operating leases regardless of lease duration and apply current funding and cost sharing requirements associated with STLs to all operating leases. Additionally, OIG recommended that the Bureau of the Comptroller and Global Financial Services (CGFS) and the Bureau of Diplomatic Security (DS), in coordination with OBO, revise volumes 4, 6, and 12 of both the FAM and the FAH to account for the revisions in volume 15 of the FAM regarding leases. OIG also recommended OBO establish guidelines and procedures that require posts to track and report on make-ready funds expended for individual properties to help ensure funds are used for

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[1] Per 15 FAM 313.1, "Alterations, Improvements, and Repairs to Short-Term Lease Properties," make-ready costs can include minor alterations, improvements, and repairs.
[2] Per 15 FAM 121, "General Definitions," the duration of an STL is less than 10 years.

authorized purposes and do not exceed the Department limitations.

OIG provided the draft report to OBO, CGFS, and DS on October 9, 2012, for review and comment. In its November 5, 2012, response, OBO agreed with Recommendations 1, 2, and 6 (see Appendix E). In its November 6, 2012, response, DS agreed with Recommendation 5 (see Appendix G). In its November 19, 2012, response, CGFS agreed to implement Recommendation 4 but did not agree to implement Recommendation 3 (see Appendix F). Based on the responses, OIG considers Recommendations 1, 2, 4, 5, and 6 directed to OBO, CGFS, and DS resolved, pending further action. However, OIG considers Recommendation 3, directed to CGFS, unresolved.

Management's comments have been considered and incorporated into the report as appropriate. Management's responses to the recommendations and OIG's replies are presented after each recommendation.

# Background

A significant annual contracting activity performed by the Department is leasing overseas properties. The United States Code[3] grants the Secretary of State the authority to lease or rent such buildings and grounds for the use of the Foreign Service as may be necessary. The Secretary of State is also authorized "to provide residential and office space and necessary related facilities to other agencies abroad whose employees are under the authority of the chief of mission."[4] This authority is delegated to OBO, who acts as the single real property manager for all nonmilitary U.S. Government property overseas.

## Capital Leases and Operating Leases

The Federal Accounting Standards Advisory Board (FASAB) established standards of federal financial accounting and reporting for leases.[5] For the lessee,[6] a lease is a financing transaction called a "capital lease" if it meets any one of four specified criteria: (1) lease transfers ownership to the Government at the end of the lease term, (2) lease contains an option to purchase the leased property at a bargain price, (3) lease term is equal to 75 percent or more of the economic life of the leased property, and (4) present value at the beginning of the lease for the minimum lease payment is 90 percent or more of the fair value of the leased property. If none of the above criteria applies, the lease is considered an "operating lease." The lessee treats capital leases as the acquisition of assets and the incurrence of obligations, while operating leases are treated as current operating expenses. The FAM[7] is consistent with the FASAB in this regard.

A capital lease is reported on the balance sheet as both an asset and a liability. The Government claims depreciation each year on the asset and deducts interest expense on its

[3] 22 U.S.C. § 291, "Lease of buildings, etc., for offices, living quarters, heat, light, and equipment."
[4] 15 FAM 112.2, "Department of State Authorities."
[5] Statement of Federal Financial Accounting Standards Number 5, Sept. 1995.
[6] A lessee is the person or entity renting property under a written lease from the landlord.
[7] 4 FAM 033.8-7, "Capital Leases."

statement of net cost. Operating leases are reflected on the statement of net cost, with the current annual rent payments recorded as expenses. In FY 2011, the Department had 24 capital leases with lease terms ranging from 7 years to 90 years in duration. In contrast, the Department had 9,183 operating leases, most of which had lease terms of less than 10 years.

**Short-Term Leases and Long-Term Leases**

In addition to the capital and operating lease designations, the FAM stipulates an additional lease designation based on duration. The FAM[8] defines an STL as a real property lease with duration of less than 10 years and a long-term lease (LTL) as a real property lease with duration of 10 years or longer. Real property is defined as land and/or structures such as office buildings, houses, warehouses, and parking lots. Volume 15 of the FAM, "Overseas Buildings Operations," provides guidance for leasing, allows the Department to enter into either an STL or an LTL for overseas properties, and provides guidance regarding when to consider LTLs. According to the FAM,[9] "Normally, it is in the U.S. Government's interest to own or lease on long-term chanceries, ambassadors' residences, and Marine guard quarters…." The FAM[10] also states, "LTLs allow posts better control of lease costs and greater flexibility and control of maintenance, renovation, and improvements." As of September 30, 2011, the Department had 8,933 overseas real property short-term operating leases with annual operating rents totaling $458.6 million and 250 long-term operating leases with annual operating rents totaling $23.6 million. Of the 8,933 short-term operating leases, 1,304 with annual operating rents totaling $84.6 million had been in existence for more than 10 years; each had original and renewal durations of less than 10 years.

The FAM's requirement to differentiate leases by duration is significant as this dictates how lease costs are funded. Specifically, the Department, in accordance with the FAM, must pay all lease costs for leases with duration of 10 years or greater regardless of the occupying agency, whereas the funding of STLs depends on the occupant. Lease costs for STLs may be directly charged to the sole occupying agency, shared among multiple occupying agencies, or funded by the Department if solely occupied by Department personnel. It is important to note that the Office of Management and Budget does not differentiate leases based on duration; it only designates between capital and operating leases.

**Total Leasing Costs**

Total leasing costs include rental payments and could include make-ready, maintenance and repair, and Department-required security improvement expenditures necessary to meet Department security and safety standards.[11] Make-ready costs are incurred to prepare a property for occupancy, whereas maintenance and repair costs are incurred to keep a property in working condition. For both short-term and long-term operating leases, the FAM[12] states, "Every effort

[8] 15 FAM 121.
[9] 15 FAM 332.1, "When to Consider Long-Term Leases (LTLs)."
[10] Ibid.
[11] Per 15 FAM 165.2, "Residential, U.S. Government-Owned/Long-Term Leased Properties," and 15 FAM 313.1, the Bureau of Diplomatic Security is responsible for funding necessary security improvements and upgrades.
[12] 15 FAM Exhibit 341(1), "Model Lease Explanations and Instructions," Article Seven, Section B.

must be made to include provisions that place the responsibility for initial make-ready improvements, renovations, alterations, repairs, and security upgrades consistent with the Department's A-32 standards (local guard program and residential security) with the landlord and at the landlord's expense." However, if posts are unable to negotiate these provisions at the landlord's expense, the Department may be responsible for these expenditures. The various lease costs are funded differently based on the duration of the lease and the use of the property. See Appendix B.

**The Leasing Process**

As the single real property manager for the Department, OBO establishes and oversees all policies and procedures governing real property at post for personnel under chief of mission authority. This applies to all nonmilitary land, office, residential, and other functional properties owned or leased in the name of the U.S. Government, except for "where the U.S. Agency for International Development (USAID) independently manages its USAID-owned and long-term leased housing program under its independent authorities."[13]

Posts use Department regulations found in volume 15 of the FAM that include leasing checklists, a model lease, and other guidance when entering into a lease. Posts are responsible for maintaining lease file documentation, to include original contracts, leases, renewals, amendments, and related records. OBO and posts must consider factors such as current regulations, requirements, cost, budget authority, funding, and flexibility when executing a lease.

