Financial Section

Fiscal Year 2004 Performance and Accountability Report

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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 Bulletin 01-09, *Form and Content of Agency Financial Statements*. 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 2003 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. The components of net position are separately displayed in two columns: Cumulative Results of Operations and Unexpended Appropriations to more clearly identify the components of and changes to Net Position. Intra-departmental transactions have been eliminated from the amounts presented.

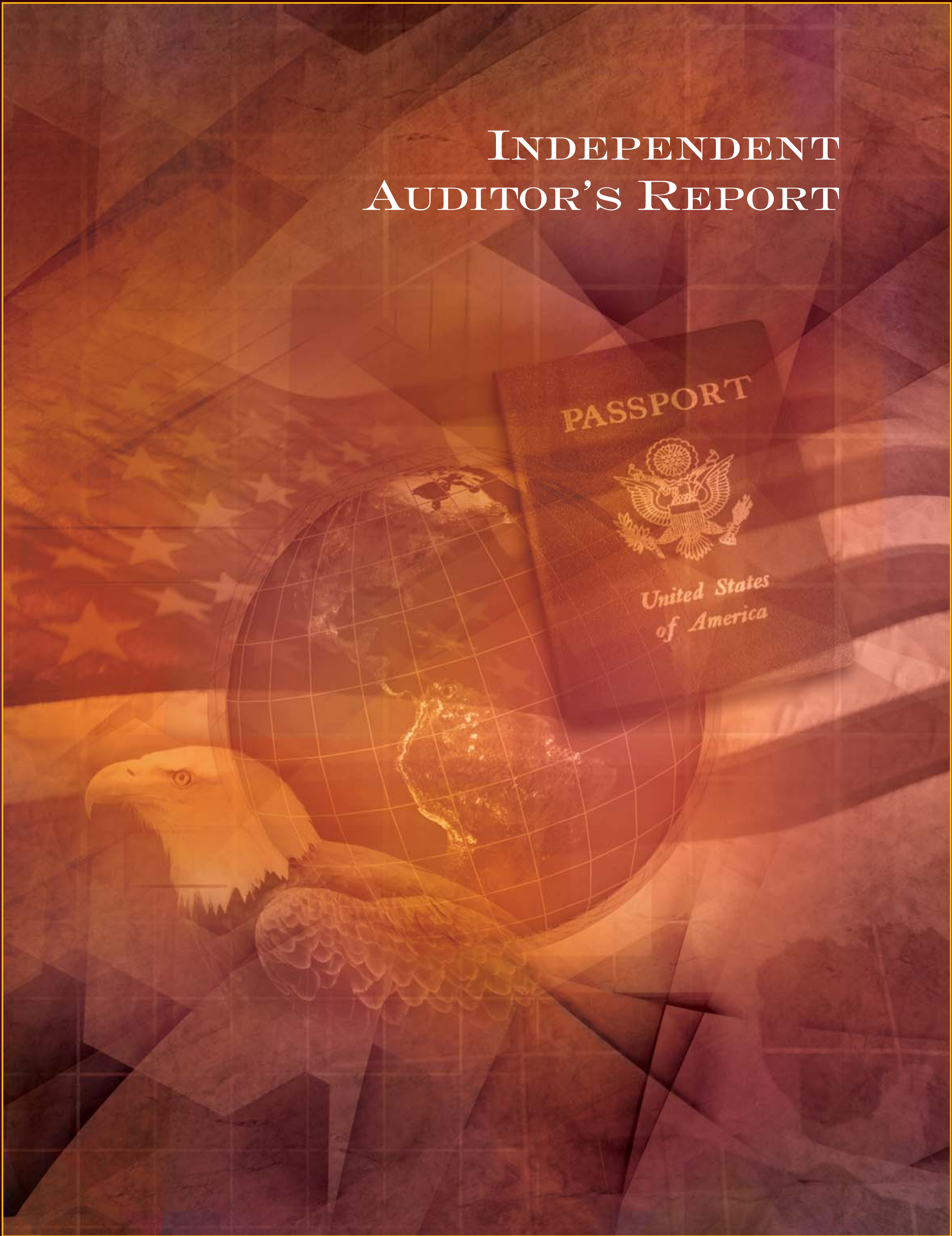
The **Combined Statement of Budgetary Resources** provides information on how budgetary resources were made available and their status at the end of the year. Information in this statement is reported on the budgetary basis of accounting. Intra-departmental transactions have not been eliminated from the amounts presented.

The **Consolidated Statement of Financing** reports the relationship between budgetary transactions and financial transactions.

Required Supplementary Stewardship Information provides information on the Department's Heritage Assets. **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 intragovernmental amounts, deferred maintenance, and the Department's Working Capital Fund.

The Department received an "Unqualified Opinion" on its financial statements for each of the eight years since 1997 from an independent public accounting firm engaged by the Department's Office of Inspector General.

Independent Auditor's Report



United States Department of State
and the Broadcasting Board of Governors

Office of Inspector General

November 15, 2004

INFORMATION MEMORANDUM

UNCLASSIFIED

TO: The Secretary

FROM: OIG – John E. Lange, Acting Deputy Inspector General

SUBJECT: *Audit of the U.S. Department of State 2004 and 2003 Principal Financial Statements* (Report AUD/FM-05-09)

In compliance with the Chief Financial Officers Act, as amended, OIG contracted with Leonard G. Birnbaum and Company, LLP (LGB), an independent certified public accounting firm, to audit the Department's principal financial statements as of September 30, 2004, and for the year then ended.

During its audit, LGB found that:

- the financial statements were fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America;

- there were four reportable conditions related to internal control over information system security, the financial and accounting system, undelivered orders, and the implementation of managerial cost accounting standards;

- the Department's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA); and

- there were instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management systems.

UNCLASSIFIED

Address correspondence to: U.S. Department of State, Office of Inspector General, Washington, D.C. 20520–6817

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LGB's report is attached for your review. LGB is responsible for this report and the opinions and conclusions expressed therein. OIG is responsible for technical and administrative oversight regarding performance under the terms of the contract, including ensuring that the audit was performed in accordance with *Government Auditing Standards* and Office of Management and Budget Bulletin 01-02, Audit Requirements for Federal Financial Statements. OIG made appropriate inquiries of LGB representatives and monitored the audit by:

- evaluating the nature, timing, and extent of the work;
- evaluating the qualifications and independence of the auditors;
- monitoring the progress throughout the audit;
- examining audit work papers and evaluating key judgments;
- reviewing the audit report to ensure compliance with appropriate standards; and
- performing other procedures that were deemed appropriate in the circumstances.

OIG's review, as differentiated from an audit in accordance with *Government Auditing Standards*, was not intended to enable OIG to express, and OIG does not express, an opinion on the Department's financial statements or conclusions about the effectiveness of internal control and compliance with certain laws and regulations. However, OIG's review disclosed no instances where LGB did not comply, in all material respects, with *Government Auditing Standards*.

With the exception of the finding related to FFMIA, the Bureau of Resource Management (RM) agreed with the findings and conclusions in the draft report. In its response, the Department stated that it will make a determination regarding compliance with FFMIA no later than March 2005. RM's comments are included in their entirety as Appendix A to the report.

In addition to this report, OIG will transmit a separate management letter to RM discussing several other matters that were identified during the audit.

OIG appreciates the cooperation extended to it and its contractors by the Department's managers and staff during the audit.

Attachment: As stated.

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INDEPENDENT AUDITOR'S REPORT

To the Secretary, Department of State:

We have audited the Department of State's (Department) Consolidated Balance Sheets, Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, Combined Statements of Budgetary Resources, and Consolidated Statements of Financing as of, and for the years ended, September 30, 2004 and 2003 (collectively the Principal Financial Statements); we have examined internal control over financial reporting in place as of September 30, 2004; and we have examined compliance with applicable laws and regulations.

In our opinion, the Department's 2004 and 2003 Principal Financial Statements are presented fairly in all material respects.

We found:

- reportable conditions on weaknesses in the Department's internal controls,
- instances of noncompliance with selected provisions of applicable laws and regulations involving the Department's financial management system, and
- the Department was not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996.

Each of these conclusions is discussed in more detail below. This report also discusses the scope of our work.

PRINCIPAL FINANCIAL STATEMENTS

In our opinion, the Department's 2004 and 2003 Consolidated Balance Sheets, Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, Combined Statements of Budgetary Resources, and Consolidated Statements of Financing, including the notes thereto, present fairly, in all material respects, the Department's financial position as of September 30, 2004 and 2003, and the net cost of operations, the changes in net position, the use of budgetary resources, and the use of financing, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

INTERNAL CONTROL

We considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Principal Financial Statements. We limited our internal control testing to those controls necessary to achieve the objectives described in the Office of Management and Budget's (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

- The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the following objectives are met:
- transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over assets;
- funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition;
- transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that OMB, Department management, or the Inspector General have identified as being significant for which compliance can be objectively measured and evaluated; and
- data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters of internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts, which would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted four matters, discussed in the following paragraphs, involving internal control that we consider to be reportable conditions.

- We have identified weaknesses related to information system security that we believe could be exploited to have a detrimental effect on the information used to prepare the financial statements. We believe that the information system networks for domestic operations are vulnerable to unauthorized access. Consequently, systems, including the Department's financial management system, which process data using these networks, may also be vulnerable. The Department has initiated a program to assess its information systems security on a comprehensive basis. These weaknesses were cited in our audit of the Department's 1997 Principal Financial Statements and subsequent audits.

- The Department's financial and accounting system, as of September 30, 2004, was inadequate. There is a risk of materially misstating financial information under the current conditions. The principal areas of inadequacy were:

  - Certain elements of the financial statements, including, but not limited to, personal property, capital leases, and certain accounts payable, are developed from sources other than the general ledger. This is due, at least in part, to untimely processing and reporting of transactions by posts and bureaus. The use of sources other than the general ledger to generate elements of the financial statements increases the potential for omission of significant transactions.

  - During 2004, the Department used several systems for the management of grants and other types of financial assistance. These lacked standard data classifications and common processes and were not integrated with the Department's centralized financial management system. Further, the Department could not produce reliable financial information that defined the universe of grants and other federal financial assistance. The Department has undertaken an initiative jointly with the U.S. Agency for International Development to establish a grant management system. Subject to funding approval, implementation of such a system is expected to begin in the FY 2006-2007 time frame.

- The Department's internal control process related to the management of undelivered orders was inadequate. The Department has made significant improvements in this area over the past two years. The Department has actively worked with bureaus to validate undelivered orders and has successfully cleared up a significant number of obligations that were outstanding from past years. However, the Department needs to perform additional work to correct this weakness. Our tests indicated that over $524 million of undelivered orders should have been deobligated as of September 30, 2004. Also, we noted that the Department's undelivered orders balance has grown significantly to $9.2 billion, as of September 30, 2004. The Budget and Accounting Procedures Act of 1950 requires that the Department's accounting system provide effective control over funds. Failure to deobligate funds in a timely manner may result in the loss of availability of those funds.

The above two reportable conditions were cited in our audits of the Department's 1997 Principal Financial Statements and subsequent audits.

- Although the Department complied with certain aspects of Statement of Federal Financial Accounting Standards (SFFAS) No.4, *Managerial Cost Accounting Standards* - for instance, it chose reasonable responsibility segments, recognized the cost of goods and services that it receives from other entities, and used an appropriate allocation methodology - it did not implement an effective process to routinely collect managerial cost accounting information or establish outputs for each responsibility segment. Until this is done, we do not believe the information will be useful as a management decisionmaking tool. This was first reported in our audit of the Department's 2000 Principal Financial Statements.

These deficiencies in internal control may adversely affect any decision by management that is based, in whole or in part, on information that is inaccurate because of them. Unaudited financial information reported by the Department, including budget information, also may contain misstatements resulting from these deficiencies.

In addition, we considered the Department's internal control over Required Supplementary Stewardship Information and Required Supplementary Information by obtaining an understanding of the Department's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of controls as required by OMB Bulletin 01-02, and not to provide assurance on those internal controls. Accordingly, we do not provide an opinion on those controls.

Finally, with respect to internal control related to performance measures reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant controls relating to the existence and completeness assertions and determined whether those controls had been placed in operation as required by OMB Bulletin 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We noted certain other internal control issues that we have reported to the Department's management in a separate letter dated November 14, 2004.

COMPLIANCE WITH LAWS AND REGULATIONS

The Department's management is responsible for complying with laws and regulations applicable to the Department. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin 01-02, including the requirements referred to in FFMIA. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department. The objective of our audit of the Principal Financial Statements, including our tests of compliance with selected provisions of applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions in statutes and regulations, that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements or that sensitivity warrants disclosure thereof.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed the following instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards issued by the Comptroller General of the United States and OMB Bulletin 01-02.

Overall, we found that the Department's financial management system did not comply with a number of laws and regulations, as follows:

- *Budget and Accounting Procedures Act of 1950*. This requires an accounting system to provide full disclosure of the results of financial operations; adequate financial information needed in the management of operations and the formulation and execution of the budget; and effective control over income, expenditures, funds, property, and other assets. However, we found that the Department's financial system did not manage undelivered orders effectively.

- *Federal Managers' Financial Integrity Act of 1982.* This requires the implementation of internal accounting and administrative controls that provide reasonable assurance that: (1) obligations and costs are in compliance with applicable laws; (2) funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to Department operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets. However, as discussed above, we found that the Department's financial system did not manage undelivered orders effectively. Hence, these funds are not adequately protected from waste or loss.

- *Chief Financial Officers Act of 1990*. This 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 did not provide complete information in that certain elements of the financial statements are developed from sources other than the general ledger.

- *OMB Circular A-127*. This 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 undelivered orders. Further, the Department's failure to implement an effective managerial cost accounting system precludes effective control over revenues and expenditures.

The above areas of noncompliance were cited in our audit of the Department's 1997 Principal Financial Statements and subsequent audits.

The results of our tests of compliance with other laws and regulations disclosed no material instances of noncompliance. Compliance with FFMIA is discussed below.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with federal financial management system requirements, applicable accounting standards, and the U.S. Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance, using the implementation guidance for FFMIA issued by OMB on January 4, 2001.

The results of our tests disclosed instances, described below, where the Department's financial management systems did not, in our view, substantially comply with the requirement to follow the federal financial management system requirements. OMB implementation guidance states that, to be in substantial compliance with this requirement, the Department must adhere to all applicable SFFASs, and meet specific requirements of OMB Circular A-127, including the computer security controls required by OMB Circular A-130, *Management of Federal Information Resources*.

- SFFAS No. 4, as noted above, requires implementation of an effective process to routinely collect managerial cost accounting information and establish outputs for each responsibility segment. We found, as discussed above, that the Department had not met this requirement.

- Circular A-127 requires that the Department's systems support management's fiduciary role by providing complete, reliable, consistent, timely, and useful financial management information. Based on the weaknesses related to financial management systems discussed in the report on internal controls and the preceding paragraphs in the report on compliance with laws and regulations, we determined that the Department was not substantially in compliance with this standard.

- Circular A-130, Appendix III, requires that the Department ensure an adequate level of security for all agency automated information systems. Specifically, the Department should ensure that automated information systems operate effectively and have appropriate safeguards to ensure the integrity of those systems. Based on our concerns related to the financial management systems discussed in the report on internal control and the preceding paragraphs in the report on compliance with laws and regulations, we consider the Department to not substantially comply with this standard.

The Department's Bureau of Resource Management (RM) has overall responsibility for the Department's financial management systems. The foregoing noncompliance has its roots in the lack of organization and integration of the Department's financial management systems. In our audits of the Department's Principal Financial Statements since 1997, we observed that the Department's financial management systems were not in compliance with FFMIA and recommended, in connection with our audits of the Department's 1997 and 1998 Principal Financial Statements, that a remediation plan be prepared. RM submitted its plan to remediate noncompliance with FFMIA to OMB on March 16, 2000. Although RM has made significant progress in completing several phases of its plan, the plan has not effectively dealt with the issues related to managerial cost accounting or eliminated the weaknesses in systems security and management of grants and other types of federal assistance.

We noted certain other instances of noncompliance that we reported to the Department's management in a separate letter dated November 14, 2004.

RESPONSIBILITIES AND METHODOLOGY

Department management has the responsibility for:

- preparing the Principal Financial Statements and required supplementary stewardship information, required supplementary information, and other accompanying information in conformity with accounting principles generally accepted in the United States of America;
- establishing and maintaining effective internal control; and
- complying with applicable laws and regulations.

Our responsibility is to express an opinion on the Principal Financial Statements based on our audit. Auditing standards generally accepted in the United States of America require that we plan and perform the audit to obtain reasonable assurance about whether the Principal Financial Statements are free of material misrepresentation and presented fairly in accordance with accounting principles generally accepted in the United States of America. We considered the Department's internal control for the purpose of expressing our opinion on the Principal Financial Statements referred to above and not to provide an opinion on internal control. We are also responsible for testing compliance with selected provisions of applicable laws and regulations that may materially affect the financial statements.

In order to fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the Principal Financial Statements;
- obtained an understanding of the internal controls over financial reporting by obtaining an understanding of the Department's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls;
- obtained an understanding of the internal controls relevant to performance measures included in Management's Discussion and Analysis, including obtaining an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether they had been placed in operations;
- obtained an understanding of the process by which the agency identifies and evaluates weaknesses required to be reported under FMFIA and related agency implementing procedures;
- tested compliance with selected provisions of laws and regulations that may have a direct and material effect on the financial statements;
- obtained written representations from management; and
- performed other procedures as we considered necessary in the circumstances.

Our audits were conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin 01-02. We believe that our audits provide a reasonable basis for our opinion.

The Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information are not a required part of the Principal Financial Statements, but are supplementary information required by OMB Bulletin 01-09, *Form and Content of Agency Financial*

Statements, and the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

This report is intended for the information of the Inspector General of the U.S. Department of State, the Department's management, the Office of Management and Budget, and the Congress. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Comments by the Department's management on this report are presented as Appendix A.

