Statement of
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House Committee on Oversight and Government Reform
Subcommittee on Government Management, Organization, and Procurement

"Oversight of Federal Financial Management"

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Good afternoon Chairman Watson, Ranking Member Bilbray, and distinguished Members of the Subcommittee.

I am pleased to have this opportunity to testify before the Subcommittee regarding the Department of State's FY 2009 Financial Statement. Our annual audit and 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. We take this responsibility very seriously and take great pride in improvements we have made in the Department's financial platform over the last decade.

The Department's financial activities are complex and set against the backdrop of the global issues and engagements we face as a Nation and institution working to carry out our foreign policy and advance U.S. interests abroad. They reflect 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, often in the most challenging environments. They also reflect our position as a shared financial services provider to more than 40 customer organizations overseas and the inclusion of the International Boundary and Water Commission (IBWC) in our financial system and as part of our financial statements.

We know that strong financial management and internal controls provide the building blocks to support the transparency of operations and accountability to effectively manage limited resources. 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 will continue to do so into the future. At the same time, we want to continue working with OMB and the entire Federal Financial Community on the question of striking the right balance between data-driven and balance-sheet compliance and reasoned and value-added practices linked to meaningful reporting outcomes. The ultimate goal 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.

We are proud that the Department has received a clean audit opinion for 8 of the last 10 years. Last 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 U.S. foreign policy activities 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 an unfunded actuarial liability for defined benefit supplemental pension plans for overseas locally employed staff, and strengthening the coordination of information 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 our 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.

However, the Department's new Independent Auditor issued an unqualified opinion on the Consolidated Statement of Net Cost and qualified opinions on the Consolidated Balance Sheet and Consolidated Statement of Changes in Net Position. The qualified opinions were based on the auditor's inability to satisfy itself that property and equipment was free of material misstatements as of Sept 30, 2009. Additionally, the new auditor was not able to satisfy itself as to whether the FY 2009 Combined Statement of Budget Resources (SBR) was free of material misstatement in time to meet the December 15 extended deadline granted by OMB, which resulted in a disclaimer of an audit opinion (or no opinion) on the SBR. The new auditor identified three material weaknesses and three significant deficiencies, as a result of its FY 2009 audit work. The material weaknesses relate to the need for an environmental liability restatement for the International Boundary and Water Commission's (IBWC), accounting for property and equipment and timely financial reporting. While we are disappointed with these results, we are committed to addressing these issues, implementing corrective action plans, and improving our process for this year.

I have included information on each of the material weaknesses, as part of this statement, for the record. I would like to thank the Subcommittee members for this opportunity to speak before you today and would be pleased to respond to any of your questions.

Environmental Liability Restatement

The FY 2009 independent audit 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 inclusion in the Department's consolidated financial statements. As noted, the Department consolidates financial amounts for the IBWC in our financial statements.

For over a decade, in addition to having its amounts included in our Department-wide financial statements, IBWC has issued separate, audited component financial statements that have received unqualified opinions. 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 included in our financial statements with us first recording the environmental liability in FY 2004. In our Appendix A program[1], we strive to integrate internal control related activities within our control framework and leverage the internal reviews already being performed such as the separately audited and issued IBWC financial statements. Therefore, we saw no reason to question the IBWC amounts

[1] In 2004, Appendix A of OMB Circular No. A-123 was added by OMB 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, which is an addition to and also a component of the overall Federal Managers' Financial Integrity Act assurance statement.

based on the issuance of the unqualified audit opinions on IBWC's financial statements by the OIG and independent auditor.

The Department requested, and the Office of the Inspector General 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 the Department would follow FASAB's guidance. FASAB's determination was that no accounting liability exists or existed. The Department adopted this guidance and recorded the IBWC restatement accordingly, as recommended by our new Independent Auditor, which considered the restatement as an "automatic" material weakness because of the significance of the issue in its judgment. We are unaware of any adverse impact on users of our or the United States Government (USG) financial statements, or on IBWC and Department operations, as a result of the reporting of the environmental liability in our prior financial statements. The restatement had no effect on the Department's or IBWC's reporting of budgetary resources and we consider this material weakness resolved and hope the Independent Auditor reaches the same conclusion for the upcoming FY 2010 audit.

Property and Equipment

Based on the deficiencies our auditor identified in internal controls and the related potential risk of a material misstatement in the financial statements, our auditor assessed the Department's property accounting challenges as a material weakness in FY 2009. Our auditor elected to combine all of its findings related to all types of property and equipment rather than on an individual basis for real versus personal property. Regarding the material weaknesses, while we agree with the issues that were identified, we disagree with the severity of how they were assessed.

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 (FMV) of real property gifts to the Department from other countries. In 1996, the Department first valued these properties, this was the same time we started 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 Consumer Price Index (CPI) inflation indices in 1996 instead of when the gifts were first received. The methodology erred in that it used the FMV as of 1996 instead of as of the date the gift was received. 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 overstated estimated values that we reported. The restatement had no effect on the Department's statement of budgetary resources.

Capital Leases: We agree that we need to expand our processes to analyze property leases, and will work with our auditor 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 a $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 with our auditor, we completed a reconciliation between RPA/BMIS and GFMS-FA for all governmentowned Chancery and Consulate Buildings. These buildings comprise $5.5 billion (86%) of the total overseas buildings' $6.4 billion NBV. 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 of 20 of our international 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 our controls. We established personal property contacts for each of our posts who work directly with the property accountability officer at that particular post to improve the timeliness of recording acquisitions and disposals. The contacts also assist the posts with various issues in recording personal property, such as proper fiscal data. Also, the frequency of the review of the asset detail by the Bureau of Resource Management (RM) was increased from the prior year. We will continue our efforts in FY 2010 to improve our accounting for personal property.

Accounting for Construction-In-Process (CIP): The Independent Auditor selected a statistical sample of current year CIP additions through March 31, 2009 and tested proper capitalization, accuracy of the amounts that were recorded, and the internal controls surrounding the process. The exceptions the auditor identified resulted in a $2.5 million net overstatement of the Department's balance of approximately $1.5 billion reported for property and equipment in interim reports during the year. The Department will work to strengthen our 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.

Timely Financial Reporting

As noted by the Independent Auditor, the Department compiles its financial statements through a multi-step process by using a combination of manual and automated procedures. The existing accounting system does not fully compile the required financial statements for several reasons, including not receiving information to include in the statements from external sources. For example, the Independent Auditor reported that journal vouchers totaling over $80.4 billion (this amount is calculated by adding all amounts together regardless of whether they are positive or negative) were recorded for the Balance Sheet, Statement of Net Costs, and Statement of Changes in Net Position. Of this amount, about $40 billion was to include financial information received in mid-to-late October (i.e., after the financial statement audit reporting year-end) from other agencies that have allocations of the Department's budget authority[2]. There are other similar type of activities areas for large portions of the remaining balances where it is more efficient to record the amounts at the agency-wide financial statement level (e.g., accrual estimates that are made to report accounts payable) than to attempt to

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[2] Allocation transfers are legal delegations by one Federal agency ("parent") of its authority to obligate budget authority and outlay funds to another agency ("child"). 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, and outlays) are reported in the financial statements of the parent agency (in this case the Department of State) under OMB's financial reporting guidance.

record it to the detailed level that our financial system requires. The same is true for our Statement of Budgetary Resources preparation process. Regardless, the Department agrees that these processes can be improved, and will work with Independent Auditor to do so in FY 2010.