The leasing process for all leases starts with a requirement for either functional space, such as offices and common-use areas, or residential accommodations for personnel assigned to a post. Posts research locations and availability of properties, as well as compare similar properties for costs, terms, and suitability. Posts must submit a justification to OBO for approval of all functional leases or LTLs; however, posts are authorized to execute residential STLs with annual rents totaling $25,000 or less per year. In 2007, OBO introduced the Rental Benchmark Program that allows participating posts to exceed the $25,000 per year rental limit (up to $50,000 per year) resulting in quicker lease processing times and more autonomy for posts.

## Objective

OIG conducted this performance audit to determine whether OBO was utilizing STLs for overseas real property operating leases to fulfill the Department's long-term requirements rather than securing leases with longer durations.

[13] 15 FAM 113.1, "Department of State."

# Audit Results

## Finding A. Department Regulations Inhibit Lease Options and May Adversely Impact Lease Costs

OIG found that OBO and the audited posts in Rome, Mexico City, Tel Aviv, and Jerusalem rarely utilized real property operating leases with durations longer than 10 years. This occurred because neither OBO nor posts were inclined to secure lease durations longer than 10 years because of a Department-imposed regulation prohibiting the sharing of lease costs with other occupying Federal agencies when the lease duration is 10 years or longer. As a result, the duration of most of the Department's real property operating leases was less than 10 years, and the Department may be missing opportunities to secure more preferable lease durations and reduce the vulnerability of losing leased properties that could lead to higher lease costs.

On May 25, 2012, OIG issued a memorandum to the Under Secretary for Management to provide interim audit information on this key finding prior to the issuance of the draft report. (See Appendix C for the memorandum.)

### The Department Rarely Utilized Operating Leases With Durations Longer than 10 Years

On September 30, 2011, the Department had 9,183 overseas real property operating leases with annual rents totaling about $482 million. Approximately 97 percent of these leases were STLs, as defined in the FAM to be a lease with terms of less than 10 years. Table 1 presents the number, percentage, and value of annual rents of the Department's overseas short-term and long-term operating leases at the end of FY 2011.

**Table 1. Department of State Overseas Real Property Operating Leases and Annual Rents as of Fiscal Year Ending September 30, 2011**

| | Short-Term Operating Leases | Long-Term Operating Leases | Totals |
|---|---|---|---|
| Total Number of Overseas Operating Leases | 8,933 | 250 | 9,183 |
| Percent of Total | 97.3 | 2.7 | 100.0 |
| **Total Annual Rents at the End of the Fiscal Year** | **$ 458,585,149** | **$ 23,582,068** | **$ 482,167,217** |

Source: The Department's financial statements auditor, Kearney & Company.

The Department used STLs to fulfill long-term property requirements. OIG found that approximately 15 percent (1,304 of 8,933) of the Department's leases considered STLs had been acquired before January 1, 2001, and had been renewed at least once in increments of less than 10 years. The Department had leased 92 of these properties for at least 30 years and had leased an additional 200 STLs from 20 to 30 years. These 1,304 overseas STLs represented nearly $85 million of approximately $482 million of total annual rent for all overseas operating leases.

Table 2 presents the number, percentage, and annual rent data, by period of acquisition, for overseas STLs that were in existence at the end of FY 2011.

**Table 2. Department of State Overseas Short-Term Real Property Operating Leases as of Fiscal Year Ending September 30, 2011, by Period of Acquisition**

| Period Lease Acquired | Number of Short-Term Operating Leases | Percent of Short-Term Operating Leases | Annual Rent |
|---|---|---|---|
| 01/01/1947 – 12/31/1980 | 92 | 1.0 | $8,325,312 |
| 01/01/1981 – 12/31/1990 | 200 | 2.2 | 17,659,663 |
| 01/01/1991 – 12/31/2000 | 1,012 | 11.3 | 58,653,777 |
| **Subtotals** | **1,304** | **14.5** | **$84,638,752** |
| 01/01/2001 – 09/30/2011 | 7,629 | 85.4 | 373,946,397 |
| **Totals** | **8,933** | **100.0*** | **$458,585,149** |

*Percentage adjusted for rounding.
Source: The Department's financial statements auditor, Kearney & Company.

OIG reviewed 116 of 1,304 short-term operating leases acquired on or prior to December 31, 2000, and in existence as of September 30, 2011.[14] OIG found that neither OBO nor the posts audited determined whether the lease durations for the 116 STLs in our audit sample were more beneficial to the U.S. Government than longer term leases. OBO and posts did not utilize real property operating leases with durations of 10 years or longer because of a Department-imposed regulation prohibiting the sharing of lease costs with other occupying Federal agencies when the lease duration is 10 years or longer.

### Tenant Agency Cost Sharing of Long-Term Leases

The Department's regulations designate leases 10 years or longer as LTLs and prohibit sharing lease costs among the Department's tenant agencies for these leases. However, if the FAM did not define leases based on the duration of time, the Department could stipulate that the Department share lease costs with other tenant agencies for all operating leases, including those leases with durations of 10 years or longer.

According to the FAM[15] and the FAH,[16] lease costs for office, functional, and residential space under LTLs are funded by OBO regardless of the tenant agencies. However, both the FAM[17] and the FAH[18] state that lease costs associated with STL functional properties are shared

[14] The 116 leases selected for this audit were located at Embassies in Rome (Italy), Mexico City (Mexico), and Tel Aviv (Israel), and at the U.S. Consulate General in Jerusalem. (See Appendix A for detailed sampling methodology.)
[15] 15 FAM 162.1, "U.S. Government-Owned/Long-Term Leased (GO/LTL) Space."
[16] 6 FAH-5 H-341.12, "Building Operations."
[17] 15 FAM 162.2, "Short-Term Leased (STL) Space."
[18] 6 FAH-5 H-341.12.

via International Cooperative Administrative Support Services (ICASS)[19] when the property is occupied by multiple tenant agencies, otherwise the costs are paid entirely by the agency occupying the facility.

OIG verified that OBO generally funded lease costs for LTLs regardless of the occupying agency. Of the 18 LTL properties OIG reviewed,[20] OBO had funded the lease costs for 17, including three properties shared with other agencies and one property occupied by the Department of Defense. OIG found that ICASS currently funds one of the 18 LTL properties reviewed contrary to FAM regulations. This consulate office building located in Nuevo Laredo, Mexico, and occupied by tenant agencies under chief of mission authority, was funded by OBO until FY 2012. The Mexico lease originated in 1974 and was designated an LTL because of its duration of 10 years. The lease was extended via amendments for three additional 5-year option periods and two additional 9-year option periods. The lease end date is now December 2018. According to OBO, post personnel decided to treat this LTL as an STL because of its current duration of less than 10 years. However, had the FAM designated all noncapital leases as operating leases and not distinguished between STLs and LTLs, funding for this lease could have been shared from its initiation and post would not be funding the lease contrary to the FAM regulation.