Leonard G. Birnbaum and Company, LLP

Alexandria, Virginia
November 14, 2004

United States Department of State

Assistant Secretary and Chief Financial Officer

Washington, D.C. 20520

November 15, 2004

MEMORANDUM

TO: OIG - Mr. Cameron R. Hume

FROM: RM - Christopher B. Burnham CBB

SUBJECT: Draft Audit Report on the Department of State's 2004 and 2003 Principal Financial Statements

This is in response to your request for comments on the draft report titled "Audit of the U.S. Department of State 2004 and 2003 Principal Financial Statements" (Report).

For the eighth consecutive year, the independent CPA firm selected by the Office of Inspector General (OIG) will issue an unqualified ("clean") opinion on the Department's consolidated financial statements. Achieving an unqualified opinion is an important accomplishment for both of our offices. Also noteworthy is that this year's opinion and issuance of our Performance and Accountability Report met the Office of Management and Budget's accelerated deadline of November 15 - 45 days after the close of the fiscal year. This accomplishment is especially momentous for RM in light of our extensive resource commitment this past year to successfully relocate our Washington, D.C.-based financial operations to our Charleston Center, and to support our mission in Iraq. We would like to extend our appreciation to your staff and to your contractor, Leonard G. Birnbaum and Company, LLP, for the professional and cooperative manner in which they conducted the audit.

In relation to internal control, the Report cites four reportable conditions: (1) information systems security, (2) the management of unliquidated obligations, (3) the inadequacy of the Department's financial management systems, and (4) the implementation of Managerial Cost Accounting Standards. The Department's financial management systems are also reported as noncompliant with laws and regulations, including the Federal Financial Management Improvement Act of 1996 (FFMIA).

The Report cites the Department's security for information systems networks as a reportable condition, an improvement from years prior to FY 2003 that identified this area as a material weakness. While improvement efforts in this area will continue, we are pleased that our progress is recognized in the Report, including our program to assess information systems security on a comprehensive basis. The Department's FISMA Report for FY 2004 highlights our significant accomplishments. These accomplishments include increased risk management by fully authorizing over 90% of major operational systems, enhanced performance measures, effective information security management procedures, improved security awareness, online security training and upgrades in technology deployment, public key infrastructure and biometrics.

Strengthening the management of unliquidated obligations is an important financial management initiative. As mentioned in the Report, the Department has made significant progress in this area. The Unliquidated Obligation System was implemented in FY 2000, and we use this system to facilitate the reconciliation, monitoring, reporting and oversight of unliquidated obligations worldwide. Data in the system is analyzed in various strata and reports to facilitate the review and management of open items. This information, together with new processes implemented in our financial systems, provide for improved management and oversight of unliquidated obligations. We are now faced with the issue of enforcement (versus financial system inadequacies) with offices and posts that fail to take the requisite action(s) to actively review and deobligate these items. In 2004, instructions and reports were issued to offices to review the billions of dollars in unliquidated obligations reported by the Department. In 2005, the Department will continue to develop reports and procedures to improve the management of unliquidated obligations.

Substantial compliance with Federal financial systems requirements is a top priority of the Department, and many improvements have taken place to address the longstanding weaknesses in the Department's financial systems. Based on these improvements, including the implementation of the new Regional Financial Management Systems at all overseas posts, the Department's Management Control Steering Committee voted in 2003 to close the Department's one remaining material non-conformance for Financial and Accounting Systems. In 2004, we continued our efforts to enhance our financial systems.

- Building on our successful RFMS implementation, the two existing overseas accounting databases were merged into one database residing at the Charleston Financial Service Center – all overseas accounting transactions for both the Department and our serviced agencies are now recorded in a single database, and many activities (e.g., software upgrades, annual close outs) are performed only in one place.
- The Department's Central Financial Management System (CFMS) successfully closed the FY 2004 books on October 2, 2004. This is the earliest fiscal year closing ever, and represents a 10-day improvement over the FY 2003 closing. The earlier closing facilitated the accelerated reporting deadline of November 15th for our FY 2004 audited financial statements.
- Our work on the Department's certification and accreditation program resulted in the authorization of all of RM's financial management systems.
- Several new systems interfaces were implemented in 2004 that improved the timeliness of our financial data and were important to meeting the FY 2004 accelerated financial statements submission date of November 15, 2004.

    - The Department uses the Department of Health and Human Services' (HHS) Payment Management System (PMS) to allow grantees to request and receive payments for their grants. The PMS, run by HHS, now has an automated interface with CFMS. The interface automatically records the daily disbursements made by PMS for Department grant obligations. In 2004, over 7,000 transactions for $400 million were processed through this new interface. In addition, a new CFMS interface went into production that provides bureaus the ability to input grant data directly into a CFMS table, that creates the obligation in CFMS and sends the appropriate information to the PMS. Lastly, a new interface was implemented between the Bureau of Education and Cultural Affairs' (the Department's highest-volume grant making organization) Grants Management Information System (GMIS) and CFMS. Grant obligations in GMIS are now automatically interfaced and recorded in CFMS, and PMS payments interfaced into CFMS are now automatically interfaced back to GMIS.

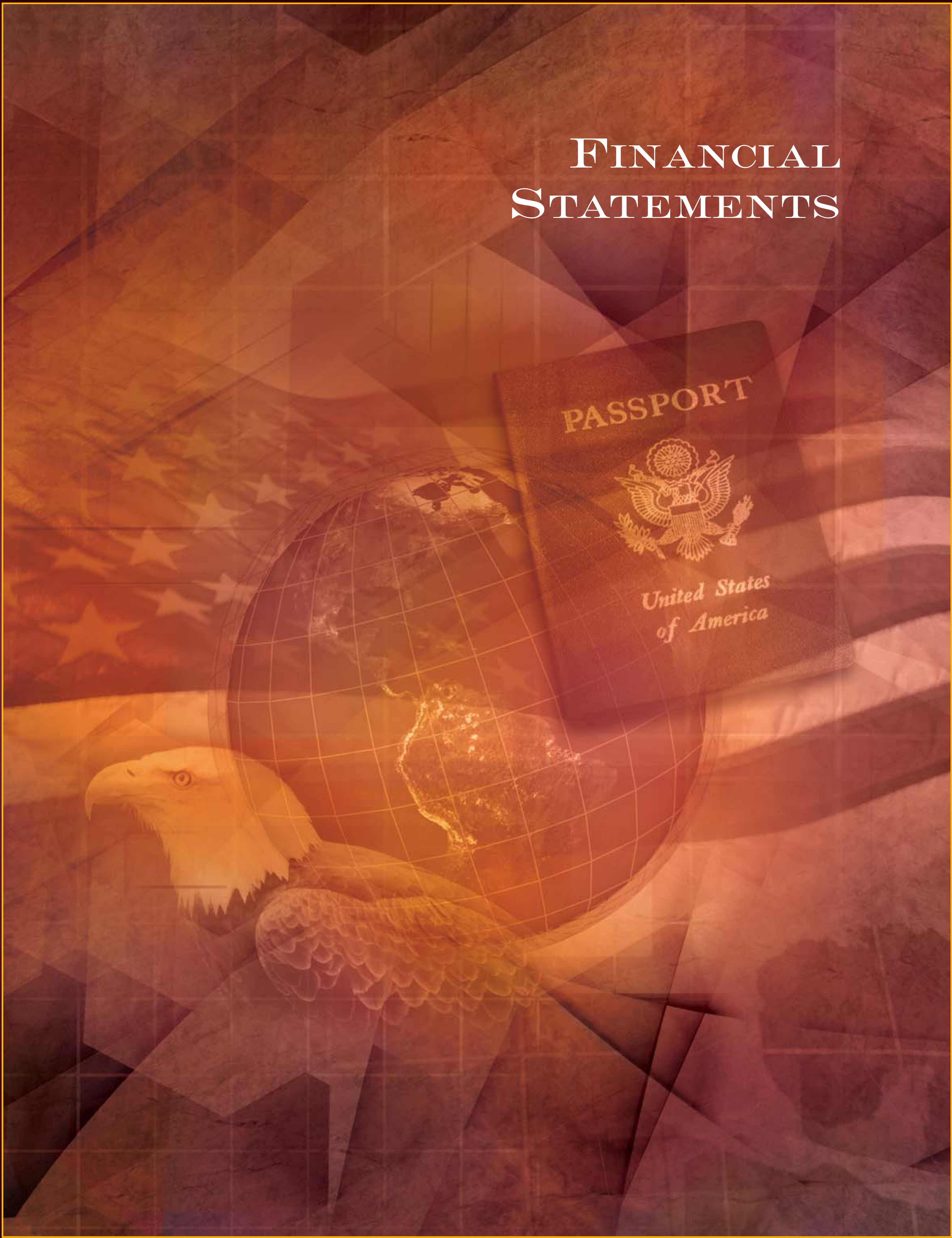
- o In October 2003, a new interface was implemented between the Department's Central Resource Management System (CRMS) and CFMS. This new interface automates the recording in CFMS of the billions of dollars of appropriations, apportionments and allotment transactions initiated in CRMS. In December 2003, the CRMS to CFMS interface was further enhanced to automate the processing of billions of dollars in reimbursable agreements administered by the Department.

The Department is making progress in implementing Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Standards* (MCAS), but acknowledges that additional work is needed to fully comply with these standards. To address MCAS requirements, the Department developed a revised Statement of Net Cost methodology that allows for the reporting of cost information by strategic objectives and goals. This new method was used to produce the FY 2004 and 2003 Statements of Net Cost. In FY 2005, the Department will define significant outputs for each responsibility center, and support the reporting on efficiency measures established for programs in coordination with the Program Assessment Rating Tool (PART) process. We also intend to work with your office in 2005 to understand the specific actions necessary to address your concerns in this area.

The Report cites the Department's financial management systems as noncompliant with laws and regulations, including the Federal Financial Management Improvement Act of 1996 (FFMIA). In December 2003, the Department determined that its financial systems comply substantially with the requirements of the FFMIA. This determination was made after considering (1) the audited financial statement results as of September 30, 2003, whereby the material weakness on Information Systems Security was reduced to a reportable condition, (2) the approval of the Management Control Steering Committee to close the longstanding FMFIA material nonconformance for our financial systems, and (3) systems efforts completed in FY 2003 along with additional improvements to our financial systems in the first quarter of FY 2004. FFMIA compliance neither requires nor results in ideal or state-of-the-art system performance or system efficiency, nor does it require that systems be entirely automated. In the end, management and the auditors need to use judgment in assessing whether known deficiencies prevent the agency from meeting the revised implementation guidance established by OMB in its January 4, 2001 memorandum entitled *Revised Implementation Guidance for the Federal Financial Management Improvement Act*. The Guidance recognizes that not every requirement or compliance indicator may be applicable to every agency, and that a determination of "substantial compliance" may be made without satisfying every indicator. The Department will make its FY 2004 FFMIA determination no later than March 2005 after considering the FY 2004 Report and the results of our OMB Circular A-127 compliance review completed in November 2004.

We thank you for the opportunity to comment on the draft report and for working with us in a collaborative manner on the FY 2004 financial statements. We believe that our offices have made considerable progress over the past several years. The Department is committed to continuing its efforts to improve management of its programs and the quality of its financial reporting.

Financial Statements



PRINCIPAL FINANCIAL STATEMENTS

DEPARTMENT OF STATE
CONSOLIDATED BALANCE SHEET

(Dollars in Thousands)

As of September 30,	Notes	2004	2003
ASSETS	3		
Intragovernmental Assets:			
Fund Balances With Treasury	4	$ 11,926,434	$ 9,953,197
Investments, Net	5	12,846,060	12,301,173
Accounts Receivable, Net	6	464,300	372,303
Interest Receivable		190,263	189,366
Total Intragovernmental Assets		25,427,057	22,816,039
Accounts and Loans Receivable, Net	6	56,851	22,561
Cash and Other Monetary Assets	7	31,603	16,086
Inventory	8	5,821	5,259
Property and Equipment, Net	9	6,323,916	5,996,493
Other Assets	10	84,627	38,208
Total Assets		$ 31,929,875	$ 28,894,646

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

DEPARTMENT OF STATE
CONSOLIDATED BALANCE SHEET

(Dollars in Thousands)

As of September 30,	Notes	2004	2003
LIABILITIES	11		
Intragovernmental Liabilities:			
Accounts Payable		$ 37,046	$ 39,889
Other Liabilities		43,640	36,800
Total Intragovernmental Liabilities		80,686	76,689
Accounts Payable		1,238,961	1,018,625
Foreign Service Retirement Actuarial Liability	12	13,317,900	13,093,800
Liability to International Organizations	13	897,381	919,428
Capital Lease Liability	14	45,627	85,985
Funds Held in Trust	7	13,208	13,322
Federal Employees' Compensation Act Benefits		59,984	61,628
Accrued Annual Leave	11	211,860	198,864
Other Liabilities	11	492,453	312,795
Total Liabilities		16,358,060	15,781,136
Commitments and Contingencies	15		
NET POSITION	22		
Unexpended Appropriations	16	9,279,214	7,608,996
Cumulative Results of Operations		6,292,601	5,504,514
Total Net Position		15,571,815	13,113,510
Total Liabilities and Net Position		$ 31,929,875	$ 28,894,646

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

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF NET COST (NOTE 17)

(Dollars in Thousands)

For the year ended September 30,	2004	2003
Achieve Peace and Security		
Regional Stability		
Total Cost	$ 1,067,396	$ 982,449
Earned Revenue	(54,171)	(46,567)
Net Program Costs	1,013,225	935,882
Counterterrorism		
Total Cost	848,785	461,209
Earned Revenue	(43,076)	(21,861)
Net Program Costs	805,709	439,348
Homeland Security		
Total Cost	519,197	450,960
Earned Revenue	(26,349)	(21,375)
Net Program Costs	492,848	429,585
Weapons of Mass Destruction		
Total Cost	485,179	366,038
Earned Revenue	(24,622)	(17,350)
Net Program Costs	460,557	348,688
International Crime and Drugs		
Total Cost	1,651,238	1,005,795
Earned Revenue	(32,198)	(32,127)
Net Program Costs	1,619,040	973,668
American Citizens		
Total Cost	2,020,883	1,492,507
Earned Revenue	(1,466,246)	(1,442,760)
Net Program Costs	554,637	49,747
Advance Sustainable Development and Global Interests		
Democracy and Human Rights		
Total Cost	524,775	492,444
Earned Revenue	(26,633)	(23,341)
Net Program Costs	498,142	469,103
Economic Prosperity and Security		
Total Cost	857,708	1,040,527
Earned Revenue	(43,530)	(49,319)
Net Program Costs	814,178	991,208
Social and Environment Issues		
Total Cost	236,455	255,740
Earned Revenue	(12,000)	(12,121)
Net Program Costs	224,455	243,619
Humanitarian Response		
Total Cost	973,797	775,718
Earned Revenue	(143)	(392)
Net Program Costs	973,654	775,326
Promote International Understanding		
Public Diplomacy and Public Affairs		
Total Cost	1,515,852	1,482,740
Earned Revenue	(94,789)	(129,811)
Net Program Costs	1,421,063	1,352,929
Executive Direction and Other Costs Not Assigned		
Total Cost	3,060,380	3,416,513
Earned Revenue	(1,297,321)	(1,365,999)
Net Program Costs	1,763,059	2,050,514
Total Cost	**13,761,645**	**12,222,640**
Total Revenue	**(3,121,078)**	**(3,163,023)**
Total Net Cost	**$ 10,640,567**	**$ 9,059,617**

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

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

(Dollars in Thousands)

For the Year Ended	September 30, 2004		September 30, 2003	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balances	$ 5,504,514	$ 7,608,996	$ 4,861,731	$ 7,154,023
Budgetary Financing Sources:				
Appropriations Received	—	11,784,671	—	10,320,841
Appropriations Transfered In	—	1,966,746	—	558,225
Rescissions and Other Adjustments	—	(190,442)	—	(150,850)
Appropriations Used (Note 22)	11,890,757	(11,890,757)	10,273,243	(10,273,243)
Nonexchange Revenue	16,648	—	862	—
Donations	4,304	—	3,927	—
Other Financing Sources:				
Transfers In/Out Without Reimbursements (+/-)	(574,372)	—	(663,172)	—
Imputed Financing From Costs Absorbed by Others	91,317	—	87,540	—
Total Financing Sources	11,428,654	1,670,218	9,702,400	454,973
Net Cost of Operations (+/-)	(10,640,567)	—	(9,059,617)	—
Ending Balances (Note 22)	**$ 6,292,601**	**$ 9,279,214**	**$ 5,504,514**	**$ 7,608,996**

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

DEPARTMENT OF STATE
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 18)

(Dollars in Thousands)

For the Year Ended September 30,	2004	2003
Budgetary Resources:		
Budget Authority:		
Appropriations received	$ 12,971,455	$ 11,952,495
Net transfers	1,785,231	110,219
Other	244,000	—
Unobligated balances:		
Beginning of period	2,625,376	2,579,307
Net transfers	181,735	(17,645)
Spending authority from offsetting collections:		
Earned		
Collected	3,137,184	3,360,669
Receivable from Federal sources	325,810	(266,146)
Change in unfilled customer orders		
Advances Received	—	—
Without advance from Federal sources	(91)	1,619
Recoveries of Prior Year Obligations		
Actual	802,055	529,542
Anticipated for rest of year	—	—
Temporarily not available pursuant to Public Law	(539,288)	(555,093)
Permanently not available	(201,246)	(144,406)
Total Budgetary Resources	**$ 21,332,221**	**$ 17,550,561**

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

DEPARTMENT OF STATE
COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 18)

(Dollars in Thousands)

For the Year Ended September 30,	2004	2003
Status of Budgetary Resources:		
Obligations incurred:		
Direct	$ 15,147,816	$ 15,170,135
Reimbursable	2,711,072	(244,950)
Unobligated balances available:		
Apportioned	3,256,138	2,356,174
Exempt from apportionment	28,273	7,489
Unobligated balances not available	$ 188,922	$ 261,713
Total Status of Budgetary Resources	**$ 21,332,221**	**$ 17,550,561**
Relationship of Obligations to Outlays:		
Obligated balance, net, beginning of period	$ 7,280,369	$ 5,990,322
Obligated balance transferred, net	—	—
Obligated balance, net, end of period:		
Accounts receivable	(683,935)	(370,797)
Unfilled customer orders from Federal sources	(2,795)	(2,886)
Undelivered orders	7,591,305	6,679,670
Accounts payable	1,673,952	974,382
Outlays:		
Disbursements	15,446,728	13,614,334
Collections	(3,150,954)	(3,360,669)
Less: offsetting receipts	(242,547)	(896,582)
Net Outlays	**$ 12,053,227**	**$ 9,357,083**

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

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF FINANCING (NOTE 19)

(Dollars in Thousands)

For the Year Ended September 30,	2004	2003
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 17,858,888	$ 14,925,185
Less: Spending Authority from offsetting collections and recoveries	(4,264,958)	(3,625,684)
Obligations net of offsetting collections and recoveries	13,593,930	11,299,501
Less: Offsetting receipts	(242,547)	(896,582)
Net obligations	13,351,383	10,402,919
Other Resources		
Donations	$ —	$ 3,927
Transfers in/out without reimbursement	(574,372)	(663,171)
Imputed financing from costs absorbed by others	91,317	87,540
Net other resources used to finance activities	(483,055)	(571,704)
Total Resources used to Finance Activities	**$ 12,868,328**	**$ 9,831,215**
Resources Used to Finance Items not Part of Net Cost of Operations:		
Change in budgetary resources obligated for goods, services, and benefits ordered but not yet received	1,335,212	349,811
Resources that fund expenses recognized in prior periods	23,071	156,320
Budgetary offsetting collections and receipts that do not affect net cost of operations	(7,973)	976,287
Resources that finance the acquisition of assets	698,014	494,118
Other resources or adjustments to net obligated resources that do not affect net cost of operations	(274)	—
Total Resources used to Finance Items not Part of the Net Cost of Operations	2,048,050	1,976,536
Total Resources Used to Finance the Net Cost of Operations	$ 10,820,278	$ 7,854,679

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

DEPARTMENT OF STATE
CONSOLIDATED STATEMENT OF FINANCING (NOTE 19)

(Dollars in Thousands)

For the Year Ended September 30,	2004	2003
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components requiring or generating resources in future periods		
Increase in annual leave liability	$ 12,996	$ 17,945
Increase in actuarial liability	224,100	887,369
Increase in contingent liabilities	205,450	—
Other, net	37,302	68
Total components of Net Cost of Operations that will require or generate resources in future periods	479,848	905,382
Components not Requiring or Generating Resources:		
Depreciation and Amortization	$ 306,982	$ 275,281
Trust Fund Interest and Benefit Revenue	(967,525)	—
Other	984	24,275
Total components of Net Cost of Operations that will not require or generate resources	(659,559)	299,556
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	(179,711)	1,204,938
Net Cost of Operations	$ 10,640,567	$ 9,059,617

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 Department's primary objective is to promote the security and well-being of the United States.