The Department-imposed policy prohibiting the sharing of LTL costs among tenant agencies at posts has been the basis for the Department's reliance on STLs. However, OIG was unable to find any Federal policy or regulation that prohibited the Department from cost sharing LTLs with tenant agencies. Office of Management and Budget officials confirmed that they only designate leases as either capital or operating and that Office of Management and Budget requirements do not affect whether the Department can cost share leases.

OBO officials have been in the process of converting LTLs to STLs because of the cost sharing limitations of leases 10 years or longer. Specifically, a June 2, 2010, information memorandum from OBO's Office of the Deputy Director to the Acting OBO Director states that "OBO/PRE/BAS [Directorate of Planning and Real Estate, Office of Building Acquisitions and Sales] will endeavor, as a matter of practice, to convert expiring Long-Term Leases (LTL) to Short-Term Leases (STL) when office or functional space is occupied by tenant agencies." The memorandum outlines the steps to be taken by OBO to coordinate with individual posts with expiring LTLs on the lease conversion process. (See Appendix D for the information memorandum.) OIG reviewed cables the Department sent to posts with expiring LTLs and verified the implementation of this strategy. For example, on July 27, 2010, the Department sent a cable to Vancouver stating:

> 1. The lease for Consulate General Vancouver is due to expire on September 30, 2010. It was originally signed in September 1990 as a Long-Term Lease (LTL) when State/Program was the sole occupant and the lease has been funded by OBO

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[19] The ICASS system is the principal means by which the Department provides and shares the cost of common administrative support, to include lease costs, needed to ensure effective operations at its more than 200 diplomatic and consular posts abroad.

[20] OIG judgmentally selected 18 of 225 overseas property leases designated as LTLs in OBO's Real Property Application database as of July 10, 2012. (See Appendix A for detailed sampling methodology.)

through its 7400 account. Since then, other agencies have added personnel to Consulate General Vancouver's staffing and State/Program is no longer the sole occupant.

2. Per Ref A, [15 FAM 162.2] when functional space is occupied by multiple agencies, those agencies should be charged for their proportionate share of lease costs and BOE [Building Operating Expenses] through ICASS. It is therefore OBO's policy to renew all leases for space occupied by multiple tenant agencies as ICASS-funded short-term leases (STLs).

**Vulnerabilities of Short-Term Leases**

The Department's predominant use of leases with duration less than 10 years can put posts at risk of higher rental costs and losing properties because of increased competition in the area, as well as increased costs associated with finding new properties and preparing them for occupancy. For example, post officials in Rome stated that an influx of private investors heavily investing in real estate had created increased competition for property. Similarly, post officials in Tel Aviv explained that competition from expatriates and employees of hi-tech, oil, and other private companies were driving up housing prices. The officials added that the post had lost many leases to these competitors. As competition increases in a location, so do rental costs. Therefore, the ability to negotiate longer lease terms in competitive real estate markets could be in the U.S. Government's interest.

OIG noted another example of a post at risk of losing properties or experiencing higher rental costs because of the nearly exclusive use of STLs in Mexico City. According to post officials**,** the new embassy compound in the Nuevo Polanco area of Mexico City is expected to open in 2017. Post officials stated they were relocating more of the Department's residential properties closer to where the new embassy will be built. However, as of March 2012, 98 of 152 STLs in the Nuevo Polanco area will expire before 2017. Of 152 STLs, 65 were renegotiated or secured in 2011, all of which will expire before or during 2020. Since most of these leases expire before or soon after the compound is expected to open in 2017, the post is at risk that these properties will not be available for renewal or will be available at higher rental costs because of increased property values once the new embassy compound opens.

There are costs associated with procuring new leases for the Department. These costs could include security improvements necessary to meet Department security and safety standards and make-ready costs. The FAM[21] encourages lease terms of longer than 5 years to amortize make-ready and security upgrade costs thereby reducing the overall yearly lease costs. With longer duration leases, the Department incurs less administrative and upgrade costs associated with locating and preparing new properties when shorter duration leases cannot be renewed. According to Tel Aviv post officials, obtaining a new lease is typically more expensive and labor intensive than renewing an existing lease.

[21] 15 FAM 313.2, "Preference for 5-Year Minimum Term."

### *Foreign Affairs Manual* Changes Would Enhance Lease Options and Reduce Vulnerabilities

The FAM guides posts to secure LTLs to "allow posts better control of lease costs and greater flexibility and control of maintenance, renovation, and improvements."[22] However, both the FAM and the FAH prohibit the sharing of real property operating lease costs when the lease terms are 10 years or longer. In practice, OBO's directive to share lease costs with other Federal agencies at posts had taken precedent over utilizing optimum durations for operating leases. OBO officials could not explain, and OIG could not determine, the rationale for restricting the sharing of operating lease costs based on the duration of the lease.

By changing the FAM, the Department would be in the position to negotiate longer lease durations when preferable and provide posts better control of operating lease costs and greater flexibility and control of maintenance, renovation, and improvements. OBO officials stated they would consider entering into longer duration leases if the cost sharing prohibition of leases 10 years or longer was removed from the FAM. They added that sharing these operating lease costs with other agencies would be consistent with other cost sharing procedures in effect for managing overseas properties.

**Recommendation 1.** OIG recommends that the Bureau of Overseas Buildings Operations revise volumes 15 of the *Foreign Affairs Manual* and *Foreign Affairs Handbook* to designate all noncapital leases as operating leases, regardless of lease duration, in accordance with Statements of Federal Financial Accounting Standards.

**OBO Response:** OBO concurred with the recommendation, stating that it is revising the FAM and the FAH, as appropriate, and expects revisions to be completed by January 2013.

**OIG Reply:** OIG considers the recommendation resolved. The recommendation can be closed when OIG reviews and approves documentation showing that OBO has revised volumes 15 of the FAM and the FAH to designate all noncapital leases as operating leases, regardless of lease duration, in accordance with Statements of Federal Financial Accounting Standards.

**Recommendation 2.** OIG recommends that the Bureau of Overseas Buildings Operations revise volumes 15 of the *Foreign Affairs Manual* and the *Foreign Affairs Handbook* to apply current funding and cost sharing requirements associated with short-term leases to all operating leases.

**OBO Response:** OBO concurred with the recommendation, stating that it is revising the FAM and the FAH as appropriate and expects to have revisions completed by January 2013.

**OIG Reply:** OIG considers the recommendation resolved. The recommendation can be closed when OIG reviews and approves documentation showing that OBO has revised

[22] 15 FAM 332.1.

volumes 15 of the FAM and the FAH to apply current funding and cost sharing requirements associated with short-term leases to all operating leases.