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity and Basis of Consolidation

The accompanying principal financial statements (statements) present the financial activity for the Department of State. The statements include the accounts of all funds under Department control that have been established and maintained to account for the resources entrusted to Department management, or for which the Department acts as a fiscal agent or custodian. The Department maintains General Funds, Special Funds, Revolving Funds, Trust Funds, and Deposit Funds.

- General and Special Funds are used to record financial transactions under Congressional appropriations or other authorization for spending general revenues.
- Revolving Funds are established by law to finance a continuing cycle of operations. Receipts derived from such operations are usually available in their entirety for the Funds to use without further action by Congress.
- Trust Funds are credited with receipts that are generated by the terms of a trust agreement or statute. At the point of collection, these receipts are either available immediately or unavailable depending upon statutory requirements. The largest trust fund is the Foreign Service Retirement and Disability Fund (FSRDF).
- Deposit Funds are established for: (1) amounts received for which the Department is acting as a fiscal agent or custodian; (2) unidentified remittances; (3) monies withheld from payments for goods and services received; and (4) monies held awaiting distribution on the basis of a legal determination.

Basis of Presentation

The accompanying statements have been prepared to report the financial position and results of operations for the Department of State. These statements are prepared as required by the Government Management and Reform Act (GMRA) of 1994 and presented in accordance with form and content requirements contained in Office of Management and Budget (OMB) Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. OMB Bulletin No. 01-09 defines the form and content for annual financial statements that are required to be submitted to the Director of OMB. The statements presented herein are in addition to the 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.

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.

Basis of Accounting

Transactions are recorded on both an accrual and budgetary basis. Under the accrual basis, exchange revenues are recognized when earned, and expenses are recognized when a liability is incurred. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds.

Budgets and Budgetary Accounting

Congress annually enacts one-year appropriations that provide the Department with the authority to obligate funds within the respective fiscal year for necessary expenses to carry out mandated program activities. In addition, Congress enacts multi-year appropriations and appropriations that are available until expended. All appropriations are subject to OMB apportionment as well as Congressional restrictions. The Department also implements internal restrictions to ensure efficient and proper use of all appropriations. One-year and multi-year appropriations are canceled and cannot be used for disbursements if five years have passed since the appropriation was last available for obligation.

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.

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. The applicable depreciation expense for real and personal property is recorded over the asset's useful life as described below in Property and Equipment.

Work performed for other Federal agencies under reimbursable agreements is initially financed through the account providing the service and is subsequently reimbursed. Reimbursements are recognized as revenue when earned, i.e., goods have been delivered or services rendered, and the associated costs have been incurred.

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 all 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 specific user fees for machine-readable visas, expedited passport processing, and fingerprint checks on immigrant visa applicants. The Department is also authorized to credit the respective appropriations with (1) fees for the use of Blair House; (2) lease payments and transfers from the International Center Chancery Fees held in Trust to the International Center Project; (3) registration fees for the Office of Defense Trade Controls; (4) reimbursement for international litigation expenses; and (5) reimbursement for training foreign government officials at the Foreign Service Institute.

Generally, donations received in the form of cash or financial instruments are recognized as revenue at their fair value in the period received. Contributions of services are recognized if the services received (a) create or enhance non-financial assets, or (b) require specialized skills that are provided by individuals possessing those skills, which would typically need to be purchased if not donated. Works of art, historical treasures, and similar assets that are added to collections are not recognized at the time of donation. If subsequently sold, proceeds from the sale of these items are recognized in the year of sale.

The Department receives most of the funding it needs to support the Repatriation Loan Program through an annual appropriation and permanent, indefinite borrowing authority. The appropriation has two components: (1) a subsidy portion for the present value of long-term cash flow, and (2) estimated expenses to administer the program. Appropriations are recognized as used at the time the loans are obligated and administrative expenses are incurred.

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 Balance Sheet, except for the Emergencies in the Diplomatic and Consular Services, Office of Foreign Missions, Foreign Service National Defined Contributions Retirement Fund, and the International Center, which maintains a commercial account for lease fees held in trust — see Note 7, "Cash and Other Monetary Assets." Treasury processes domestic receipts and disbursements. During 2004 and 2003, the Department operated three Financial Service Centers, which are located in Paris, Bangkok, and Charleston, South Carolina, and provide financial support for the Department and other Federal agencies' operations overseas. The Paris operations were relocated to Charleston and Bangkok during 2003. The U.S. Disbursing Officer at each Center has the delegated authority to disburse funds on behalf of the Treasury.

Accounts Receivable

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

Accounts Receivable from non-Federal entities are subject to the full debt collection cycle and mechanisms, e.g., salary offset, referral to collection agents, and Treasury offset. In addition, Accounts Receivable from non-Federal entities are assessed interest, penalties and administrative fees if they become delinquent. Interest and penalties are assessed at the Current Value of Funds Rate established by Treasury. Except for amounts assessed on FSRDF accounts and repatriation loans, any interest, penalties or fees collected are not retained but are treated as miscellaneous receipts and are deposited directly to a Treasury account. Amounts assessed on FSRDF accounts are credited to the FSRDF. Amounts assessed on repatriation loans disbursed after 1991 are retained and credited to the loan program's financing fund.

Allowances for uncollectible Accounts Receivable are based on criteria established for each type of receivable. Due to the relatively small number and dollar amount of non-Federal receivables, accounts are independently assessed to determine whether they are collectible and need an offsetting allowance. All Intragovernmental Accounts Receivable are considered collectible. However, an allowance may be established to recognize billing disputes. Similar to non-Federal receivables, Intragovernmental receivables are independently assessed to determine collectibility and the need for an offsetting allowance.

Interest Receivable

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

Loans Receivable

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.

Advances and Prepayments

Payments made in advance of the receipt of goods and services are recorded as advances or prepayments, and recognized as expenses when the related goods and services are received. Advances are made principally to Department employees for official travel, miscellaneous prepayments and advances to other entities for future services, and salary advances to Department employees transferring to overseas assignments. Advances and prepayments are reported as Other Assets on the Balance Sheet.

Valuation of Investments

The FSRDF investments consist solely of special issues of U.S. Government securities, which are redeemable on demand at par. For financial statement purposes, the investments are therefore valued at par. Interest on investments is paid semi-annually on June 30 and December 31.

The investments of the Gift Funds consist of U.S. guaranteed securities. These investments are reported at the acquisition cost, which equals the face value plus or minus the unamortized premium or discount. Premiums and discounts are amortized over the life of the Treasury bill using the straight-line method.

The Department administers the Israeli-Arab Scholarship and Eisenhower Exchange Fellowship Programs. The Israeli-Arab Scholarship Program provides grants and scholarships to Israeli-Arab students for degree programs at universities and colleges in the United States. The Eisenhower Exchange Fellowship Program honors the late president and increases educational opportunities for young leaders in preparation for and enhancement of their professional careers and advancement of peace through international understanding. The Israeli-Arab Scholarship Fund and Eisenhower Exchange Fellowship Program Trust Fund investments consist of market-based U.S. Treasury Securities. Interest on investments is paid semiannually at various rates. Investments are valued at their par value, net of unamortized premiums and discounts. Premiums and discounts are amortized over the life of the security on an effective interest basis. See Note 5, "Investments."

Judith Miller
Water Lillies/Greenbrook Sanctuary #1

Works of Art and High Value Furnishings

The Department has collections of art and furnishings that are held for public exhibition, education, and official entertainment for visiting Chiefs of State, Heads of Government, Foreign Ministers, and other distinguished foreign and American guests. The Department has six separate collections: 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 consist of items that were donated, purchased using donated or appropriated funds, or are on loan from individuals, organizations, or museums. The Department provides protection and preservation services for these collections.

The items that the Department owns are considered heritage assets (see " Required Supplementary Stewardship Information — Heritage Assets"). In accordance with SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* no value is assigned to these assets in the Consolidated Balance Sheet. Purchases of items for collections are recorded as an expense in the year of purchase. Proceeds from disposals are recognized as revenue in the year of sale and are designated for future collection acquisitions.

Inventories

The Department's Consolidated Balance Sheet reflects inventories held by WCF's Publishing Services, and the Supply Services Center and Stock Account. The WCF inventory consists primarily of paper and ink used for printing and reproduction services (Publishing Services), furniture held for sale to bureaus in the Department (Supply Services Center and Stock Account), and publications held for sale.

The WCF's Publishing Services inventory is valued at the latest acquisition cost. The Supply Services Center and Stock Account inventory is valued monthly using a weighted moving average. The inventory value of the publications held for sale is based on the cost of production. Recorded values are adjusted for the results of periodic physical inventories.

Property and Equipment—Real Property

Real property assets primarily consist of facilities used for U.S. diplomatic missions abroad and capital improvements to these facilities, including unimproved land; residential and functional-use buildings such as embassy/consulate office buildings; office annexes and support facilities; and construction-in-progress. Title to these properties is held under various conditions including fee simple, restricted use, crown lease, and deed of use agreement. Some of these properties are considered historical treasures and are considered multi-use heritage assets. These items are reported on the Balance Sheet and included on the Required Supplementary Stewardship Information—Heritage Assets.

Since 1997, additions to the real property asset accounts have been based on historical costs. Construction-in-Progress represents the costs incurred for new facilities, major rehabilitations, or other improvements in the design or construction stage. After these projects are completed, costs are transferred to Buildings and Structures or Leasehold Improvements as appropriate. The Department capitalizes construction of new buildings and all building acquisitions regardless of cost. The Department also capitalizes improvements greater than $250,000.

Prior to 1997, historical cost information for most of the Department's overseas properties was either unavailable or incomplete. The Department therefore estimated the value of overseas real property assets as of September 30, 1996.

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.). These properties have been recorded at either actual or estimated historical cost.

The International Boundary and Water Commission (IBWC) has buildings and structures related to its boundary preservation, flood control, and sanitation programs. IBWC's buildings and structures are capitalized at cost.

Depreciation of buildings and other structures is computed on a straight-line basis, and depreciated principally over a 30-year period.

The Tangier Old Legation, the first property that the United States Government acquired for a diplomatic mission, was presented as a gift to the American people by Sultan Moulay Suliman in 1821.

Property and Equipment—Personal Property

In general, personal property and equipment with an acquisition cost of $25,000 or more, and a useful life of two or more years is capitalized at cost. However, there are exceptions to this capitalization policy. All vehicles are capitalized, and ADP software costing over $500,000 with a useful life of two or more years is capitalized.

Depreciation of property and equipment is calculated on a straight-line basis over the asset's estimated life with salvage values generally ranging from 5 to 10%. Depreciation begins when the item is put into service. Vehicles are depreciated over periods ranging from 3 to 6 years. Other personal property and equipment is depreciated over periods generally ranging from 5 to 8 years. Telecommunication equipment is depreciated over 20 years. ADP software is generally amortized over the lesser of its estimated useful life or seven years.

Capital Leases

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

Grants

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

Accounts Payable and Other Liabilities

Accounts payable and other liabilities represent the amounts accrued for employees' salaries; employee and annuitant benefits; contracts for goods and services received but unpaid at the end of the fiscal year; unreimbursed grant expenditures; and unearned revenue from the sale of real property. The Department changed its method for estimating the value of domestic accounts payable beginning in FY 2003. In addition to payables recorded through the Department's normal business activities, domestic accounts payable also includes an estimate of unbilled payables existing at year end for which payment will be made in the subsequent period based on an average of actual disbursements over a five-year period. Before this change, the accrual for unbilled domestic accounts payable was based on actual post-year end disbursements.

Annual, Sick and Other Leave

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. At the end of each fiscal 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 10.70%. 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 $90.5 million and $84.5 million in 2004 and 2003, respectively, for unfunded pension and post-retirement benefits. The additional costs are not actually owed or paid to OPM, and thus are not reported on the Balance Sheet as a liability, but instead are reported as an imputed financing source from costs absorbed from others on the Statement of Changes in Net Position.

Future Workers' Compensation Benefits

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to cover Federal employees injured on the job or who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to job-related injury or occupational disease. The U.S. Department of Labor (DOL) administers the FECA program. DOL initially pays valid claims and bills the employing Federal agency. DOL calculates the actuarial liability for future workers' compensation benefits and reports to each agency its share of the liability.

The present value of the liability for 2004 and 2003 was computed using discount rates of 4.9% for year one and 5.2% for all years thereafter. In 2004 and 2003, the Department's liability changed by ($1.6) million and $5.4 million, respectively. The total actuarial liability for which the Department is responsible totaled $60.0 million as of September 30, 2004 and $61.6 million as of September 30, 2003.

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

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.

Under existing law, an actuary from the Treasury determines the Pension Actuarial Liability. This year, in order to meet its statutory requirement, Treasury contracted with independent actuaries to prepare the valuation. The Pension Actuarial Liability is calculated by applying actuarial assumptions to adjust the projected plan benefits to reflect the discounted time value of money and the probability of payment (by means of decrements such as death, disability, withdrawal or retirement) between the valuation date and the expected date of payment.

The economic assumptions used for valuing the Plan were revised last year so that they would be the same as the economic assumptions adopted during FY 2003 by the Civil Service Board of Actuaries for valuing CSRS and FERS. The prior assumption of 3.75% for annual increase in inflation and 6.75% for the interest assumption were both decreased by 0.50%. The annual salary increase assumption of 4.25% was decreased by 0.25 to 4.00%.

The Plan uses the aggregate entry age normal actuarial cost method, whereby the present value of projected benefits for each employee is allocated on a level basis (such as a constant percentage of salary) over the employee's service between entry age and assumed exit age. The portion of the present value allocated to each year is referred to as the normal cost.

The calculation of normal cost considers both economic and demographic assumptions. Based on the new economic assumptions, the plan actuary revised the normal cost percentages. The table below presents the normal costs for FY 2004 and FY 2003.

	FY 2004	FY 2003
Normal Cost:		
FSRDS	28.59%	32.52%
FSPS	21.57%	23.23%

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.

Net Position

The Department's net position contains the following components:

1. **Unexpended Appropriations** — the sum of undelivered orders and unobligated balances. Undelivered orders represent the amount of obligations incurred for goods or services ordered, but not yet received. An unobligated balance is the amount available after deducting cumulative obligations from total budgetary resources. As obligations for goods or services are incurred, the available balance is reduced.

2. **Cumulative Results of Operations** — include (1) the accumulated difference between revenues and financing sources less expenses since inception; (2) the Department's investment in capitalized assets financed by appropriation; (3) donations; and (4) unfunded liabilities, whose liquidation may require future Congressional appropriations or other budgetary resources.

Foreign Currency

Accounting records for the Department are maintained in U.S. dollars, while a significant amount of the Department's overseas expenditures are in foreign currencies. For accounting purposes, overseas obligations and disbursements are recorded in U.S. dollars based on the rate of exchange as of the date of the transaction. Foreign currency payments are made by the U.S. Disbursing Officers located at the Department's Financial Service Centers.

2 REPORTING IMPROVEMENTS

The Department implements financial statement reporting requirements and new Statement of Federal Financial Accounting Standards (SFFAS) when they become effective. No new SFFASs were implemented during FY 2004 and FY 2003.

On September 25, 2001, OMB issued Bulletin 01-09 (Bulletin), *Form and Content of Agency Financial Statements.* This Bulletin provides guidance for preparing agency financial statements and supersedes OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. It contains significant changes. The requirements contained in the Bulletin are phased in beginning with FY 2001, are effective in their entirety for the preparation of financial statements for fiscal years beginning after September 30, 2001 (i.e., FY 2002 and beyond), and significantly affect how the Department reports on its programs.