**Recommendation 3.** OIG recommends that the Bureau of the Comptroller and Global Financial Services, in coordination with the Bureau of Overseas Buildings Operations, revise volumes 4 of the *Foreign Affairs Manual* and the *Foreign Affairs Handbook* to account for the revisions in volume 15 of the *Foreign Affairs Manual* regarding leases.

**CGFS Response:** CGFS stated that it sees no need to revise existing provisions in volume 4 of the FAM, since, as noted by OIG within the draft report, language in volume 4 of the FAM is consistent with FASAB guidance. However, CGFS also stated that it will work with OBO to ensure that the language in volumes 15 of the FAM and the FAH, when revised, is consistent with FASAB guidance articulated in volume 4 of the FAM.

**OIG Reply:** OIG considers the recommendation unresolved. The recommendation can be closed when OIG reviews and approves documentation showing that CGFS has revised volumes 4 of the FAM and the FAH to reflect the changes in lease designations resulting from OBO's revisions to volumes 15 of the FAM and the FAH. Although, volume 4 of the FAM is consistent with the FASAB, OIG noted that sections of volumes 4 of the FAM and the FAH reference "long-term" and "short-term" lease designations, which should be revised accordingly.

**Recommendation 4.** OIG recommends that the Bureau of the Comptroller and Global Financial Services, Office of International Cooperative Administrative Support Services, in coordination with the Bureau of Overseas Buildings Operations, revise volume 6 of the *Foreign Affairs Handbook* to account for the revisions in volume 15 of the *Foreign Affairs Manual* regarding leases.

**CGFS Response:** CGFS stated it would revise, as needed, volume 6 of the FAH after OBO finalizes and publishes its revisions to volume 15 of the FAM.

**OIG Reply:** OIG considers the recommendation resolved. The recommendation can be closed when OIG reviews and approves documentation showing that CGFS has revised volume 6 of the FAH to correspond with OBO's revisions to volume 15 of the FAM.

**Recommendation 5.** OIG recommends that the Bureau of Diplomatic Security, in coordination with the Bureau of Overseas Buildings Operations, revise volumes 12 of the *Foreign Affairs Manual* and the *Foreign Affairs Handbook* to account for the revisions in volume 15 of the *Foreign Affairs Manual* regarding leases.

**DS Response:** DS concurred with the recommendation, stating it would revise, as needed, volumes 12 of the FAM and the FAH after OBO finalizes and publishes its revisions to volumes 15 of the FAM and the FAH.

**OIG Reply:** OIG considers the recommendation resolved. The recommendation can be closed when OIG reviews and approves documentation showing that DS has revised volumes 12 of the FAM and the FAH to correspond with OBO's revisions to volumes 15 of the FAM and the FAH.

## Finding B. Accounting and Reporting of Make-Ready Costs at Posts Need Improvement

Rome, Mexico City, Tel Aviv, and Jerusalem post personnel could not account for funds expended on make-ready costs for any of the 116 properties reviewed in our audit sample. This occurred because OBO did not have formal procedures to ensure that make-ready costs for individual STL properties were consistently tracked and reported. Without formal procedures in place to account for and report these costs, the Department cannot (1) ensure that make-ready costs specific to a property do not exceed the FAM limitation, (2) verify that funds were used for legitimate make-ready costs, and (3) determine the full cost of leasing overseas properties to make fully informed decisions about whether lease agreements should be renewed or terminated.

### Tracking and Reporting Make-Ready Costs

Prior to occupancy, posts must ensure that leased properties are prepared in a manner that meets safety, hygiene, comfort, and efficiency standards, as well as specific operational requirements. Preparations for occupancy can include minor alterations, improvements, and necessary repairs defined as "make-ready" costs in 15 FAM 313.1. The FAM further states that make-ready costs are allowed when a lease is initially acquired or reassigned and must not exceed $5,000 but does not differentiate between residential and nonresidential STLs. In addition, 15 FAM 162.2 states:

> Posts may expend up to $5,000 from D&CP [Diplomatic and Consular Programs] (for State program officers) or ICASS funds (for ICASS service providers), as appropriate, to prepare Department of State-held STL residential properties for occupancy. For all other agencies, the occupying agency pays similar make-ready expenses for residential properties. Justification and accounting documentation should be maintained in the lease file.

OIG found that the four posts reviewed could not account for make-ready costs associated with the 116 properties audited. The lease files for these properties were inconsistent and unorganized. Although the files generally contained documentation such as lease contracts, memoranda, invoices, spreadsheets, and e-mails, OIG could not determine the amount spent on make-ready costs or verify that make-ready expenditures did not exceed the FAM limitation because documentation was insufficient. OIG made several attempts to obtain documentation and information from the posts audited to explain how make-ready costs were budgeted, tracked, and reported. However, posts were either unresponsive to our requests or the information provided was incomplete. For example, the Mexico City general services officer told OIG that post could provide average make-ready costs. OIG asked the official to explain how post calculated that average. However, post did not provide OIG with either the average make-ready costs or the calculations; therefore, it is unknown whether the post tracks average make-ready costs on a regular basis. By compiling average make-ready costs, rather than tracking expenditures for individual properties, post officials cannot verify that expenditures did not exceed the FAM limitation and cannot determine the total cost of leasing individual properties. Without knowing the total cost of leasing individual properties, post officials cannot make fully informed decisions regarding whether to renew or terminate leases for specific properties based on expenditures.

Although Rome officials provided OIG with spreadsheets for the make-ready costs incurred for Department-occupied properties from 2005 to 2011, these spreadsheets did not include detail identifying the properties receiving the make-ready improvements nor could the expenditures recorded in the spreadsheets be reconciled to invoices or other substantiating documentation. Post also provided OIG with financial reports to show funds expended from the Diplomatic and Consular Program funds for make-ready costs expended for FYs 2005–2011. However, these reports did not include sufficient detail for OIG to identify the properties or verify whether the expended funds were used for legitimate purposes. Post did not maintain records of make-ready costs spent on STL properties occupied by other agencies.

OIG asked OBO officials to explain how the Department budgets and tracks make-ready expenditures and ensures compliance with the FAM limitation. OBO officials referred OIG to sections in the FAM that indicated regional bureaus (Diplomatic and Consular Program funds), ICASS, or the occupying agency funded make-ready costs. OBO officials also stated, "It is post's responsibility to capture and maintain records of these costs in the lease files locally. OBO has no way of capturing these expenses." Because make-ready cost preparations are similar to maintenance and repair costs that are funded by OBO, such as painting, minor repairs, and supplies, it is important to properly track these expenses to ensure funds are used for legitimate purposes. OIG determined that posts do not track make-ready costs expended on a per property basis because there are no requirements to report these expenses for individual properties and officials do not question expenditures as long as costs do not exceed the established aggregate funding targets for the fiscal year. Furthermore, the Department lacked formal guidance and procedures requiring posts to track and report make-ready costs to ensure compliance with the FAM limitation and ensure funds are used for legitimate purposes.