The major changes required by the Bulletin are as follows.

- **Integrated Reporting.** Combined performance and accountability reports that present both performance and financial reports are required for FY 2002 and beyond.

- **Accelerated Reporting.** For FY 2003 and FY 2002, performance and accountability reports are due to OMB and the Congress by February 1. For FY 2004 and beyond, OMB accelerated the due date for submitting performance and accountability reports to November 15—that is, 45 days after the end of the fiscal year.

- **Budget Integration.** The Statement of Budgetary Resources is revised to improve the linkage between this statement and the Budget of the United States Government.

- **Financial Statement Formats.** Significant changes in labeling and formatting of line items on the Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing are effective to facilitate an understanding of the flow of information between statements. Labeling and formatting of line items on the Balance Sheet are streamlined to improve usefulness to readers of the financial statements.

- **Comparative Reporting.** The preparation of comparative financial statements is required for FYs 2003 and beyond. FY 2003 is the first year for which comparative Statements of Changes in Net Position, Budgetary Resources, and Financing (and related footnotes) are presented. Also, information presented in the Financial Highlights Section of the Management Discussion and Analysis, Required Supplementary Stewardship Information and Required Supplementary Information are presented on a comparative basis when the information is meaningful to the user of the financial report.

- **Interim Financial Reporting.** Beginning in FY 2003, unaudited financial statements are required to be prepared and submitted to OMB on a quarterly basis (i.e., December 31, March 31, and June 30) no later than 45 days after the end of the reporting period. Beginning with the second quarter of FY 2004, the due date for quarterly statements accelerates to no later than 21 days after the end of each quarter. Since inception, the Department has met the interim financial reporting requirement on a timely basis.

The Statement of Net Cost for FY 2004 and 2003 reflects the changes made in FY 2003 to present net cost by strategic goals which is consistent with OMB Bulletin 01-09, and explained more fully in Note 17 to the financial statements.

3 ASSETS

The Department's assets are classified as entity assets and non-entity assets. Entity assets are those assets that the Department has authority to use for its operations. Non-entity assets are those held by the Department but are not available for use in its operations. The vast majority of the Department's assets are entity assets. The non-entity assets consist primarily of lease fees collected by the Department for the International Chancery Center. Total non-entity assets at September 30, 2004 and 2003 were $13.2 million and $11.1 million, respectively. These items are included in amounts reported as Cash and Other Monetary Assets (See Note 7, " Cash and Other Monetary Assets " for further information).

4 FUND BALANCES WITH TREASURY

Fund Balances with Treasury at September 30, 2004 and 2003, are summarized below (Dollars in Thousands).

Fund Balances	2004	2003
Appropriated Funds	$ 11,560,386	$ 9,515,532
Revolving Funds	130,704	220,499
Trust Funds	109,064	110,990
Special Funds	11,726	11,849
Deposit & Receipt Accounts	114,554	94,327
Total	$ 11,926,434	$ 9,953,197

Status of Fund Balance	2004	2003
Unobligated Balances		
Available	$ 3,284,411	$ 2,363,663
Unavailable	188,922	261,713
Obligated Balances not yet Disbursed	$ 8,338,547	7,233,494
Total Unobligated and Obligated	$11,811,880	$ 9,858,870
Deposit & Receipt Accounts	114,554	94,327
Total	$11,926,434	$ 9,953,197

5 INVESTMENTS

The Department has activities that have the authority to invest excess cash resources. A description of those activities, the investments made and a listing of the outstanding investments follow. Although funds in the Chancery Development Trust Account and the Bosnia Federation Defense Fund are invested, because they are considered non-entity assets the investments for these funds are not shown in this section, but are described in Note 7, " Cash and Other Monetary Assets."

Foreign Service Retirement and Disability Fund (FSRDF)

Treasury initially invests FSRDF receipts in special, non-marketable U.S. Government securities. These special-issue Certificates of Indebtedness mature on the following June 30. On June 30, the Treasury rolls over the Certificates of Indebtedness into special, non-marketable bonds, with maturities spread over 15 years and a yield equaling the average of all marketable Treasury securities. All securities are purchased and redeemed at par, regardless of market conditions. Interest is paid semi-annually on December 31 and June 30. Maturity dates on these securities range from FY 2005 through 2017, and interest rates range from 3.50% to 8.75%.

Israeli-Arab Scholarship and Eisenhower Exchange Fellowship Program Trust Funds

The Israeli-Arab Scholarship and Eisenhower Exchange Fellowship Program Trust Funds are invested in market-based securities, issued at either a premium or a discount, and are redeemable for par at maturity. The discounts and premiums on these investments are amortized over the life of the security using the effective interest method. Maturity dates on these securities range from FY 2005 to 2013; interest rates range from 3.25% to 7.875%.

Summary of Investments

Investments at September 30, 2004 and 2003, are summarized below (Dollars in Thousands). All investments are classified as Intragovernmental Securities.

At September 30, 2004:	Par	Amortization Method	Unamortized (Discount)	Investments (Net)	Market Value
Non-Marketable, Par Value:					
FSRDF Certificates of Indebtedness	$ 3,812,351	N/A	$ —	$ 3,812,351	$ 3,812,351
FSRDF Special Bonds	9,015,277	N/A	—	9,015,277	9,015,277
Subtotal	$ 12,827,628		$ —	$ 12,827,628	$ 12,827,628
Non-Marketable, Market Based:					
Israeli-Arab Scholarship, Notes	4,277	Interest	42	4,319	4,409
Eisenhower Exchange Fellowship, Notes	7,534	Interest	(51)	7,483	9,112
Middle Eastern–Western Dialogue, Note	5,771	Interest	859	6,630	6,624
Subtotal	$ 17,582		$ 850	$ 18,432	$ 20,145
Total Investments	$ 12,845,210		$ 850	$ 12,846,060	$ 12,847,773

At September 30, 2003:	Par	Amortization Method	Unamortized (Discount)	Investments (Net)	Market Value
Non-Marketable, Par Value:					
FSRDF Certificates of Indebtedness	$ 2,576,177	N/A	$ —	$ 2,576,177	$ 2,576,177
FSRDF Special Bonds	9,713,125	N/A	—	9,713,125	9,713,125
Subtotal	$ 12,289,302		$ —	$ 12,289,302	$ 12,289,302
Non-Marketable, Market Based:					
Israeli-Arab Scholarship, Notes	4,277	Interest	111	4,388	4,689
Eisenhower Exchange Fellowship, Notes	7,534	Interest	(51)	7,483	8,172
Subtotal	$ 11,811		$ 60	$ 11,871	$ 12,861
Total Investments	$ 12,301,113		$ 60	$ 12,301,173	$ 12,302,163

6 ACCOUNTS AND LOANS RECEIVABLE, NET

The Department's Accounts Receivable and Loans Receivable at September 30, 2004 and 2003, are summarized here (Dollars in Thousands). All are entity receivables.

	2004			2003		
	Entity Receivables	Allowance for Uncollectible Receivables or Subsidy Allowance	Net Receivables	Entity Receivables	Allowance for Uncollectible Receivables or Subsidy Allowance	Net Receivables
Intragovernmental Accounts Receivable	$ 486,815	$ (22,515)	$ 464,300	$ 372,348	$ (45)	$ 372,303
Non-Federal Accounts and Loans Receivable	61,589	(4,738)	56,851	30,656	(8,095)	22,561
Total Receivables	$ 548,404	$ (27,253)	$ 521,151	$ 403,004	$ (8,140)	$ 394,864

Included in Non-Federal Accounts and Loans Receivable above, net of allowance for uncollectible loans or subsidy allowance, are approximately $827 thousand and $1.191 million, in 2004 and 2003, respectively, of Repatriation Loans made under a program administered by the Department that enables destitute American citizens overseas to return to the United States. Repatriation direct 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 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, we borrow from Treasury the difference between the face value of loans disbursed and their calculated subsidy costs. Additionally, we budget and receive funding for administrative costs separately.

7 CASH AND OTHER MONETARY ASSETS

The Cash and Other Monetary Assets at September 30, 2004 and 2003, are summarized below (Dollars in Thousands). There are no restrictions on entity cash. Non-Entity cash is restricted as discussed below.

	2004			2003		
	Entity Assets	Non-Entity Assets	Total	Entity Assets	Non-Entity Assets	Total
Bosnia Federation Defense Fund	$ —	$ —	$ —	$ —	$ 39	$ 39
Chancery Development						
Trust Account:						
Cash	—	—	—	—	2	2
Treasury Bills, at par	—	13,278	13,278	—	11,169	11,169
Unamortized Discount	—	(70)	(70)	—	(88)	(88)
Cash-Imprest and Other Funds	18,395	—	18,395	4,964	—	4,964
Total	$ 18,395	$ 13,208	$ 31,603	$ 4,964	$ 11,122	$ 16,086

Lease fees collected from foreign governments by the Department for the International Chancery Center are deposited into an escrow account called the Chancery Development Trust Account. The funds are unavailable to the Department at time of deposit, and do not constitute expendable resources until funds are necessary for additional work on the Center project. The Chancery Development Trust account invests in six-month marketable Treasury bills issued at discount and redeemable for par at maturity. A corresponding liability for these amounts is reflected as Funds Held in Trust.

8 INVENTORY

Inventory held at September 30, 2004 and 2003, is summarized below (Dollars in Thousands).

	2004	2003
Inventory Held for Current Sale:		
Publishing Services – Raw Materials	$ 2,096	$ 1,214
Publishing Services – Publications for Sale	2,206	2,215
Inventory for Resale	1,519	1,830
Total	$ 5,821	$ 5,259

The inventories of Raw Materials are valued using the latest acquisition cost. Publications for Sale are valued at cost of production. Inventories for resale are valued at cost for items held in the European Logistics Support Office's Expedited Logistics Program, and the weighted moving average method is used for items in the Material Management Branch.

9 PROPERTY AND EQUIPMENT, NET

Property and equipment balances at September 30, 2004 and 2003, are shown in the following table (Dollars in Thousands):

	2004			2003		
Major Classes	**Cost**	**Accumulated Depreciation**	**Net Value**	**Cost**	**Accumulated Depreciation**	**Net Value**
Real Property:						
Overseas —						
Land and Land Improvements	$ 1,955,595	$ (224)	$ 1,955,371	$ 1,938,191	$ (159)	$ 1,938,032
Buildings and Structures	3,889,344	(2,503,792)	1,385,552	3,827,738	(2,362,612)	1,465,126
Construction-in-Progress	1,792,133	—	1,792,133	1,383,703	—	1,383,703
Assets Under Capital Lease	62,074	(28,332)	33,742	117,542	(46,985)	70,557
Leasehold Improvements	61,372	(22,996)	38,376	58,467	(18,645)	39,822
Domestic —						
Structures, Facilities and Leaseholds	564,809	(203,793)	361,016	564,467	(190,222)	374,245
Construction-in-Progress	37,703	—	37,703	20,370	—	20,370
Land and Land Improvements	80,681	(4,461)	76,220	80,654	(4,148)	76,506
Subtotal — Real Property	$ 8,443,711	$ (2,763,598)	$ 5,680,113	$ 7,991,132	$ (2,622,771)	$ 5,368,361
Personal Property:						
Vehicles	$ 255,911	$ (155,015)	$ 100,896	$ 185,468	$ (123,718)	$ 61,750
Communication Equipment	53,137	(16,432)	36,705	50,382	(13,575)	36,807
ADP Equipment	23,022	(19,379)	3,643	23,615	(18,532)	5,083
Reproduction Equipment	13,262	(10,987)	2,275	13,204	(10,255)	2,949
Security	85,104	(41,331)	43,773	79,218	(32,484)	46,734
Software	114,299	(43,719)	70,580	108,794	(27,210)	81,584
Software-in-Development	108,928	—	108,928	67,732	—	67,732
Other Equipment	388,483	(111,480)	277,003	376,961	(51,468)	325,493
Subtotal — Personal Property	$ 1,042,146	$ (398,343)	$ 643,803	$ 905,374	$ (277,242)	$ 628,132
Total	$ 9,485,857	$ (3,161,941)	$ 6,323,916	$ 8,896,506	$ (2,900,013)	$ 5,996,493

10 OTHER ASSETS

The Department's other assets at September 30, 2004 and 2003, are summarized below (Dollars in Thousands).

	2004	2003
Salary Advances to Employees	$ 8,321	$ 6,944
Travel Advances to Employees	62,311	12,627
Other Advances	13,995	18,637
Total Other Assets	$ 84,627	$ 38,208

11 LIABILITIES

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 major liabilities in this category include assessments from international organizations, unfunded actuarial liability for FSRDF, future workers' compensation benefits, capital leases, and accrued annual leave. Liabilities not covered by budgetary resources at September 30, 2004 and 2003, are summarized below (Dollars in Thousands).

	2004	2003
Intragovernmental Liabilities –		
Accounts Payable	$ —	$ —
Other Liabilities	18,565	17,961
Total Intragovernmental Liabilities	$ 18,565	$ 17,961
Foreign Service Retirement Actuarial Liability	345,831	653,804
Liability to International Organizations	897,381	919,428
Capital Lease Liability	45,627	85,985
Funds Held in Trust	13,208	13,322
Federal Employees' Compensation Act Benefits	59,984	61,628
Accrued Annual Leave	211,860	198,864
Other Liabilities	206,000	5,228
Total Liabilities not Covered by Budgetary Resources	$ 1,798,456	$ 1,956,220
Total Liabilities Covered by Bugetary Resources	$14,559,604	$13,824,916
Total Liabilities	$16,358,060	$15,781,136

Other Liabilities on the Balance Sheet at September 30, 2004 and 2003 were $492.4 million and $312.8 million, respectively, and consist primarily of accrued employee benefits and an environmental liability. The environmental liability for approximately $206 million is for upgrades, constructions, and projected operation and maintenance costs of wastewater treatment plants owned and operated by IBWC.

12 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 provides benefits from three sources: a basic benefit (annuity) from FSPS, Social Security, and the Thrift Savings Plan.

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, 2004 and 2003 (Dollars in Millions).

For the Year Ended September 30,	**2004**	**2003**
Pension Actuarial Liability, Beginning of Year	$ 13,093.8	$ 12,211.8
Add Pension Expense:		
Normal Cost	220.7	227.0
Interest on Pension Liability	804.8	810.9
Prior Service Costs	—	—
Actuarial Losses/(Gains)	(147.9)	468.2
Total Pension Expense	877.6	1,506.1
Less Payments to Beneficiaries (annuities and refunds)	(653.5)	(624.1)
Pension Actuarial Liability, End of Year	13,317.9	13,093.8
Less: Net Assets Available for Benefits	(12,972.1)	(12,440.0)
Actuarial Unfunded Pension Liability for Projected Plan Benefits	$ 345.8	$ 653.8
Actuarial Assumptions:		
Rate of Return on Investments	6.25%	6.25%
Rate of Inflation	3.25%	3.25%
Salary Increase	4.00%	4.00%

Net Assets Available for Benefits at September 30, 2004 and 2003, consist of the following (Dollars in Thousands):

	2004	**2003**
Fund Balances with Treasury	$ 2	$ 43
Receivables	198,512	202,949
Investments in USG Securities	12,827,628	12,289,302
Total Assets	13,026,142	12,492,294
Less: FSRDF Liabilities	(54,074)	(52,298)
Net Assets Available for Benefits	$ 12,972,068	$ 12,439,996

13 LIABILITY TO INTERNATIONAL ORGANIZATIONS

The Department reports an unfunded liability for the accumulated arrears assessed by the United Nations (UN), its affiliated agencies, and other international organizations in the amount of $60.0 million and $50.1 million for 2004 and 2003, respectively, for regular budget assessments and international peacekeeping. These financial commitments mature into obligations (as that term is used in domestic law) only when funds are authorized and appropriated by Congress. As of September 30, 2004, a total of $926 million had been appropriated by Congress for payment of the U.S. arrearage. These amounts, however, were made available subject to certifications by the Secretary of State that certain legislative requirements were met. A payment of $100 million was made in FY 2000; a payment of $475 million and a credit of $107 million were made in FY 2002; and payments totaling $242 million were made in FY 2003.

The financial statements also report an unfunded liability of $837.4 and $869.2 million at September 30, 2004 and 2003, respectively, for the current year 2004 and 2003 unfunded or restricted annual assessments from the United Nations, its affiliated agencies and several other international organizations, as well as for peacekeeping. It has been the Department's policy to pay annual assessments for the UN and certain international organizations out of the following fiscal year's appropriation, usually in the last quarter of the calendar year (i.e., the 2004 calendar year assessment is paid from the Department's 2005 appropriation). The Liability to International Organizations at September 30, 2004 and 2003, is summarized below (Dollars in Thousands).

	2004	2003
Accumulated Arrears	$ 60,029	$ 50,191
Unfunded Annual Assessments	837,352	869,237
Liability to International Organizations	$ 897,381	$ 919,428

14 LEASES

The Department is committed to over 8,000 leases, which cover office and functional properties, and residential units at diplomatic missions overseas. The majority of these leases are short-term operating leases. In most cases, management expects that the leases will be renewed or replaced by other leases. Personnel from other 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 approximately $44.0 million 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.

Following is a summary of Net Assets Under Capital Leases and future minimum lease payments as of September 30 (Dollars in Thousands).

	2004	2003
Net Assets Under Capital Leases:		
Land and Buildings	$ 62,074	$ 117,542
Accumulated Depreciation	(28,332)	(46,985)
Net Assets under Capital Leases	$ 33,742	$ 70,557

Future Minimum Lease Payments:

	2004		2003	
	Fiscal Year	Lease Payments	Fiscal Year	Lease Payments
	2005	$ 3,271	2004	$ 6,982
	2006	2,923	2005	6,982
	2007	2,977	2006	6,344
	2008	3,026	2007	6,344
	2009	3,406	2008	6,314
	2010 and thereafter	123,945	2009 and thereafter	491,594
Total Minimum Lease Payments		$ 139,548		$ 524,560
Less: Amount Representing Interest		(93,921)		(438,575)
Obligations under Capital Leases		$ 45,627		$ 85,985

During FY 2004, the Department performed a periodic review of its lease portfolio to ensure consistency with GAAP for federal entities. As a result of this process, certain leases were determined to be operating leases. This resulted in a decrease in *Net Assets under Capital Leases* and *Obligations under Capital Leases* of $34 million and $39 million, respectively, as of September 30, 2004, which did not materially affect the Department's principal financial statements.