**Guidelines and Procedures Needed For Tracking and Reporting Total Leasing Costs**

As the single real property manager for nonmilitary U.S. Government property overseas, OBO has the responsibility for establishing, implementing, and overseeing all policies and procedures governing real property. These responsibilities include establishing policies and procedures to ensure that funds provided to support overseas real property are properly spent and accounted for and to oversee the use of funds, regardless of the funding source. The fact that the total leasing costs for overseas properties are funded by various means and are comprised of more than the annual rent costs increases the need to account for and oversee funds expended per property.

Although the FAM states that justification and accounting documentation for make-ready expenditures should be maintained in the lease file, OBO did not provide posts with guidelines and procedures to account for and oversee the funds spent on individual properties. As a result, the Department cannot (1) ensure that make-ready costs do not exceed the FAM limitation, (2) verify that funds are used for legitimate make-ready expenditures, and (3) determine the full cost of leasing overseas properties to make fully informed decisions about whether a lease agreement should be renewed or terminated.

**Recommendation 6.** OIG recommends the Bureau of Overseas Buildings Operations establish guidelines and procedures that require posts to track and report on make-ready funds expended for individual properties to help ensure funds are expended for authorized purposes and do not exceed the Department of State limitation.

**OBO Response:** OBO concurred with the recommendation, stating it would expand verbiage to 15 FAM 162.2 to require posts to report make-ready costs directly to the entities providing the funds.

**OIG Reply:** OIG considers the recommendation resolved. The recommendation can be closed when OIG reviews and approves documentation showing that OBO has developed and implemented guidelines and procedures for posts to track and report the use of funds for make-ready costs by individual property.

## List of Recommendations

**Recommendation 1.** OIG recommends that the Bureau of Overseas Buildings Operations revise volumes 15 of the *Foreign Affairs Manual* and *Foreign Affairs Handbook* to designate all noncapital leases as operating leases, regardless of lease duration, in accordance with Statements of Federal Financial Accounting Standards.

**Recommendation 2.** OIG recommends that the Bureau of Overseas Buildings Operations revise volumes 15 of the *Foreign Affairs Manual* and the *Foreign Affairs Handbook* to apply current funding and cost sharing requirements associated with short-term leases to all operating leases.

**Recommendation 3.** OIG recommends that the Bureau of the Comptroller and Global Financial Services, in coordination with the Bureau of Overseas Buildings Operations, revise volumes 4 of the *Foreign Affairs Manual* and the *Foreign Affairs Handbook* to account for the revisions in volume 15 of the *Foreign Affairs Manual* regarding leases.

**Recommendation 4.** OIG recommends that the Bureau of the Comptroller and Global Financial Services, Office of International Cooperative Administrative Support Services, in coordination with the Bureau of Overseas Buildings Operations, revise volume 6 of the *Foreign Affairs Handbook* to account for the revisions in volume 15 of the *Foreign Affairs Manual* regarding leases.

**Recommendation 5.** OIG recommends that the Bureau of Diplomatic Security, in coordination with the Bureau of Overseas Buildings Operations, revise volumes 12 of the *Foreign Affairs Manual* and the *Foreign Affairs Handbook* to account for the revisions in volume 15 of the *Foreign Affairs Manual* regarding leases.

**Recommendation 6.** OIG recommends the Bureau of Overseas Buildings Operations establish guidelines and procedures that require posts to track and report on make-ready funds expended for individual properties to help ensure funds are expended for authorized purposes and do not exceed the Department of State limitation.

**Appendix A**

# Scope and Methodology

The Department of State (Department), Office of Inspector General (OIG), Office of Audits, conducted this performance audit to determine whether the Bureau of Overseas Buildings Operations (OBO) was utilizing short-term leases (STL) for overseas real property operating leases to fulfill the Department's long-term requirements rather than securing leases with longer durations.

OIG conducted fieldwork for this performance audit from February 2012 to August 2012. Domestically, fieldwork was primarily performed at OBO in Washington, DC. OIG also conducted fieldwork overseas at Embassies Rome (Italy), Mexico City (Mexico), and Tel Aviv (Israel), and at Consulate General Jerusalem.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that OIG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objective. OIG believes the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

OIG researched and reviewed Federal laws and regulations to include the United States Code Title 22; the Foreign Assistance Act of 1961, as amended; and Office of Management and Budget guidelines. Additionally, OIG reviewed Department policies and additional guidance related to leasing and lease administration, including the *Foreign Affairs Manual* (FAM), the *Foreign Affairs Handbook* (FAH), and other OBO guidelines.

OIG interviewed officials from OBO, the Bureau of the Comptroller and Global Financial Services, Office of International Cooperative Administrative Support Services, and selected overseas posts to gain an understanding of the leasing process, strategies, guidance on the administration, oversight, and reporting requirements for leasing costs. OIG also consulted Office of Management Budget personnel to obtain information on Federal Government requirements for budgeting and funding of leased properties.

**Prior Reports**

OIG identified four reports issued within the last 5 years that were relevant to the audit objective:

- The U.S. Government Accountability Office report, *Overreliance on Leasing Contributed to High-Risk Designation* (GAO-11-879T, August 4, 2011), states that operating leases, particularly for long-term needs, could be costing the U.S. Government millions of dollars.

- *Management Letter Related to the Audit of the U.S. Department of State FY 2011 Financial Statements* (AUD/FM-12-06, March 2012). During their audit of the Department's consolidated financial statements as of and for the year ended

September 30, 2011, the independent certified public accounting firm tested, among other things, the accuracy and completeness of the Department's lease inventory, which identified several errors. The Real Property Application contained leases with incorrect annual lease payment amounts or lease terms, and several leases were incorrectly designated as capital leases rather than operating leases.

- *Audit of the U.S. Department of State Corrective Action Plan for Real Property* (AUD/FM-10-28, August 2010), found that the Department did not perform a formal root cause analysis to identify the underlying causes of the real property deficiencies identified in the *Independent Auditor's Report on the Department of State 2009 and 2008 Financial Statements* (AUD/FM-10-03, December 2009).

- *Independent Auditor's Report on the U.S. Department of State 2009 and 2008 Financial Statements* (AUD/FM-10-03, December 2009), identified issues related to identification and valuation of assets and liabilities under capital leases and completeness and accuracy of real property. Specifically, the Department had 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.

**Use of Computer-Processed Data**

OIG obtained the universe of short- and long-term overseas real property operating leases as of September 30, 2011, from Kearney & Company, P.C., OIG's Financial Statement contract auditors. OIG requested duplicate data from OBO; however, the data was not provided. To assess the reliability of the lease data, OIG traced information from the Department's 2011 audited financial statements to the Kearney & Company data. In addition, OIG reviewed existing documentation related to the data sources and performed tracing to source documents. More specifically, OIG obtained copies of original property leases and their amendments from the lease files at posts and compared this information to the data provided by Kearney & Company. From these efforts, OIG determined that the data was sufficiently reliable to support the conclusions and recommendations in this report.

**Work Related to Internal Controls**

OIG performed steps to assess the adequacy of internal controls related to managing STLs. OIG's review of internal controls and fraud risks indicated an area of concern. OIG reviewed make-ready costs to determine whether posts properly accounted for these costs and complied with FAM regulations. Specifically, OIG reviewed criteria and interviewed OBO and post officials to gain an understanding of the Department's policies and procedures. OIG also reviewed lease files and financial data. OIG identified an internal control weakness; the results are included in Finding B of this report.

## Detailed Sampling Methodology for Review of Short-Term Leases

OIG's objective was to determine whether OBO was utilizing STLs for overseas real property operating leases to fulfill the Department's long-term requirements rather than securing leases with longer durations.

### Population

OIG obtained a listing of all Department short- and long-term overseas real property operating leases as of September 30, 2011, from Kearney & Company, OIG's financial statement contract auditors. OIG also requested this data from OBO, but the data was not provided.

As of September 30, 2011, the Department had 9,183 overseas real property operating leases, totaling about $482 million in annual rents. Of these leases, 8,933 (approximately 97 percent) were STLs, amounting to about $459 million, and 250 (approximately 3 percent) were long-term leases (LTL), amounting to about $24 million. Of the 8,933 STLs, 1,304 were acquired on or prior to December 31, 2000, and represented approximately $85 million of the approximate $459 million of total STL annual rent. Each of the 1,304 STLs had an original lease term of less than 10 years and had been renewed in increments of less than 10 years. These 1,304 STLs with total annual rents of about $85 million served as the target population (or universe) for this audit.

### Selection of Posts and Review of Short-Term Leases

OIG selected overseas posts at three embassies and a consulate general for site visits and review using a nonstatistical sampling method known as judgment sampling. Because this method uses discretionary criteria to effect sample selection, the audit team was able to use information from its preliminary work to aid in making informed selections. As detailed below in Table 1, OIG reviewed all STLs renewed on or prior to December 31, 2000, and in existence as of September 30, 2011, at each of the four posts visited—a total of 116.

Specifically, the posts selected represent the three bureaus with the largest amount of annual rents as of September 30, 2011, for STLs that had been in existence on or prior to December 31, 2000. Criteria used to select specific posts also included the amount of annual rent, the number of leases per country and per post, and location.

The Bureau of European and Eurasian Affairs had the largest amount of annual rent of all bureaus within our sample population of STLs. Within this bureau, Italy had the largest amount of annual rents as well as the greatest number of STLs. OIG selected Embassy Rome for this audit because this post was responsible for the most STLs within Italy.

The Bureau of Western Hemisphere Affairs had the third largest amount of annual rent of all bureaus within our sample population of STLs. Within this bureau, Mexico had the largest amount of annual rents as well as the greatest number of STLs. OIG selected Embassy Mexico City for this audit because this post was responsible for the most STLs within Mexico.

The Bureau of Near Eastern Affairs had the second largest amount of annual rent of all bureaus. Within this bureau, Israel had the second largest amount of annual rent and the greatest number of STLs. OIG selected Embassy Tel Aviv and Consulate General Jerusalem because of their proximity and number of STLs.

**Table 1. Posts Selected and Number of Short-Term Leases in Existence on or Prior to December 31, 2000, as of September 30, 2011**

| Post | Bureau | Number of Short-Term Leases | Annual Rents |
|---|---|---|---|
| Embassy Rome (Italy) | European and Eurasian Affairs (EUR) | 56 | $3,223,566 |
| Embassy Mexico City (Mexico) | Western Hemisphere Affairs (WHA) | 33 | 1,376,176 |
| Embassy Tel Aviv (Israel) | Near Eastern Affairs (NEA) | 16 | 1,431,466 |
| Consulate General Jerusalem | | 11 | 591,981 |
| | **Totals** | **116** | **$6,623,189** |

Source: The Department's financial statements auditor, Kearney & Company.

While at these posts, OIG, among other tasks, interviewed officials and reviewed files. More specifically, OIG interviewed general services officials and financial management officials and their staff to determine their roles and responsibilities regarding the leasing process. OIG also reviewed files for the 116 properties to determine whether they contained required documentation, such as justifications, waivers, leasing documents, and invoices. In addition, OIG selected a sample of these STL properties with the largest annual operating rents at each post to visit for verification of their existence, condition, and use. Specifically, OIG selected six STL properties in Rome, five properties each in both Tel Aviv and Jerusalem, and 10 properties in Mexico City. If a site was unavailable for a visit, OIG chose the property with the next largest annual rent to visit instead. No anomalies were found for any of the 26 properties at the four locations.

**Detailed Sampling Methodology for Review of Long-Term Leases**

OIG also sampled the Department's LTLs to verify how the leases were funded. As of July 10, 2012, there were 225 LTLs in OBO's Real Property Application. The FAM[1] states:

> Real Property Application (RPA) is the Department of State's standard automated system that supports the management of U.S. Government real property abroad. RPA serves as the primary source of information on all foreign real property holdings managed and maintained by the Department of State as the single real property manager for U.S.

[1] 15 FAM 140, "Post Administrative Software Suite PASS/Real Property Application (RPA) and Work Orders for Windows (WOW) Module."

> Government agencies abroad and owned and long-term leased real property holdings managed by USAID [U.S. Agency for International Development].

OIG judgmentally selected 18 of 225 LTLs for review. Post location and property use were among the factors considered in selecting the LTLs. OIG included all LTLs in Italy, Mexico, and Israel and selected LTLs in other countries to include a variety of leases for land, residences, and offices. OIG reviewed FY 2011 financial documentation for each lease, including transaction amounts and appropriations, to determine the source and type of funding used for each lease. OIG also reviewed lease contract documentation for all 18 LTLs to identify negotiated annual rental payments and the lease terms, which was reconciled to the financial documents.

**Appendix B**

## Selected Leasing Costs and Funding Responsibilities of Agencies Occupying U.S. Government-Held Properties

| ITEM OF COST | PROPERTY | TYPE | OCCUPANTS | FUNDING |
|---|---|---|---|---|
| LEASE COSTS[a] | LTL | O & R | DOS/OA | OBO |
| | STL | O & R | DOS only | OBO |
| | STL | O & R | OA only | OA |
| | STL | O | DOS/OA | ICASS or OBO/OA |
| MAKE READY[b] | STL | R | DOS only | D&CP |
| | STL | R | OA only | OA |
| | STL | R | DOS/OA | ICASS |
| PHYSICAL SECURITY UPGRADES | GO/LTL | O | DOS/OA | OBO or OA |
| | STL | O | DOS only | OBO |
| | STL | O | DOS/OA | DOS/OA |
| | GO/LTL | R | DOS/OA | DS, OBO, or OA |
| | STL (&LQA) | R | DOS/OA | DS |
| MAINTENANCE, REPAIR, AND IMPROVEMENTS | GO | O & R | DOS/OA | OBO |
| | LTL | O & R | DOS/OA | Lessor/OBO |
| | STL | O & R | DOS/OA | Lessor |
| | GO/LTL | R | Marine security guard | OBO |
| | STL | R | Marine security guard | Lessor |

[a] Gross rent including real estate taxes and landlord's operating expenses (i.e., all costs passed on to the tenant).
[b] Per 15 FAM 313.1, make-ready costs are authorized when a lease is initially acquired or reassigned. It does not differentiate between nonresidential and residential STLs.
Source: 15 FAM Exhibit 161, "Matrix of Costs and Funding Sources."