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, 2004 for each of the next 5 years and in aggregate are as follows (Dollars in Thousands).

Year Ended September 30	Operating Lease Amounts
2005	$ 344,477
2006	237,891
2007	150,658
2008	97,363
2009	63,217
2010 and thereafter	115,352
Total Minimum Future Lease Payments	$1,008,958

15 COMMITMENTS AND CONTINGENCIES

Commitments

In addition to the future lease commitments discussed in Note 15, "Leases," the Department is committed under obligations for goods and services which have been ordered but not yet received (undelivered orders — see Note 17, "Unexpended Appropriations" and Note 19, "Statement of Budgetary Resources") at fiscal yearend.

Contingencies

Rewards for Justice Program. The Department operates rewards programs for information critical to combating international terrorism, narcotics trafficking, and war crimes. The Terrorism Information Rewards Program offers rewards up to $5 million (or higher, if personally authorized by the Secretary under certain conditions) for information leading to: the arrest or conviction in any country of persons committing (or conspiring or attempting to commit, or aiding or abetting the commission of) acts of international terrorism against United States persons or property; the prevention, frustration or favorable resolution of such acts; or the identification or location of key leaders of a terrorist organization. The Narcotics Information Rewards Program offers rewards up to $5 million for information leading to: the arrest or conviction in any country of persons committing (or conspiring or attempting to commit, or aiding and abetting the commission of) major foreign violations of U.S. narcotics laws or the killing or kidnapping of U.S. narcotics law enforcement officers or their family members; or the prevention, frustration or favorable resolution of such criminal acts. The War Crimes Information Rewards Program currently offers rewards up to $5 million for information leading to the arrest, transfer, or conviction of persons indicted by the International Criminal Tribunal for the Former Yugoslavia or the International Criminal Tribunal for Rwanda for serious violations of international humanitarian law, or their arrest or conviction in any country for such violations. Authority exists to create a similar war crimes program for information related to indictees of the Special Court of Sierra Leone.

The Department is a party in various administrative proceedings, legal actions, environmental suits, and claims brought by and against it. Some of the actions are not related directly to Department programs but the Department is involved because of its status as the U.S. Government's foreign policy agency. In the opinion of management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or results of operations of the Department.

Claims Filed in Response to Embassy Bombings: Nearly 4,000 Kenyan nationals filed administrative tort claims against the Department alleging that Department negligence was responsible for the damages they suffered when terrorists bombed the American Embassy in Nairobi, Kenya on August 7, 1998. These claims are for sums ranging from $150 to $10,000,000 and total approximately $1.5 billion. Two lawsuits, in the amounts of $1 billion and $500 million, arising from these tort claims were dismissed this year by the Federal District Court in Washington, D.C. Both of the cases have been appealed to the D.C. Circuit Court of Appeals. After that court affirmed the District Court's dismissal of the $1 billion action in July 2003, the plaintiffs in the other, almost identical, suit abandoned their appeal. The plaintiffs in the first case have petitioned the Supreme Court for certiorari, which was denied. In addition, the families of eleven of the twelve Americans killed in the bombing also filed administrative tort claims with the Department alleging that Department negligence led to the death of their family members in Nairobi. These claims, including those by the estates of the deceased, are for a total of $117 million. The Department is vigorously defending against all of the tort claims and lawsuits. Any settlements or judgments in excess of $2,500 would be funded and paid from the Judgment Fund maintained by the Treasury.

North American Free Trade Agreement (NAFTA) Arbitrations: NAFTA allows Canadian and Mexican investors to bring arbitration proceedings against the United States for breaches of certain NAFTA provisions. These cases raise allegations of expropriation as well as other claims of treatment inconsistent with international law or specific treaty commitments that provide investment protections. The United States has successfully defended itself against two claims submitted to arbitration under Chapter 11 of the NAFTA. The United States is currently defending itself against eight claims submitted to arbitration and nine claims not yet submitted under Chapter 11 of NAFTA. These claims total approximately $3.4 billion. The United States has also received notice of another claim not submitted in the amount of either $5.8 billion or $13.6 billion, depending on how one interprets the notice. The U.S. Government intends to vigorously contest these claims. In no case is the Department a named respondent in these arbitrations. The Department's involvement is due to its unique experience with international arbitration, particularly with respect to these types of claims. Any adverse award in any of these cases would be paid out of the Judgment Fund.

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 2004 and 2003 had a material effect on the financial position or results of operations of the Department.

16 UNEXPENDED APPROPRIATIONS

Unexpended Appropriations include the amount of unobligated appropriations and undelivered orders outstanding for Congressional appropriations provided to the Department. As these accounts incur obligations, the available balance of the appropriation is reduced.

Unobligated balances are the amount of appropriations or other authority that remains after deducting cumulative obligations. The unobligated balance is classified as unavailable for all expired accounts and for amounts appropriated subject to certain conditions. Undelivered orders represent the amount of obligations incurred for goods or services ordered but not yet received. Unexpended Appropriations at September 30, 2004 and 2003, are summarized below (Dollars in Thousands). See Note 22 "Prior Period Adjustment" for a discription of the prior period adjustment presented below.

	2004	2003		
		As Previously Reported	Prior Period Adjustment	Restated
Unexpended Appropriations:				
(1) Unobligated				
(a) Available	$ 2,075,879	$ 1,880,494	$ (927,311)	$ 953,183
(b) Unavailable	188,922	261,713	—	261,713
(2) Undelivered Orders	7,014,413	6,394,100	—	6,394,100
Total	$ 9,279,214	$ 8,536,307	$ (927,311)	$ 7,608,996

17 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). For 2000 and beyond, a new responsibility segment has been added for the Under Secretary for Public Diplomacy and Public Affairs as a result of the merger of the former USIA. Information on the Bureaus (or equivalent) that report to each Under Secretary can be found on the Organization Chart for the Department provided in the MD&A Section of this report.

The presentation of program results by strategic objectives and strategic goals is based on the Department's current Strategic Plan established pursuant to the Government Performance and Results Act of 1993.

As outlined in the Strategic Plan, the United States conducts relations with foreign governments and others to pursue U.S. national interests, and create a more secure, democratic and prosperous world for the benefit of the American people and the international community. These strategic objectives and strategic goals are:

STRATEGIC OBJECTIVE	STRATEGIC GOAL	GOAL DESCRIPTION
Achieve Peace and Security	**Regional Stability**	Avert and resolve local and regional conflicts to preserve peace and minimize harm to the national interests of the United States.
	Counterterrorism	Prevent attacks against the United States, our allies, and our friends, and strengthen alliances and international arrangements to defeat global terrorism.
	Homeland Security	Protect the homeland by enhancing the security of our borders and infrastructure.
	Weapons of Mass Destruction	Reduce the threat of weapons of mass destruction to the United States, our allies, and our friends.
	International Crime and Drugs	Minimize the impact of international crime and illegal drugs on the United States and its citizens.
	American Citizens	Assist American citizens to travel, conduct business, and live abroad securely.
Advance Sustainable Development and Global Interests	**Democracy and Human Rights**	Advance the growth of democracy and good governance, including civil society, the rule of law, respect for human rights, and religious freedom.
	Economic Prosperity and Security	Strengthen world economic growth, development, and stability, while expanding opportunities for U.S. businesses and ensuring economic security for the nation.
	Social and Environmental Issues	Improve health, education, environment, and other conditions for the global population.
	Humanitarian Response	Minimize the human costs of displacement, conflicts, and natural disasters.
Promote International Understanding	**Public Diplomacy and Public Affairs**	Increase understanding for American values, policies, and initiatives to create a receptive international environment.
Strengthen Diplomatic and Program Capabilities	**Management and Organizational Excellence**	Ensure a high quality workforce supported by modern and secure infrastructure and operational capabilities.

The Management and Organizational Excellence strategic goal relates to the Department's responsibilities for managing infrastructure, information, and human resources. The ability of the Department to advance national and foreign policy interests depends on the quality of these items — the two largest and most visible of which are Diplomatic Security and Overseas Buildings Operations.

DEPARTMENT OF STATE
CONSOLIDATING SCHEDULE OF NET COST

For the year ended September 30, 2004

(Dollars in Thousands)

	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**
Regional Stability								
Total Cost	$ 118,338	$ 11,546	$ 19,768	$ 958,577	$ —	$ 2	$ (40,835)	$ 1,067,396
Earned Revenue	(13,798)	(1,099)	(2,014)	(77,959)	—	(136)	40,835	(54,171)
Net Program Costs	104,540	10,447	17,754	880,618	—	(134)	—	1,013,225
Counterterrorism								
Total Cost	94,102	9,181	15,719	762,254	—	1	(32,472)	848,785
Earned Revenue	(10,972)	(874)	(1,601)	(61,993)	—	(108)	32,472	(43,076)
Net Program Costs	83,130	8,307	14,118	700,261	—	(107)	—	805,709
Homeland Security								
Total Cost	57,561	5,616	9,615	466,267	—	1	(19,863)	519,197
Earned Revenue	(6,712)	(534)	(979)	(37,921)	—	(66)	19,863	(26,349)
Net Program Costs	50,849	5,082	8,636	428,346	—	(65)	—	492,848
Weapons of Mass Destruction								
Total Cost	53,790	5,248	8,985	435,717	—	1	(18,562)	485,179
Earned Revenue	(6,272)	(499)	(915)	(35,436)	—	(62)	18,562	(24,622)
Net Program Costs	47,518	4,749	8,070	400,281	—	(61)	—	460,557
International Crime and Drugs								
Total Cost	—	—	1,602,192	49,122	1,962	—	(2,038)	1,651,238
Earned Revenue	—	—	(27,005)	(7,207)	(24)	—	2,038	(32,198)
Net Program Costs	—	—	1,575,187	41,915	1,938	—	—	1,619,040
American Citizens								
Total Cost	—	—	140	862,805	302,553	985,403	(130,018)	2,020,883
Earned Revenue	—	—	(16)	(140,160)	(34,972)	(1,421,116)	130,018	(1,466,246)
Net Program Costs	—	—	124	722,645	267,581	(435,713)	—	554,637
Democracy and Human Rights								
Total Cost	58,180	5,676	9,719	471,275	—	1	(20,076)	524,775
Earned Revenue	(6,784)	(540)	(990)	(38,328)	—	(67)	20,076	(26,633)
Net Program Costs	51,396	5,136	8,729	432,947	—	(66)	—	498,142
Economic Prosperity and Security								
Total Cost	95,091	9,278	15,884	770,267	—	1	(32,813)	857,708
Earned Revenue	(11,088)	(883)	(1,618)	(62,644)	—	(110)	32,813	(43,530)
Net Program Costs	84,003	8,395	14,266	707,623	—	(109)	—	814,178
Social and Environment Issues								
Total Cost	26,215	2,558	4,379	212,349	—	—	(9,046)	236,455
Earned Revenue	(3,057)	(243)	(446)	(17,270)	—	(30)	9,046	(12,000)
Net Program Costs	23,158	2,315	3,933	195,079	—	(30)	—	224,455
Humanitarian Response								
Total Cost	—	—	974,128	102	312	—	(745)	973,797
Earned Revenue	—	—	(886)	—	(2)	—	745	(143)
Net Program Costs	—	—	973,242	102	310	—	—	973,654
Public Diplomacy and Public Affairs								
Total Cost	114,999	11,220	19,210	931,532	478,572	2	(39,683)	1,515,852
Earned Revenue	(13,409)	(1,068)	(1,957)	(75,760)	(42,146)	(132)	39,683	(94,789)
Net Program Costs	101,590	10,152	17,253	855,772	436,426	(130)	—	1,421,063
Executive Direction and Other Costs Not Assigned								
Total Cost	3,851	4,358	57,808	4,040,617	469,968	1,845	(1,518,067)	3,060,380
Earned Revenue	(2,307)	(2,610)	(34,615)	(2,460,030)	(282,610)	(1,105)	1,485,956	(1,297,321)
Net Program Costs	1,544	1,748	23,193	1,580,587	187,358	740	(32,111)	1,763,059
Total Cost	622,127	64,681	2,737,547	9,960,884	1,253,367	987,257	(1,864,218)	13,761,645
Total Revenue	(74,399)	(8,350)	(73,042)	(3,014,708)	(359,754)	(1,422,932)	1,832,107	(3,121,078)
Total Net Cost	$ 547,728	$ 56,331	$ 2,664,505	$ 6,946,176	$ 893,613	$ (435,675)	$ (32,111)	$10,640,567

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, 2004 and 2003, these consist of costs and earned revenue summarized below (Dollars in Thousands).

	2004			2003		
Program	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**
Costs:						
Executive Direction	$ 2,326,992	$ 284,605	$ 2,042,387	$ 2,039,675	$ 159,629	$ 1,880,046
FSRDF	877,574	369,338	508,236	1,506,093	347,165	1,158,928
ICASS	1,075,703	862,758	212,945	965,358	670,831	294,527
International Commissions	298,178	1,366	296,812	84,427	1,415	83,012
Total Costs	$ 4,578,447	$ 1,518,067	$ 3,060,380	$ 4,595,553	$ 1,179,040	$ 3,416,513
Earned Revenue:						
Executive Direction	$ 492,876	$ 284,605	$ 208,271	$ 335,553	$ 159,629	$ 175,924
FSRDF	1,185,546	337,227	848,319	1,177,066	310,476	866,590
ICASS	1,095,169	862,758	232,411	982,504	670,831	311,673
International Commissions	9,686	1,366	8,320	13,227	1,415	11,812
Total Earned Revenue	$ 2,783,277	$ 1,485,956	$ 1,297,321	$ 2,508,350	$ 1,142,351	$ 1,365,999
Total Net Cost for Executive Direction and Other Costs Not Assigned	$ 1,795,170	$ 32,111	$ 1,763,059	$ 2,087,203	$ 36,689	$ 2,050,514

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 Management and Organizational Excellence charges for central support functions performed in 2004 and 2003 under the Under Secretary for Management by the following organizations (Dollars in Thousands):

Bureau (or equivalent)	**2004**	**2003**
Bureau of Diplomatic Security	$ 984,683	$ 1,154,129
Office of Overseas Buildings Operations	1,082,432	689,219
Bureau of Administration	654,033	520,549
Bureau of Information Resource Management	306,249	326,900
Bureau of Personnel	311,659	303,272
Bureau of Resource Management	761,382	324,899
Foreign Service Institute	121,908	113,885
Medical Services and Other	185,195	229,229
Total Central Support Costs	$ 4,407,541	$ 3,662,082

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 2004 and 2003 was as follows (Dollars in Thousands):

Program Receiving Allocation	2004	2003
Regional Stability	$ 385,357	$ 320,648
Counterterrorism	306,434	150,528
Homeland Security	187,444	147,183
Weapons of Mass Destruction	175,162	119,467
International Crime and Drugs	65,899	45,815
American Citizens	1,023,009	928,342
Democracy and Human Rights	189,457	160,722
Economic Prosperity and Security	309,655	339,604
Social and Environmental Issues	85,367	83,467
Humanitarian Response	20	18
Public Diplomacy and Public Affairs	374,485	271,269
Executive Direction and Other Costs Not Assigned	1,305,252	1,095,019
Total	$ 4,407,541	$ 3,662,082

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 Thousands):

Under Secretary	2004	2003
Political Affairs	$ 4,569,079	$ 4,450,321
Public Diplomacy	692,126	674,502
Management (Consular Affairs)	586,646	454,104
Arms Control, International Security Affairs	328,789	279,740
Global Affairs	170,199	151,211
Economic, Business and Agriculture Affairs	34,451	27,853
Total	$ 6,381,290	$ 6,037,731

Inter-Entity Costs and Imputed Financing: The Department is an agency of the U.S. Government, which performs many services for other U.S. Government agencies, especially overseas. Conversely, other U.S. Government agencies make financial decisions and report certain financial matters on behalf of the U.S. Government as a whole, including matters to which the Department may be an interested party.

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. This requirement to recognize specific inter-entity costs was extended in September 2001 and September 2000 to FY 2002 and 2001 financial statements by Bulletin 01-09 and OMB Memorandum M-00-14, "Technical Amendments to OMB Bulletin 97-01, *Form and Content of Agency Financial Statements,*" respectively.

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, 2004 and 2003 (Dollars in Thousands):

Inter-Entity Cost	**2004**	**2003**
Other Post-Employment Benefits:		
Civil Service Retirement Program	$ 25,603	$ 25,010
Federal Employees Health Benefits Program	64,621	59,256
Federal Employees Group Life Insurance Program	246	230
Litigation funded by Treasury Judgment Fund	847	3,044
Subtotal – Imputed Financing Source	$ 91,317	$ 87,540
Future Workers' Compensation Benefits	6,245	13,490
Total Inter-Entity Costs	$ 97,562	$ 101,030

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, 2004 and 2003, consist of the following (Dollars in Thousands):

	2004			2003		
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	$ 555,794	$ —	$ 555,794	$ 642,076	$ —	$ 642,076
Machine Readable Visa	623,679	—	623,679	550,597	—	550,597
Expedited Passport	108,563	—	108,563	98,207	—	98,207
Fingerprint Processing, Diversity Lottery, and Affadavit of Support	21,631	—	21,631	23,514	—	23,514
Subtotal – Consular Fees	$ 1,309,667	$ —	$ 1,309,667	$ 1,314,394	$ —	$ 1,314,394
FSRDF	$ 1,185,546	$ 337,227	$ 848,319	$ 1,177,066	$ 310,476	$ 866,590
ICASS	1,095,169	862,758	232,411	982,504	670,831	311,673
Other Reimbursable Agreements	994,741	493,150	501,591	1,088,382	543,632	544,750
Working Capital Fund	307,290	138,973	168,317	270,606	167,005	103,601
Other	60,773	—	60,773	22,015	—	22,015
Total	$ 4,953,186	$ 1,832,108	$ 3,121,078	$ 4,854,967	$ 1,691,944	$ 3,163,023

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 2004 and 2003 were $177.7 million and $185.4 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 2004 and 2003 were $218.0 million and $219.0 million, respectively. FSRDF cash resources are invested in special non-marketable securities issued by the Treasury. Total interest earned on these investments in 2004 and 2003 was $763.9 million and $772.6 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 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; individual costs for these activities have not been determined.

Gross Cost and Earned Revenue by Budget Functional Classification (BFC)

The Department's costs and revenue are included in the *Financial Report of the United States Government – Fiscal 2004* (formerly the Consolidated Financial Statements of the United States Government), which is published by the Department of the Treasury. The *Financial Report of the United States Government – Fiscal 2004* presents gross costs and earned revenue by BFC. Following is the Department's gross cost and earned revenue for both federal and non-federal vendors by BFC for the years ended September 30, 2004 and 2003 (Dollars in Thousands and reported net of intra-departmental eliminations):

	2004			2003		
Budget Functional Classification	**Gross Cost**	**Earned Revenue**	**Net Cost**	**Gross Cost**	**Earned Revenue**	**Net Cost**
International Affairs	$ 12,921,896	$ 2,245,312	$ 10,676,584	$ 10,635,744	$ 2,284,316	$ 8,351,428
Income Security	557,961	871,031	(313,070)	1,515,832	870,185	645,647
Natural Resources	281,788	4,735	277,053	71,064	8,522	62,542
Total	$ 13,761,645	$ 3,121,078	$ 10,640,567	$ 12,222,640	$ 3,163,023	$ 9,059,617

18 STATEMENT OF BUDGETARY RESOURCES

The Statement of Budgetary Resources reports information on how budgetary resources were made available and their status as of and for the years ended September 30, 2004 and 2003. 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 2004 and 2003, the Department received approximately $21.3 billion and $17.6 billion in budgetary resources, respectively, primarily consisting of the following:

Source of Budgetary Resources	**2004**	**2003**
Budget Authority:		
Direct or related appropriations	$ 13.6 billion	$ 10.9 billion
Authority financed from Trust Funds	1.2 billion	1.2 billion
Spending authority from providing goods and services	3.5 billion	3.1 billion
Unobligated Balances – Beginning of Year	2.6 billion	2.6 billion
Other	0.4 billion	(0.2) billion
Total Budgetary Resources	$ 21.3 billion	$ 17.6 billion

The Department received permanent indefinite appropriations of $39.2 million and $35.6 million for 2004 and 2003, respectively. The permanent indefinite appropriation provides payments to the Foreign Service Retirement and Disability Fund to finance the interest on the unfunded pension liability for the year and disbursements attributable to military service. The amount of budgetary resources obligated for undelivered orders for all activities as of September 30, 2004 and 2003 was approximately $7.6 and $6.7 billion, respectively. This includes amounts of $650 million for September 30, 2004 and $286 million for September 30, 2003, pertaining to revolving funds, trust funds, and substantial commercial activities.

Information on U.S. Government agencies' budgets is reported in the *Budget of the United States Government, Fiscal Year 2005 –* Appendix (*Appendix*). The *Appendix* includes for each agency (including the Department), among other things, budget schedules for the agency's accounts. Information on budgetary resources and their status will be displayed in the *Program and Financing (P&F)* Schedule under each account. Amounts presented in the *P&F Schedules* are in millions of dollars. Each agency is responsible for submitting the data presented in the *P&F Schedules*. Amounts shown on the 2004 Statement of Budgetary Resources will differ from "2004 Actual" reported in the *P&F Schedules* for the Department's accounts as follows:

- The Budget Authority and Net Outlays reported on the Statement of Budgetary Resources includes $1,999 and $1,139 million, respectively, the Department received in 2004 to administer programs related to International Security Assistance. Amounts for these programs are not presented under the Department in the *Appendix*, but are reported in the *Appendix* under the section titled International Assistance Programs.

- The Unobligated Balances and Obligated Balance, Net – Beginning of Year reported on the Statement of Budgetary Resources includes a $335 million adjustment (increase and decrease, respectively) pertaining to undelivered orders that will not be reported in the *Appendix.*

- The Unobligated Balances – Beginning of Year and End of Year reported on the Statement of Budgetary Resources includes $19 and $184 million, respectively, of unavailable unobligated balances (primarily for expired annual accounts) that will not be reported in the *Appendix*. These unavailable unobligated balances in expired accounts (2003 and prior) remain available for adjustment, liquidation of obligations and other purposes authorized by law, until such amounts are closed as required by law (Public Law 101-510) and any remaining amounts will be returned to the General Fund of the U.S. Treasury. However, they are not available to incur new obligations since their period of availability to do such has expired. Consequently, the P&F Schedule reports only available unobligated balances (versus unavailable) as budgetary resources available for obligation.

- The Unobligated Balance, Available and Unavailable and Obligated Balance, Net– End of Year reported on the Statement of Budgetary Resources includes a $64 million adjustment (increase and decrease, respectively) pertaining to undelivered orders that will not be reported in the *Appendix*.

- The Department's 2004 Statement of Budgetary Resources reflects Offsetting Receipts per OMB Bulletin 01-09 guidance. However, the Department also receives "General Funds Receipts" that per OMB 01-09 are not included in the Statement of Budgetary Resources even though they are included in the *Appendix* for the Department. General Fund Receipts for 2004 are approximately $597 million primarily for passport and visa services.

The *Appendix* is organized by major subordinate organizations or program areas within the agency, and then by the nature of account(s) (e.g., general, special, revolving, trust) within organization or program area. The Department's section consists of the following areas: Administration of Foreign Affairs, International Organizations and Conferences, International Commissions, Foreign Assistance, and Other. The Combining Schedule of Budgetary Resources appearing as Required Supplementary Information presents amounts in the Combined Statement of Budgetary Resources by these areas.

19 CONSOLIDATED STATEMENT OF FINANCING

Accrual-based measures used in the Statement of Net Cost differ from the obligation-based measures used in the Statement of Budgetary Resources. The Statement of Financing for the years ended September 30, 2004 and 2003, presents information to reconcile these different measures. In doing so, the Statement of Financing provides assurance that the financial information is consistent with similar amounts found in budget reports. The Statement of Financing reconciles obligations of budget authority to the accrual-based net cost of operations. The Net Cost of Operations as presented on the Statement of Financing is determined by netting the obligations as adjusted and non-budgetary resources and making adjustments for the total resources that do not fund net cost of operations, the total costs that do not require resources, and financing sources yet to be provided. The result is Net Cost of Operations as reported on the Statement of Net Cost.

20 CUSTODIAL ACTIVITY

The Department administers certain activities associated with the collection of non-exchange revenues, which are deposited and recorded directly to the General Fund of the Treasury. The Department does not retain the amounts collected. Accordingly, these amounts are not considered or reported as financial or budgetary resources for the Department. At the end of each fiscal year, the accounts are closed and the balances are brought to zero by Treasury. Specifically, the Department collects interest, penalties and handling fees on accounts receivable; fines for Munitions Control violations; international contributions for ice patrol activities; and other miscellaneous receipts. In 2004 and 2003, the Department collected $13.0 million and $8.2 million, respectively, in custodial revenues that were transferred to the Treasury.

21 DEDICATED COLLECTIONS

The Department administers nine Trust Funds that receive dedicated collections. In the U.S. Government budget, Trust Funds are accounted for separately and used only for specified purposes. A brief description of these Funds and their purpose 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 $3.6 million and $3.0 million in 2004 and 2003, respectively. Cash is invested in U.S. Treasury securities until it is needed for disbursement.

Foreign Service National Separation Liability Trust Fund (FSNSLTF) (19X8340)

FSNSLTF funds separation liabilities to foreign service national (FSNs) and personal service contractor (PSCs) employees who voluntarily resign, retire, or lose their jobs due to a reduction in force. The liability is applicable only in those countries that, due to local law, require a lump-sum voluntary separation payment based on years of service. The FSNSLTF was authorized in 1991 and initially capitalized with a transfer from the Department. Contributions are made to the FSNSLTF by the Department's appropriations, from which the FSNs and PSCs are paid. Once the liability to the separating FSN or PSC is computed in accordance with the local compensation plan, the actual disbursement is made from the FSNSLTF.

Conditional and Unconditional Gift Funds (19X8821 and 19X8822)

The Department maintains two Trust Funds for receiving and disbursing donations. It is authorized to accept gifts from private organizations and individuals in the form of cash, gifts-in-kind, and securities. Gifts are classified as Restricted or Unrestricted Gifts. Restricted Gifts must be used in the manner specified by the donor. Unrestricted Gifts can be used for any expense normally covered by an appropriation, such as representational purposes or embassy refurbishment.

Israeli-Arab Scholarship Program (19X8271)

The Israeli-Arab Scholarship Program provides grants and scholarships to Israeli-Arab students for degree programs at universities and colleges in the United States. This program was authorized by Section 214 of the Foreign Relations Authorization Act, Fiscal Years 1992 and 1993 (P.L. 102-138). A permanent endowment of $4.9 million was established in 1992.

Eisenhower Exchange Fellowship Program Trust Fund (95X8276)

The Eisenhower Exchange Fellowship Act of 1990 (P.L. 101-454) authorized a permanent endowment for the Eisenhower Exchange Fellowship Program to honor the late president by increasing educational opportunities for young leaders who wish to prepare for and enhance their professional careers and advance peace through international understanding. The 1992 Department of State and Related Agencies Appropriations Act provided $5.0 million to establish a permanent endowment for the Program, and appropriated the interest and earnings. The 1995 Department of State and Related Agencies Appropriations Act made an additional payment of $2.5 million to the endowment.

Miscellaneous Trust Funds, Information and Exchange Programs (19X8166, 19X8167, 19X8272, and 19X8813)

Funds advanced by other governments, business concerns, and private organizations to the Department are used to send experts abroad to perform requested services; give foreign nationals scientific, technical, or other training; purchase films and other products owned or controlled by the Department; and for international exhibitions. In FY 04, DOS received an appropriation to establish a trust fund for operation of an International Center for Middle Eastern – Western Dialogue in Istanbul, Turkey (19x8813). The center will develop programs of cooperative study, training, and research for students and scholars to exchange views and ideas.

State Secretary of the German Foreign Office Klaus Scharioth, German Minister of the Interior Otto Schily, Ambassador of the United States in Germany Daniel Coats, Director of Overseas Buildings Operations of the U.S. Department of State Charles Williams and the Governing Mayor of Berlin Klaus Wowereit, from left, during the groundbreaking ceremony of the new U.S. Embassy next to the Brandenburg Gate in Berlin. © AP/ Wide World

(Dollars in Thousands)	FSRDF	FSNSLTF	Gift Funds	Israeli-Arab Scholarship	Eisenhower Exchange Fellowship	Misc. Trust Funds
For the year ended September 30, 2004:						
Assets:						
Fund Balances with Treasury	$ 2	$ 92,935	$ 13,385	$ 506	$ 6	$ 2,230
Investments	12,827,628	—	—	4,319	7,483	6,630
Other Assets	198,512	—	21	105	—	51
Total Assets	13,026,142	92,935	13,406	4,930	7,489	8,911
Liabilities:						
Payable to Beneficiaries	44,086	—	—	—	—	—
Actuarial Liability	13,317,900	—	—	—	—	—
Other Liabilities	9,987	—	18	—	—	2
Total Liabilities	13,371,973	—	18	—	—	2
Net Position (Deficit)	(345,831)	92,935	13,388	4,930	7,489	8,909
Total Liabilities and Net Position	$ 13,026,142	$ 92,935	$ 13,406	$ 4,930	$ 7,489	$ 8,911
Revenues and Financing:						
Exchange Revenue:						
Intragovernmental	$ 1,159,673	$ 10,086	$ —	$ —	$ —	$ —
Governmental	25,873	—	—	—	—	—
Non Exchange Revenue:						
Intragovernmental	—	—	39	255	—	6,927
Governmental	—	—	4,302	—	—	—
Other Financing Sources	—	—	—	—	—	—
Total Revenues and Financing	1,185,546	10,086	4,341	255	—	6,927
Expenses:						
Program Expenses	—	7,088	(306)	303	—	589
Actuarial Expenses	877,574	—	—	—	—	—
Total Expenses	$ 877,574	$ 7,088	$ (306)	$ 303	$ —	$ 589

(Dollars in Thousands)	FSRDF	FSNSLTF	Gift Funds	Israeli-Arab Scholarship	Eisenhower Exchange Fellowship	Misc. Trust Funds
For the year ended September 30, 2003:						
Assets:						
Fund Balances with Treasury	$ 43	$ 94,878	$ 12,908	$ 484	$ 6	$ 2,670
Investments	12,289,302	—	—	4,388	7,483	—
Other Assets	202,949	—	11	106	—	4
Total Assets	12,492,294	94,878	12,919	4,978	7,489	2,674
Liabilities:						
Payable to Beneficiaries	42,645	—	—	—	—	—
Actuarial Liability	9,653	—	—	—	—	—
Other Liabilities	13,093,800	4,941	4,178	—	—	103
Total Liabilities	13,146,098	4,941	4,178	—	—	103
Net Position (Deficit)	(653,804)	89,937	8,741	4,978	7,489	2,571
Total Liabilities and Net Position	$ 12,492,294	$ 94,878	$ 12,919	$ 4,978	$ 7,489	$ 2,674
Revenues and Financing:						
Exchange Revenue:						
Intragovernmental	$ 1,151,649	$ 9,454	$ —	$ 259	$ —	$ —
Governmental	25,416	—	—	—	—	—
Non Exchange Revenue:						
Intragovernmental	—	—	54	—	450	2
Governmental	—	—	3,927	—	—	—
Other Financing Sources	—	—	—	—	—	—
Total Revenues and Financing	1,177,065	9,454	3,981	259	450	2
Expenses:						
Program Expenses	—	9,712	3,661	371	419	229
Actuarial Expenses	1,506,093	—	—	—	—	—
Total Expenses	$ 1,506,093	$ 9,712	$ 3,661	$ 371	$ 419	$ 229

22 PRIOR PERIOD ADJUSTMENT

The accompanying Consolidated Balance Sheet and Consolidated Statement of Changes in Net Position for FY 2003 have been restated. In FY 2003, $927 million was reported as a non-operating expense rather than an operating expense in accounts related to Contributions to International Organizations. As presented below, the effect of the adjustment is to reclassify $927 million from Unexpended Appropriations (see also Note 16, "Unexpended Appropriations") to Cumulative Results of Operations. The adjustment has no effect on the Total Net Position reported as of September 30, 2003, Net Cost of Operations, or other Principal Financial Statements (Dollars in Thousands).

Consolidated Balance Sheet

	As of September 30, 2003		
	Cumulative Results of Operations	**Unexpended Appropriations**	**Total**
Net Position, as Previously Reported	$ 4,577,203	$ 8,536,307	$ 13,113,510
Prior Period Adjustment	927,311	(927,311)	–
Net Position, Restated	$ 5,504,514	$ 7,608,996	$ 13,113,510

Consolidated Statement of Changes in Net Position

	For the Year Ended September 30, 2003	
	Cumulative Results of Operations	**Unexpended Appropriations**
Appropriations Used, as Previously Reported	$ 9,345,932	$ (9,345,932)
Prior Period Adjustment	927,311	(927,311)
Appropriations Used, Restated	$ 10,273,243	$(10,273,243)
Ending Net Position, as Previously Reported	$ 4,577,203	$ 8,536,307
Prior Period Adjustment	927,311	(927,311)
Ending Net Position, Restated	$ 5,504,514	$ 7,608,996

REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION
HERITAGE ASSETS

FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2004 AND 2003

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.

Photo: Richard Cheek

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

Thomas Jefferson State Reception Room.

Photo: Richard Cheek

The Benjamin Franklin State Dining Room.

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.




Volkwup Wertzel
(clockwise from top left)
U.S. Capitol
The Washington Monument
Q Street Bridge
Pennsylvania Avenue

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 Overseas Buildings Operations' Interior Planning, Design and Furnishings Division, is responsible for antiques, works of art, and high-value furnishings that the Department owns abroad. These objects are important due to their historical significance, antiquity, rare quality, or high dollar value. These items may have been donated or obtained as part of the furnishings acquired with a building.

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.

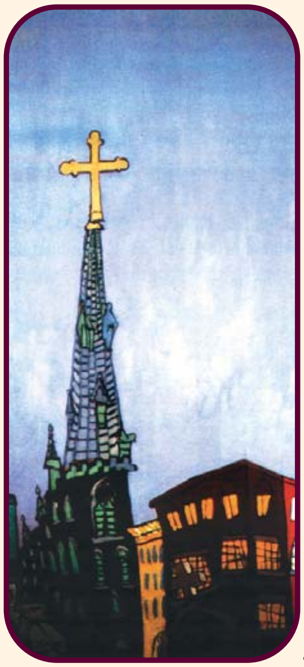
1

1. Mary Sheppard Burton Fantasia 1975 (132x96 cm) hooked and hand-dyed wool on linen mounted board. Courtesy of the artist, Germantown, Maryland

2. 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

3. Barbara Cooper Hanson, Federal Hill, 1992 (180 x 81 cm) oil on canvas. Courtesy of the artist, Baltimore, Maryland

2



3

"There are many ways to conduct diplomacy. The Art in Embassies Program is a special way. Works of American art, on display around the world, share our beloved country, our values, our history, our culture, our deep belief in freedom of expression, and in the creative power of the individual. Each work of art becomes a diplomatic instrument, each artist an ambassador. It is an outstanding program."

Colin L. Powell

U.S. Secretary of State

Secretary of State's Register of Culturally Significant Property

The Secretary of State's Register of Culturally Significant Property was established in January 2001 to recognize the Department's owned properties overseas, which have historical, architectural, or cultural significance. Properties in this category include chanceries, consulates, and residences. All these properties are used predominantly in general government operations and are thus classified as multi-use heritage assets. Financial information for multi-use heritage assets is presented in the principal statements.

Situated adjacent to Regent's Park in London, England, Winfield House is the residence of the U.S. Ambassador to the Court of St. James. Heiress Barbara Hutton built this country manor in 1936, and named it after her grandfather F.W. (Winfield) Woolworth, who had founded the famous Woolworth stores where any item could be purchased for five or ten cents. After World War II, Hutton offered the building to the United States Government to use as the ambassador's residence for the price of one American dollar.