**Legend:**
D&CP: Post-held funds allotted under Diplomatic and Consular Programs appropriated by regional bureaus
DOS: Department of State
DS: Bureau of Diplomatic Security
GO/LTL: U.S. Government (Department of State)-owned/long-term leased
ICASS: International Cooperative Administrative Support Services
LQA: Living quarters allowance
O: Office (nonresidential)
OA: Other agency
OBO: Bureau of Overseas Buildings Operations
R: Residential
STL: Short-term lease

**Appendix C**

# Office of Inspector General Interim Audit Information Memorandum

United States Department of State
and the Broadcasting Board of Governors

*Office of Inspector General*

MAY 25 2012

MEMORANDUM

TO: M – Patrick F. Kennedy

FROM: OIG – Harold W. Geisel HWG

SUBJECT: Interim Information on Audit of U.S Department of State Use of Short-Term Leases Overseas

The Office of Inspector General (OIG) is concluding its audit relating to short-term versus long-term leases overseas, and this memorandum is to provide you information on a key finding contained in the draft report before the report is issued.

OIG determined that a Department of State-imposed regulation prohibiting the sharing of long-term lease costs with other occupying Federal agencies could be inhibiting the Bureau of Overseas Buildings Operations (OBO) from considering and/or entering into long-term leases that may be more cost beneficial. As a result, the Department may be paying more for leases than necessary and may not be acquiring the most preferable property locations or lease terms. Although no Federal laws or Office of Management and Budget (OMB) guidance prohibits the sharing of long-term lease costs, the Department-imposed cost-sharing prohibition is found in the *Foreign Affairs Manual* (15 FAM 162.1). It states that lease costs for long-term leased office, functional, and residential space are to be funded by OBO regardless of the occupying agency except for certain U.S. Agency for International Development properties.

OBO has instructed posts to enter into short-term leases rather than long-term leases and to convert expiring long-term leases into short-term leases without any analysis to determine which would be more cost beneficial to the Department. The major reason given for OBO's short-term lease preference is that lease costs are shared in accordance with 15 FAM 162.2. Specifically, section b, "Nonresidential space–joint occupancy," states, "When short-term leased office or functional space is occupied by several agencies, those agencies are charged for their proportionate share of lease costs and BOE [building operating expenses] through ICASS [International Cooperative Administrative Support Services]." OBO classifies all leases over 10 years to be long-term leases in accordance with 15 FAM 312.7(12). However, neither OMB nor Statements of Federal Financial Accounting Standards (SFFAS) classify leases by specific lengths of time. Instead, they classify leases as either operating leases or capital leases.

Although OBO does not classify every long-term lease as a capital lease, OBO treats all long-term leases as acquisitions for programming, authorization, and funding purposes in accordance with 15 FAM 311.2. Leases must be considered capital leases, according to 4 FAM 033.8-7, if they meet SFFAS requirements. Further, the FAM states that all leases other than those that must be designated as capital leases "shall be classified as operating leases." It is also important to note that OMB does not designate between long-term leases and short-term leases; OMB distinguishes between operating leases and capital leases.

OIG believes that because OBO treats capital leases like acquisitions, this treatment contributes to the difficulty of sharing lease costs among the Department's partner agencies. However, if 15 FAM 311.2 did not stipulate that all long-term leases be treated as acquisitions, OBO would be able to share lease costs with other occupying agencies for non-capital leases, including those leases that were longer than 10 years. OBO could not explain and OIG could not find a basis for why OBO routinely classifies leases longer than 10 years as long-term leases.

In its report, OIG will be recommending that the Department change the FAM to designate leases as either operating leases or capital leases regardless of length of time as appropriate and that funding and cost-sharing requirements now associated with short-term leases apply to all operating leases.

The draft report relating to the audit will be issued shortly. However, if you have any questions in the interim, please contact me. You may also have a member of your staff contact Evelyn R. Klemstine, Assistant Inspector General for Audits, by email at [redacted]@state.gov or at (202) 633-[redacted] or Denise Colchin, Director, Human Capital and Infrastructure Division, by email at [redacted]@state.gov or at (703) 284-[redacted]

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**Appendix D**

# Information Memorandum for Lease Conversion

United States Department of State

*Washington, D.C. 20522-0611*

JUN -2 2010

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**INFORMATION MEMORANDUM FOR ACTING DIRECTOR NAMM**

6/2/10

FROM: OBO/DD – Lydia Muniz LM

SUBJECT: Converting Expiring Long-Term Leases to Short-Term Leases

OBO/PRE/BAS will endeavor, as a matter of practice, to convert expiring Long-Term Leases (LTL) to Short-Term Leases (STL) when office or functional space is occupied by tenant agencies.

Tenant Agencies must pay for their share of occupancy costs if they occupy an office or functional property that has a STL and they do not pay if the lease is a LTL. OBO funds the leasehold costs for all LTL office or functional space regardless of the occupying agency, except for certain USAID properties (15 FAM 160). After conversion to a STL tenant agencies will be charged for their proportionate share of lease costs and building operating expenses through ICASS (15 FAM 162.2 b).

The BAS portfolio manager will do the following:

- Work with OBO/PRE/RPM to confirm the LTL status of an expiring lease and to identify the conversion candidates.
- Obtain Area Management (AM) and OBO/PRE/OSP input and will confirm the tenant agencies' occupancy.
- Evaluate the circumstances of the tenancy and evaluate whether a STL is more suitable than a LTL.
- Coordinate with AM in advising posts of the change to a STL upon lease renewal and in requesting that they inform their local ICASS councils of the lease change.
- Coordinate advising the Washington ICASS counsel of the change to a STL.
- Clear on AM's cable to post that explains the LTL to STL conversion, defines the funding source for the new STL, and advises whether there will be a transition period prior to ICASS funding when OBO will pay the occupancy costs for the tenant agency. The cable will also cite the

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applicable FAM reference and explain the tenant agencies' responsibility for their share of the building operating expenses.

- Obtain L/BA legal guidance so the new lease will include applicable provisions about the landlord's maintenance and repair responsibilities.

**Appendix E**

# Bureau of Overseas Buildings Operations Response

**United States Department of State**

*Washington, D.C. 20520*

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NOV 5 2012

TO: OIG – Evelyn R. Klemstine

FROM: OBO – Jürg Hochuli

SUBJECT: OBO Comments on Draft Report on *Audit of the U.S. Department of State's Use of Short-Term Leases Overseas*

The attached responds to the OIG's request for comments for its audit on the use of short-term leases.

Attachment:

As stated.