	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	Collectibles – Art and furnishings of cultural or historic value	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.	Acquired through purchase or donation. Excess items are sold.	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 – 09/30/2002	3,405	2,062	953	4,414	1,035	8
Acquisitions	10	59	25	45	—	—
Adjustments	—	—	—	—	(2)	—
Disposals	(3)	—	(16)	(1)	—	—
Number of Items – 09/30/2003	3,412	2,121	962	4,458	1,033	8
Deferred Maintenance – 09/30/2003	N/A	N/A	N/A	N/A	N/A	$14,324,707
Acquisitions	10	48	6	10	—	—
Adjustments	(1)	—	7	—	—	—
Disposals	(10)	—	—	—	—	—
Number of Items – 09/30/2004	3,411	2,169	975	4,468	1,033	8
Deferred Maintenance – 09/30/2004	N/A	N/A	N/A	N/A	N/A	$19,247,587

REQUIRED SUPPLEMENTARY INFORMATION

DEPARTMENT OF STATE
COMBINING SCHEDULE OF BUDGETARY RESOURCES
For the Year Ended September 30, 2004
(Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Budgetary Authority:						
Appropriations received	$ 8,337,576	$ 1,710,305	$ 57,795	$ 835,050	$ 2,030,729	$ 12,971,455
Net transfers	110,091	—	—	1,092,037	583,103	1,785,231
Other	—	244,000	—	—	—	244,000
Unobligated Balance:						
Beginning of period	1,955,036	(136,001)	6,357	51,573	748,411	2,625,376
Net Transfers	7,512	—	—	71,482	102,741	181,735
Spending Authority from Offsetting Collections:						
Earned						
Collected	3,080,720	—	6,179	18,349	31,936	3,137,184
Receivable from Federal sources	334,683	—	(74)	(12,298)	3,499	325,810
Change in unfilled customer orders						
Without advance from Federal sources	27	—	(118)	—	—	(91)
Subtotal	3,415,430	—	5,987	6,051	35,435	3,462,903
Recoveries from Prior Year Obligations:						
Actual	628,017	10,626	2,690	62,020	98,702	802,055
Temporarily Not Available Pursuant to Public Law:	(538,286)	—	(1,000)	—	(2)	(539,288)
Permanently Not Available:	(153,230)	(20,942)	(1,159)	(9,805)	(16,110)	(201,246)
Total Budgetary Resources	13,762,146	1,807,988	70,670	2,108,408	3,583,009	21,332,221

DEPARTMENT OF STATE
COMBINING SCHEDULE OF BUDGETARY RESOURCES *Continued*
For the Year Ended September 30, 2004
(Dollars in Thousands)

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Obligations Incurred:						
Direct	8,418,649	1,807,444	59,345	1,678,181	3,184,197	15,147,816
Reimbursable	2,713,838	—	5,976	—	(8,742)	2,711,072
Subtotal	11,132,487	1,807,444	65,321	1,678,181	3,175,455	17,858,888
Unobligated Balance:						
Apportioned	2,447,904	(10)	4,632	427,887	375,725	3,256,138
Exempt from apportionment	16,969	—	—	—	11,304	28,273
Unobligated Balance Not Available:	164,788	553	716	2,339	20,526	188,922
Total Status of Budgetary Resources	13,762,146	1,807,988	70,670	2,108,408	3,583,009	21,332,221
Obligated Balance, Net,Beginning of Year:	4,461,663	564,164	24,256	486,556	1,743,730	7,280,369
Obligated Balance, Net, End of Year:						
Accounts Receivable	(669,536)	67	(752)	(8,929)	(4,785)	(683,935)
Unfilled customer orders	(27)	—	(2,768)	—	—	(2,795)
Undelivered orders	4,305,836	776	21,359	747,576	2,515,758	7,591,305
Accounts payable	734,429	490,124	1,120	213,817	234,462	1,673,952
Outlays:						
Disbursements	10,274,485	1,870,016	68,120	1,162,551	2,071,556	15,446,728
Collections	(3,094,480)	—	(6,179)	(18,349)	(31,946)	(3,150,954)
Subtotal	7,180,005	1,870,016	61,941	1,144,202	2,039,610	12,295,774
Less: Offsetting receipts	(242,062)	—	—	—	(485)	(242,547)
Net Outlays	$ 6,937,943	$ 1,870,016	$ 61,941	$ 1,144,202	$ 2,039,125	$ 12,053,227

Intragovernmental Amounts

Intragovernmental amounts represent transactions between federal entities included in the *Financial Report of the United States Government – Fiscal Year 2004* (formerly the Consolidated Financial Statements of the United States Government) published by the U.S. Department of the Treasury. All amounts presented are net of intra-departmental eliminations.

The amount of intragovernmental assets and liabilities classified by trading partner at September 30, 2004 and 2003, are summarized below (Dollars in Thousands).

As of September 30, 2004:	**ASSETS**				**LIABILITIES**	
Trading Partner	**Fund Balance With Treasury**	**Investments**	**Interest Receivable**	**Accounts Receivable, Net**	**Accounts Payable**	**Other Liabilities**
Department of Agriculture				$ 4,300	$ 71	
Department of Commerce				6,676	326	
Department of Defense				111,970	16,234	
Department of Justice				23,184	7,964	
Department of Labor				26	—	$ 18,565
Department of the Treasury	$ 11,926,434	$ 12,846,060	$ 190,263	6,805	—	13,614
Agency for International Development				22,459	153	—
Environmental Protection Agency				336	—	—
Office of Personnel Management				17	10,377	5,406
Other Agencies				288,527	1,921	6,055
Total	$ 11,926,434	$ 12,846,060	$ 190,263	$ 464,300	$ 37,046	$ 43,640

As of September 30, 2003:	**ASSETS**				**LIABILITIES**	
Trading Partner	**Fund Balance With Treasury**	**Investments**	**Interest Receivable**	**Accounts Receivable, Net**	**Accounts Payable**	**Other Liabilities**
Department of Agriculture				$ 1,689		
Department of Commerce				8,937	$ 653	
Department of Defense				215,762	24,109	
Department of Justice				30,171		
Department of Labor				2		$ 18,047
Department of the Treasury	$ 9,953,197	$ 12,301,173	$ 189,366	9,667	6,954	368
Agency for International Development				17,498		
Environmental Protection Agency				572		21
Office of Personnel Management				17	36	9,232
Other Agencies				87,988	8,137	9,132
Total	$ 9,953,197	$ 12,301,173	$ 189,366	$ 372,303	$ 39,889	$ 36,800

The amounts of intragovernmental earned revenues classified by trading partner and related gross costs, which generated this revenue, categorized by budget functional classification for the years ended September 30, 2004 and 2003, are summarized below (Dollars in Thousands). The gross cost to generate intragovernmental revenue represents costs, for both federal and non-federal vendors, the Department incurred to provide goods and services to other Federal entities. This differs from the intra-governmental expenses presented on the following page. Intragovernmental expenses represent costs the Department incurred for goods and services received from other federal entities.

Intragovernmental Earned Revenues

For the Year Ended September 30,	2004	2003
Trading Partner	**Earned Revenue**	**Earned Revenue**
Executive Office of the President	$ 6,022	$ 2,345
Department of Agriculture	24,075	18,798
Department of Commerce	28,900	31,333
Department of Defense	211,760	599,982
Department of Energy	10,242	11,124
Department of Health and Human Services	13,352	11,637
Department of Justice	79,536	72,321
Department of Transportation	1,165	3,038
Department of the Treasury	765,711	785,405
Agency for International Development	191,418	105,074
Environmental Protection Agency	436	1,675
Social Security Administration	10,777	9,178
Other Agencies	462,378	132,162
Total	$ 1,805,772	$ 1,784,072

For the Year Ended September 30,	2004			2003		
Budget Functional Classification	**Gross Cost to Generate Revenue**	**Earned Revenue**	**Net Cost**	**Gross Cost to Generate Revenue**	**Earned Revenue**	**Net Cost**
International Affairs	$ 958,080	$ 970,435	$ (12,355)	$ 935,469	$ 938,666	$ (3,197)
Income Security	872,896	832,533	40,363	863,679	841,170	22,509
Natural Resources	6,387	2,804	3,583	4,236	4,236	—
Total	$ 1,837,363	$ 1,805,772	$ 31,591	$ 1,803,384	$ 1,784,072	$ 19,312

The amounts of intragovernmental non-exchange revenues classified by trading partner for the years ended September 30, 2004 and 2003 are summarized below (Dollars in Thousands).

For the Year Ended September 30,	2004	2003
Trading Partner	**Non-Exchange Revenue**	**Non-Exchange Revenue**
Department of the Treasury	$ 294	$ 765

The amounts of intragovernmental expenses classified by trading partner and by budget functional classification for the years ended September 30, 2004 and 2003, are summarized below (Dollars in Thousands).

For the Year Ended September 30,	2004	2003
Trading Partner	**Expenses**	**Expenses**
Department of Agriculture	$ 1,829	$ 769
Department of Commerce	7,954	5,126
Department of Defense	51,089	93,557
Department of Energy	9,003	18,658
Department of Justice	3,848	35,346
Department of Labor	7,211	8,276
Department of the Treasury	9,376	20,770
General Services Administration	549,709	464,292
Government Printing Office	17	1,851
Office of Personnel Management	269,592	220,736
U.S. Postal Service	7,420	9,484
Other Agencies	35,326	100,590
Total	$ 952,374	$ 979,455

For the Year Ended September 30,	2004	2003
Budget Functional Classification	**Expenses**	**Expenses**
International Affairs	$ 945,987	$ 971,634
Natural Resources	6,387	7,821
Income Security	—	—
Total	$ 952,374	$ 979,455

Deferred Maintenance
For the Fiscal Year Ended September 30, 2004

The Department occupies more than 3,000 government-owned or long-term leased real properties at more than 260 overseas locations. It uses a condition assessment survey method to evaluate the asset's condition, and determine the repair and maintenance requirements for its overseas buildings.

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, requires that deferred maintenance (measured using the condition survey method) and the description of the requirements or standards for acceptable operating condition be disclosed. Fundamentally, the Department considers all of its overseas facilities to be in an "acceptable condition" in that they serve their required mission. Adopting standard criteria for a classification of acceptable condition is difficult due to the complex environment in which the Department operates.

From a budgetary perspective, funding for maintenance and repair has been insufficient in the past. As a result, the Department has identified current maintenance and repair backlog of $644.7 million for buildings and facilities-related equipment that have not been funded. This figure is less than the $717.2 million reported for 2003. The current estimate is a more realistic measure of maintenance and repair work that must be done to buildings and equipment to bring them up to where the Department believes they should be.

Of the deferred maintenance figure, $94.0 million is for over 150 buildings that are under consideration for the Secretary of State's Register of Culturally Significant Property and the $19.2 is for Heritage Assets.

Working Capital Fund

The Working Capital Fund (WCF) is a revolving fund, which was authorized in the Foreign Assistance Act of 1963 (P.L. 88-205) as an amendment to the Department of State Basic Authorities Act. It was created to finance a continuing cycle of business-type operations for the Department.

The WCF serves bureaus and offices within the Department of State, U.S. Government agencies operating abroad, foreign governments, and international organizations located in the U.S. WCF consists of two lines of business. The products/services provided by each business line are as follows:

- WCF — Provides centralized management for equipment, services and maintenance of unclassified voice/data telecommunications; arranges ocean and airfreight shipment of personal property and official supplies from the U.S. to overseas posts; provides permanent storage of household belongings for employees assigned to overseas posts; provides printing and editorial services; procures all publications, periodicals, books and newspapers for the Department; assists overseas posts with procuring local supplies and materials; provides motor vehicle transportation; and provides moving and delivery services; regulates foreign government activities undertaken in the U.S.; registers and licenses motor vehicles belonging to a foreign mission or its staff; administers travel restrictions and controls on members of foreign missions; reviews and approves/denies all foreign mission real property acquisitions, leases, and sales; and protects and preserves foreign mission properties that belong to countries that no longer maintain diplomatic relations with the U.S.

- International Cooperative Administrative Support Service (ICASS) — Manages the interagency administrative support services for overseas posts, which includes services such as computer and financial management services, guard service, mail and messenger service, and motor pool and health services.

The WCF balance sheet at September 30, 2004 and 2003, is presented below (Dollars in Thousands).

	2004			2003		
	WCF	ICASS	Total	WCF	ICASS	Total
Assets:						
Fund Balances with Treasury	$ 23,917	$ 101,736	$ 125,653	$ 8,458	$ 207,895	$ 216,353
Accounts Receivable, Net	58,172	276,603	334,775	78,694	159,260	237,954
Plant, Property and Equipment, Net	32,845	40,297	73,142	27,363	30,747	58,110
Other Assets	5,884	6,543	12,427	5,272	5,492	10,764
Total Assets	120,818	425,179	545,997	119,787	403,394	523,181
Liabilities:						
Accounts Payable	32,638	59,705	92,343	21,188	121,555	142,743
Other Liabilities	2,323	61,215	63,538	664	3,754	4,418
Total Liabilities	34,961	120,920	155,881	21,852	125,309	147,161
Cumulative Results of Operations	$ 85,857	$ 304,259	$ 390,116	$ 97,935	$ 278,085	$ 376,020

The cost of providing services and the exchange revenue earned for the years ended September 30, 2004 and 2003 are presented below (Dollars in Thousands). These amounts do not include intra-departmental eliminations.

	WCF	ICASS	Total
2004			
Costs	$ 320,844	$ 1,075,703	$ 1,396,547
Exchange Revenue	(307,290)	(1,095,169)	(1,402,459)
Other Financing Sources	(1,476)	(6,708)	(8,184)
Net Cost (Revenue)	$ 12,078	$ (26,174)	$ (14,096)
2003			
Costs	$ 274,383	$ 972,426	$ 1,246,809
Exchange Revenue	(270,606)	(982,504)	(1,253,110)
Other Financing Sources	(1,476)	(6,259)	(7,735)
Net Cost (Revenue)	$ 2,301	$ (16,337)	$ (14,036)

Supplemental Information and Other Reporting Requirements

FINANCIAL MANAGEMENT PLANS AND REPORTS

OVERVIEW

INTRODUCTION

The Department's Bureau of Resource Management (RM), headed by the Assistant Secretary for Resource Management and Chief Financial Officer (CFO), employs over 500 people around the globe--in Washington, Charleston, South Carolina, and Bangkok, Thailand. With five major operating units, the CFO oversees all strategic and performance planning, state operations and foreign assistance budgeting and resource management, global accounting, disbursing and payroll, financial systems, and issuance of the financial statements and "annual report" of the Department. The CFO also coordinates and leads the remediation of vulnerabilities within the Department's global critical infrastructure. RM produces a number of essential documents including the Department's Strategic Plan, Joint Performance Plan with USAID, Performance and Accountability Report, Budget-in-Brief, and the Congressional Budget Justification Document.

RM's customers are all embassies, consulates, and missions overseas, nearly 40 other U.S. Government agencies overseas, all domestic bureaus and employees of the State Department, and the Broadcasting Board of Governors. RM's services to its customers are critical in order that they can do their job to create a more secure, democratic, and prosperous world.

MISSION

"To integrate strategy, budgeting, and performance management, and secure and manage the resources necessary to accomplish the Department of State's mission."

The CFO's mission statement is incorporated into the Department's strategic goal for Management and Organizational Excellence as Performance Goal 5 (see page 277). This Performance Goal has two initiatives, one each for the President's Management Agenda's initiatives for Improved Financial Performance and Budget and Performance Integration.

IMPROVED FINANCIAL PERFORMANCE

GOALS AND STRATEGIES

INITIATIVE GOAL STATEMENT

Provide world-class financial services that support strategic decision-making, mission performance, the President's Management Agenda, and improved accountability to the American people.

Improving financial performance means that the Department knows where every dollar comes from and where every dollar goes in a timely and accurate manner. Accurate and timely information is critical to managing our programs on a day-to-day basis, obtaining the best performance, and ensuring accountability to the American public. It is also a core competency of world–class organizations.

To do this, RM will:

- Produce on-time, accurate and useful financial statements on a routine basis.
- Obtain an unqualified ("clean") opinion on annual Departmentwide financial statements.
- Produce award winning Performance and Accountability Reports.
- Implement seamless financial systems and processes that meet Federal and Department requirements.
- Ensure effective internal controls are in place and functioning.
- Consolidate and standardize financial operations.
- Leverage best business practices and electronic technologies (E-Gov).
- Build a top-notch finance team.
- Undertake other value-added activities that support strategic decision-making and mission performance.

Key measures of our success in this area are aligned with how OMB scores financial management related to achieving a "green" status rating on the President's Management Agenda. Other measures of success include:

- Are we on target in our consolidation of financial services to the Charleston Financial Services Center?
- Are we implementing the President's mandate to effectively adopt E-Gov solutions, especially in the areas of payroll, travel and grants?
- Are we adequately investing in our greatest asset – our people?

PERFORMANCE

President's Management Agenda

To date, as indicated in the chart, the Department has met seven of the nine OMB-established criteria and achieved a "Yellow" for status. We have on-time financial statements that receive unqualified opinions, award winning Performance and Accountability Reports, financial systems and processes that substantially meet Federal requirements and allow for effective budget execution, and sound internal controls. The Department continues to work with OMB to achieve the final criteria -- "financial data integration." Under this criteria, agencies must demonstrate (1) how their financial systems achieve better results through lower costs or improved outcomes, and (2) that they are implementing a plan to continuously expand the scope of this ability. We plan to achieve "Green" status in the first quarter of FY 2005.