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**Audit of the U.S. Department of State's Use of Short-Term Leases Overseas**

**AUD-HCI-XX-XX1**

***OBO Comments***

**Recommendation 1**: OIG recommends that the Bureau of Overseas Buildings Operations revise volumes 15 of the *Foreign Affairs Manual* and *Foreign Affairs Handbook* to designate all noncapital leases as operating leases, regardless of lease duration, in accordance with Statements of Federal Financial Accounting Standards.

**Recommendation 2**: OIG recommends that the Bureau of Overseas Buildings Operations revise volumes 15 of the *Foreign Affairs Manual* and the *Foreign Affairs Handbook* to apply current funding and cost sharing requirements associated with short-term leases to all operating leases.

**OBO Response**: **OBO concurs with these recommendations. There are almost 500 entries referencing long and/or short term leases. We are revising entries as appropriate, and expect to have all revisions completed for OBO senior management review in December 2012, and submitted to A/GIS/DIR by January 2013.**

**We also note that there are USAID sections of the FAM that refer to STL and LTL. Given that we have no authority to direct USAID, we would recommend that the OIG contact its counterparts at USAID in order that their sections can be adjusted accordingly.**

**Recommendation 6**: OIG recommends the Bureau of Overseas Buildings Operations establish guidelines and procedures that require posts to track and report on make-ready funds expended for individual properties to help ensure funds are expended for authorized purposes and do not exceed the Department of State limitation.

**OBO Response**: **15 FAM 162.2 provides guidance directing Posts to maintain justification and accounting documentation for make-ready funds expended for individual properties in the lease files.**

**OBO will expand verbiage in 15 FAM 162.2 to require Posts to report**

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**make-ready costs directly to the entity providing funds (D&CP [Regional Bureaus], ICASS, or other agency) for accounting and verification.**

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**Appendix F**

# Bureau of the Comptroller and Global Financial Services Response

United States Department of State
*Comptroller*
*1969 Dyess Avenue*
*Charleston, SC 29405*

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NOV 1 9 2012

**MEMORANDUM**

TO: OIG – Harold W. Geisel

FROM: CGFS – James L. Millette

SUBJECT: OIG Audit of U.S. Department of State Use of Short-Term Leases Overseas Draft

In response to the OIG Audit of U.S. Department of State Use of Short-Term Leases Overseas Draft, the Bureau of the Comptroller and Global Financial Services (CGFS) has reviewed the subject draft report and offers the following responses.

**Recommendation 3.** OIG recommends that the Bureau of the Comptroller and Global Financial Services, in coordination with the Bureau of Overseas Buildings Operations, "to revise volumes 4 of the Foreign Affairs Manual and the Foreign Affairs Handbook to account for the revisions in volume 15 of the Foreign Affairs Manual regarding leases".

The Office of Inspector General (OIG) indentified, within the draft report, that CGFS currently has policy consistent with the guidance issued by the Federal Accounting Standards Advisory Board (FASAB). At issue is whether OBO, for management reasons, should continue to use the current "long-term" and "short-term" designations for leasing real property. From a financial accounting perspective, CGFS neither agrees nor disagrees with the OIG on this matter-but will address the operational aspects of the matter in CGFS comments to recommendation 4.

CGFS' view is that OBO has management's prerogative to maintain the designations as a means or tool for executing its function within the Department and CGFS/ICASS may find the designations useful for managing real property leases overseas. However, such designations do not affect internal controls or annual financial reporting. Since CGFS and OBO serve different functions within the Department and current CGFS policy in volume 4 of the Foreign Affairs

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Manual (FAM) is correct as noted by the OIG, CGFS sees no need to revise its existing 4 FAM provisions. Should OBO, however, concur with the OIG and determine that changes must be made to volume 15 of the FAM and the Foreign Affairs Handbook (FAR), CGFS will work with OBO to ensure the language in the revised 15 FAM and FAH and subsequently 6 FAM is consistent with the FASAB guidance articulated in 4 FAM.

**Recommendation 4.** OIG recommends that the Bureau of the Comptroller and Global Financial Services, Office of International Cooperative Administrative Support Services, in coordination with the Bureau of Overseas Buildings Operations, "to revise volume 6 of the *Foreign Affairs Handbook* to account for the revisions in volume 15 of the *Foreign Affairs Manual* regarding leases".

As noted in CGFS's response to Recommendation 3, CGFS/ICASS will revise the 6 FAH to account for changes in the 15 FAM regarding leases. CGFS/ICASS can initiate these revisions only after OBO has completed their action under Recommendation 1 and transmitted their changes to the ICASS Service Center.

If you have any questions or need additional information about the response, please contact Tim Macdonald, Managing Director, Office of Financial Policy, Reporting and Analysis (CGFS/DCFO/FPRA) at 202-663-[redacted] (b) (6)

**Appendix G**

# Bureau of Diplomatic Security Response

United States Department of State

*Washington, D.C. 20520*

*www.state.gov*

NOV 6 2012

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**INFORMATION MEMO TO OIG – DEPUTY INSPECTOR GENERAL HAROLD W. GEISEL**

FROM: DS – Eric J. Boswell

SUBJECT: DS Comments – Audit of U.S. Department of State Use of Short-Term Leases Overseas – Report Number AUD-HCI-XX-XX, dated October 2012

Attached is the Bureau of Diplomatic Security's comment on Recommendation 5 of the subject report.

Attachment:
As stated.

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**DS Comments to OIG Draft Report**

## Audit of U.S. Department of State Use of Short-Term Leases Overseas

1. ***Recommendation 5.*** *OIG recommends that the Bureau of Diplomatic Security, in coordination with the Bureau of Overseas Buildings Operations, revise volumes 12 of the Foreign Affairs Manual and the Foreign Affairs Handbook to account for the revisions in volume 15 of the Foreign Affairs Manual regarding leases.* (page 9)

   **DS Comment:** (U) DS concurs with Recommendation 5 as edited below. Until OBO finalizes and publishes the updated 15 FAM, DS cannot finalize and publish updated sections of the 12 FAM to match the updates in the 15 FAM. We recommend the following edits:

   **Recommendation 5.** OIG recommends that the Bureau of Diplomatic Security, in coordination with the Bureau of Overseas Buildings Operations, revise volume 12 of the Foreign Affairs Manual and the Foreign Affairs Handbook, ~~to account for the~~ **as needed, when** revisions in volume 15 of the Foreign Affairs Manual regarding leases **are completed and published**.

Subject: OIG Draft Report on the Audit of U.S. Department of State Use of Short-Term Leases Overseas; DS Response to Recommendation 5

Approved: DS – EBoswell

Drafted by: [redacted] DS/C/PSP, ext. 3-[redacted] 10/11/2012
[redacted], DS/IP/SPC, ext. 5[redacted]
[redacted] DS/MGT/PPD, ext. 5-[redacted]

Cleared: DS/DSS – SBultrowicz (OK)
DS/EX – WTerrini, Acting (OK)
DS/EX/MGT – LWatts (OK)
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**FRAUD, WASTE, ABUSE, OR MISMANAGEMENT OF FEDERAL PROGRAMS HURTS EVERYONE.**

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