- ☑ *Receives an unqualified audit opinion on its annual financial statements;*
- ☑ *Meets financial statement reporting deadlines;*
- ☑ *Reports in its audited annual financial statements that its systems are in compliance with the Federal Financial Management Improvement Act;*
- ☑ *Has no chronic or significant Anti- Deficiency Act Violations;*
- ☑ *Has no material auditor-reported internal control weaknesses;*
- ☑ *Has no material non-compliance with laws or regulations;*
- ☑ *Has no material weaknesses or non-conformances reported under Section 2 and Section 4 of the Federal Managers' Financial Integrity Act that impact the agency's internal control over financial reporting or financial systems;*
- ☐ *Currently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operations; and*
- ☐ *Is implementing a plan to continuously expand the scope of its routine data use to inform management decision-making in additional areas of operations.*

Consolidating and Standardizing our Worldwide Financial Operations

While we modernize our major corporate financial management systems, we are also consolidating our worldwide financial operations to our Charleston and Bangkok Financial Service Centers (FSC) to provide world-class financial services. The recent highlights of RM consolidation efforts are:

- Relocated the American Payroll and Foreign Service Pension activities from Washington DC to Charleston FSC in 2003.
- Relocated servicing of posts from Paris FSC to Charleston and Bangkok FSCs in 2002 and 2003.
- Relocated significant portions of the Department's Washington DC-based financial operations to Charleston FSC in 2004.

Customer Service

Customer service is the hallmark of the Bureau of Resource Management. As the Department moves to a single world-class financial system, RM has redoubled its emphasis on customer service and support. The Overseas Post Support Desk, in addition to helping posts with implementation of new financial systems and changes, has been expanded to become a state-of-the-art help desk for financial management professionals in the Department and in other agencies we service. As part of this effort, RM is moving the customer support function towards a 24/7 operation, leveraging our presences in time zones roughly equidistant around the globe (Charleston, Bangkok and Paris), and integrating former Washington-based operations into our customer support regime. For example, the former American Payroll Resolution Center is now operational in Charleston.

Building a Top-Notch Finance Team

Establishing a worldwide cadre of qualified financial managers presents a difficult challenge to the CFO. Unlike most other Government agencies, the CFO must manage the dynamics of three personnel systems that include financial management personnel: Foreign Service, Civil Service and Foreign Service Nationals (FSNs). Our primary strategy is to maintain a vigorous and active training program for financial management practitioners. We view the training program as critical -- in implementing new systems, establishing RM as the lead bureau within the Department on financial management issues, and also in ensuring that information in the field is current and authoritative. In 2004, the training program was strengthened to provide overseas customers a full line-up of training opportunities — offering 107 separate courses, for a total of 1,605 training seats available in 14 different locations around the globe. Our training program enjoys customer approval ratings in excess of 90 percent.

THE ROAD AHEAD

Looking ahead, State will continue to achieve fundamental "compliance" results -- on-time financial statements that receive an unqualified ("clean") audit opinion, award winning Performance and Accountability Reports (PAR), and effective financial management and internal control systems. Moving beyond compliance-based results, State management will be able to make decisions based on meaningful financial information to achieve better performance results in the form of lower costs, improved efficiencies and/or improved outcomes for agency mission.

State will also undertake other value added activities that support effective strategic decision-making and mission performance. These activities include:

- **Enhancing management and internal controls.** The Department maintains a robust system of management controls overseen by senior leadership and administered by RM. The Department's strong commitment to management controls has served as a positive catalyst for change and there are no material weaknesses reported under FMFIA or by the independent auditors. Recent events in the private sector have increased concerns related to financial management, and in particular on internal controls. To address these concerns, the Sarbanes-Oxley Act of 2002 establishes new demands for corporate accountability and includes several important sections related to internal controls for public companies. While changes called for by Sarbanes-Oxley are not required for Federal agencies, RM will strengthen the Department's management control program to meet the spirit of the Act -- to improve the completeness, accuracy and transparency of financial reporting and to foster compliance with laws and regulations.
- **Streamlining and consolidating global financial operations.** In FY 2005, State will complete a multi-year effort to consolidate and streamline our worldwide financial operations in our Charleston, South Carolina and Bangkok, Thailand locations.
- **Leveraging best business practices and electronic technologies (E-Gov).** The Department will select and begin implementation of an electronic Travel (eTS) program, beginning with our overseas locations. The program will be piloted at several overseas locations by July 2005. In addition, working with the Department of Agriculture's National Finance Center, State will reach a decision for migrating its current Consolidated American Payroll Processing System (that pays both civil service and foreign service employees).
- **Partnering with other Federal agencies.** The Joint Financial Management System (JFMS) investment is a cooperative effort by the State and the U.S Agency for International Development (USAID) to improve service and save money through collaboration on financial systems and functions. USAID and State are working together to migrate from two separate

financial systems operations that use commercial off-the-shelf (COTS) software and different technical architectures to a common technical environment. The end goal of the JFMS is to create a common financial systems platform for State and USAID to manage all domestic and overseas financial management activities starting in FY 2006.

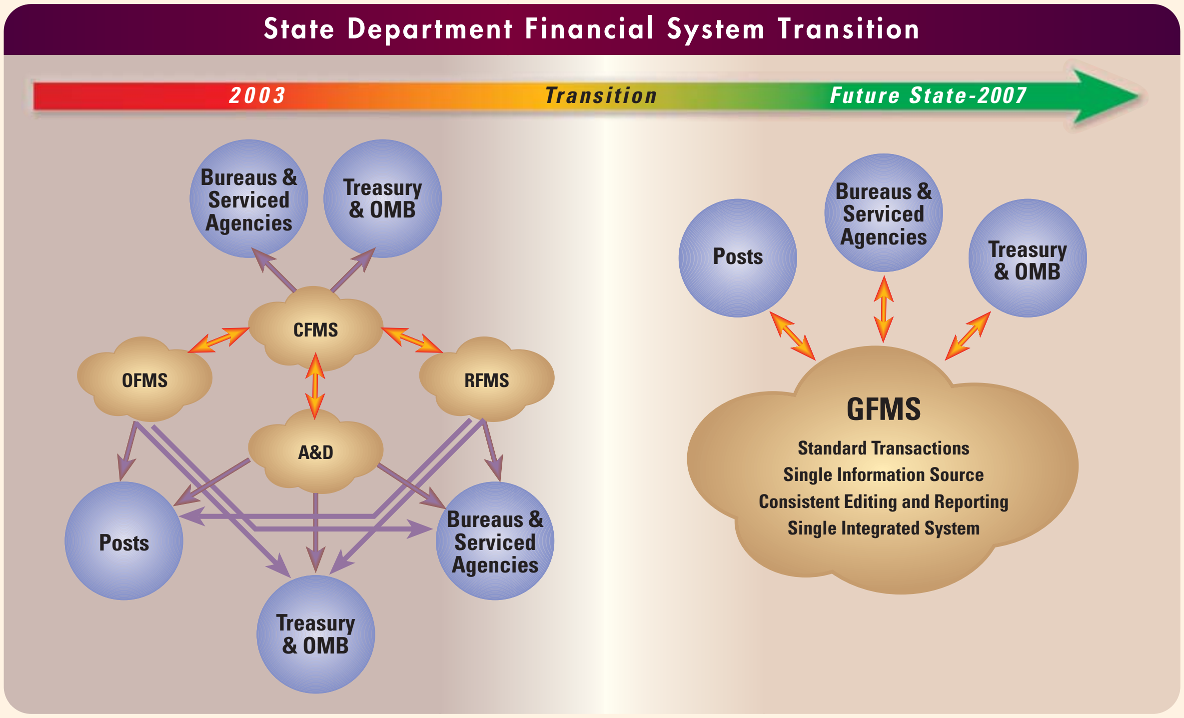
FINANCIAL MANAGEMENT SYSTEMS

IMPLEMENT A GLOBAL FINANCIAL MANAGEMENT SYSTEM (GFMS)

For the past two decades, the Department accounted for its resources through multiple outdated and disjointed legacy financial systems. Some Posts effectively conducted operations through the integration of little more than a collection of Excel spreadsheets. Often, it could take up to 45 days after a financial event occurred for overseas financial data to update the Department's Central Financial Management System (CFMS).

The Global Financial Management System (GFMS) project integrates the Department's overseas and domestic financial operations onto common financial management software platform in Charleston. The GFMS program replaces the Department's 20-year-old overseas systems and legacy mainframe systems with modern open systems technology and COTS software certified by JFMIP. The platform will provide 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. This will dramatically improve operations and reduce costs by eliminating system redundancies and replacing obsolete and unsupported financial systems. It will also provide the infrastructure for integrating other administrative activities within the Department, such as the Integrated Logistics Management System (ILMS).

The diagram below depicts the state of our financial systems at the beginning of FY 2003 and the end state of our global vision for the beginning of FY 2007.



The following implementations will become the Department's Global Financial Management System.

Regional Financial Management System (RFMS)

RFMS is the new global accounting and disbursing system that has been implemented for posts around the world, and the building stone of GFMS. RFMS is comprised of a commercial-off-the-shelf, accounting system for funds management, obligation, and voucher processing, and the RFMS/D disbursing system developed by the Department. The worldwide implementation of RFMS replaced the obsolete Paris Accounting and Disbursing system (mainframe-based) used at FSC Paris and the Overseas Financial Management System (Wang-based) used at FSCs Charleston and Bangkok. RFMS incorporates State's standard account structure and improves transaction standardization and timeliness between RFMS and CFMS, which results in the consistent, timely processing and recording of financial data on a worldwide basis. In addition, the overseas interface was reengineered for RFMS and now provides daily updates of overseas financial transactions to CFMS. These daily updates allow headquarters managers to ascertain the worldwide balance of our accounts on a daily basis, something never before possible.

Merge Overseas Databases

RFMS was implemented with the overseas accounting data recorded into two databases - one located at FSC Charleston and one located at FSC Bangkok. This was a dramatic improvement over the previous situation - six databases in three locations - but it still was time-consuming and inefficient to reconcile data, report on worldwide activities that crossed FSC service regions and provide managers within State as well as our serviced agencies with consolidated financial information. In May 2004, RM successfully merged the two databases into one overseas accounting database residing at FSC Charleston. Now all overseas accounting transactions for both the Department and our serviced agencies are recorded in a single database, and many operational/system activities (e.g. software upgrades, annual close outs, etc.) are performed in one place instead of two. Completion of this effort is also another key step in RM's efforts to integrate and consolidate worldwide financial operations.

Central Financial Management System (CFMS)

CFMS is the Department's primary and central accounting system in Washington. It is a mainframe-based COTS product that will be upgraded to the RFMS-based software for the beginning of FY 2006. Upon completion of this conversion, the Department will have in place a common worldwide core financial management system software platform.

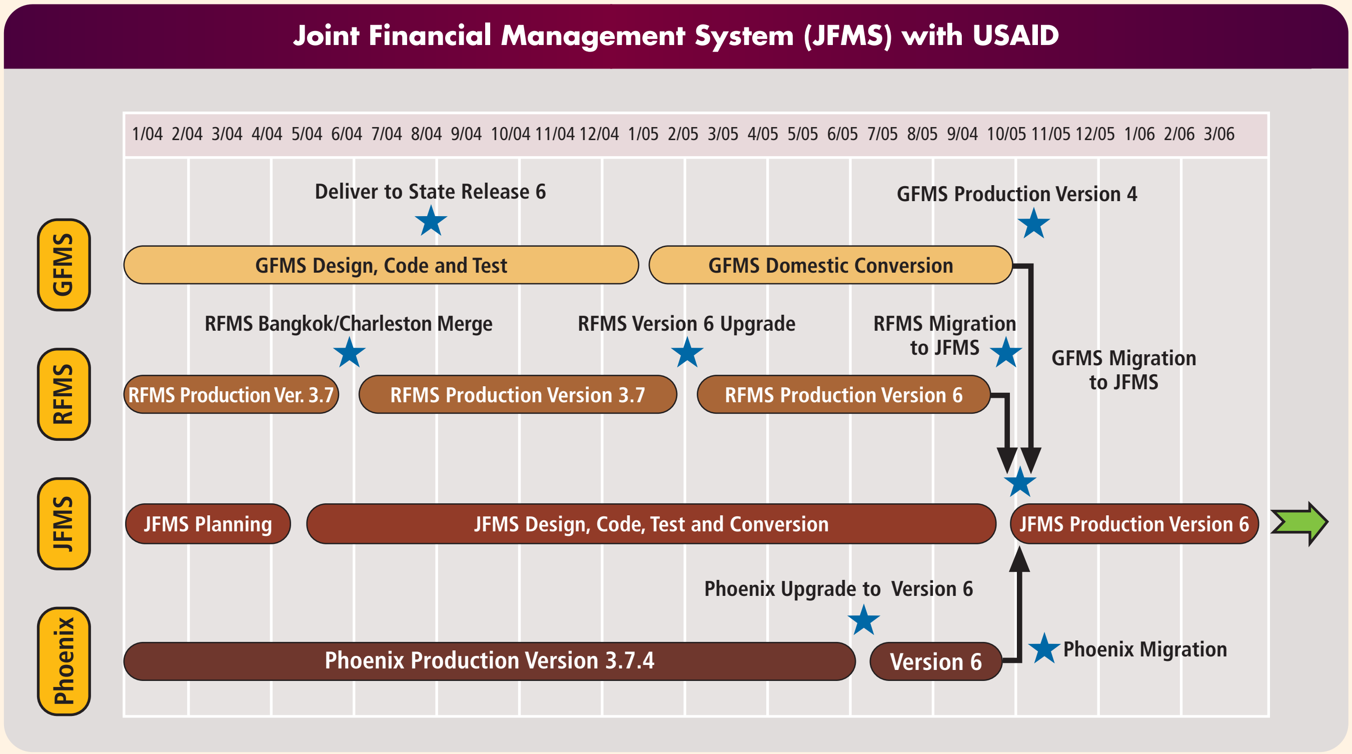
Global Direct Connect

Global Direct Connect will move posts that have operationally practical and reliable network connections (estimated at over 85% of our embassies) from their current batch processing environment to a real time, on line connection with GFMS. Currently, there are 19 posts using Global Direct Connect. Our plan is to complete the movement of posts to Global Direct Connect by no later than the end of FY 2007.

Joint Financial Management System (JFMS) with USAID

The Joint Financial Management System (JFMS) investment is a cooperative effort by the Department of State and the U.S Agency for International Development (USAID) to improve service and save money through collaboration on financial systems and functions. At issue was the pursuit of separate implementations of the same financial system software (AMS' Momentum) when a joint effort would improve efficiency based on economies of scale.

The goal of the JFMS is to create a common financial systems platform for State and USAID to manage all domestic and overseas financial management activities starting in FY 2006. The JFMS investment combines the Department's Global Financial Management System (GFMS) and USAID Phoenix investments onto a common financial management platform.



MANAGMENT OF OBLIGATIONS TO THE DEPARTMENT

DEBT MANAGEMENT

Outstanding debt from non-Federal sources (net of allowances) increased from $21.3 million in 2003 to $55.9 million in 2004. Refer to Notes to the Principal Financial Statements, Note 6, for an analysis of Accounts Receivable balances. Non-Federal receivables consist of debts owed to the International Boundary and Water Commission, and amounts owed for Repatriation Loans, medical costs, travel advances, proceeds from the sale of real property, and other miscellaneous receivables.

Of the delinquent receivables over 365 days old, the majority ($5.2 million) is for the Repatriation Loan Program. These are loans given to destitute American citizens stranded overseas to allow them to return to the United States. The loans are given only if the individual cannot obtain funds from relatives, friends, employers, or another source. The Department acts as the lender of last resort. The loan becomes delinquent 60 days after repatriation to the United States. Due to their poor economic situation, most of these individuals are unable to repay the loans on time.

The Department uses installment agreements, salary offset, and restrictions on passports as tools to collect its receivables. It also receives collections through its cross-servicing agreement with the Department of the Treasury. In 1998, the Department entered into a cross-servicing agreement with the Department of the Treasury for collection of delinquent receivables. In accordance with the agreement and the Debt Collection Improvement Act of 1996 (Public Law 104-134), the Department referred $261,322 to Treasury for cross-servicing in 2004. *The 2002 first quarter anthrax related U.S. mail disruptions affected the Department's ability to receive payments and to provide debtors proper due process notification. Thus, the Department was unable to refer debts to Treasury for most of 2002*. Of the current and past debts referred to Treasury, $176,120 was collected in 2004.

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

	FY 2004	FY 2003	FY 2002
Number of Accounts	253	927	177
Amounts Referred (In Thousands)	$ 261	$960	$194

FEDERAL CIVIL PENALTIES INFLATION ADJUSTMENT ACT

The Federal Civil Penalties Inflation Adjustment Act of 1990 established annual reporting requirements for civil monetary penalties assessed and collected by Federal agencies. Civil penalties are defined as any non-criminal penalty, fine or other sanction for which a given dollar amount or maximum amount is specified by Federal law, and that is assessed or enforced by an agency as a result of an administrative proceeding or civil action in the Federal courts. The Department has assessed fines on individuals and companies for exporting defense materials without required approvals and for misrepresenting facts on export applications.

COMPANY NAME	VIOLATION	DATE ASSESSED	AMOUNT ASSESSED	PAYMENT SCHEDULE
LOCKHEED MARTIN CORPORATION	Exporting defense articles and defense services in violation of the terms or conditions of other approvals that were provided by the Department, making proposals for the transfer of defense services, and by omitting material facts from export license applications	6/13/2000	$8,000,000	$1,500,000 for four years and $2,000,000 due in year five
BOEING COMPANY	Violating the items and conditions of the Department's munitions licenses, exporting defense articles and services without a munitions license and omitting material facts from its applications for munitions licenses	3/30/2001	$3,800,000	$1,000,000 for three years and $800,000 in year four
SPACE SYSTEMS/LORAL, INC.	Violating the express terms and conditions of the Department's munitions licenses and exporting defense services without a munitions license or other authorization to the People's Republic of China	1/9/2002	$14,000,000	$2,200,000 initially, then $1,685,714 for seven subsequent years
HUGHES ELECTRONICS CORP. & BOEING SATELLITE SYSTEMS	Violating the terms and conditions of the Department's munitions licenses and exporting defense services without munitions licenses or other authorizations (and conduct relating to two failed launches of rockets carrying spacecrafts) to the People's Republic of China	3/4/2003	$12,000,000	$1,500,000 for eight years
MULTIGEN-PARADIGM, INC.	Exporting defense articles and services (software) without munitions licenses or other authorizations to the People's Republic of China, India, Israel, Singapore, Australia, South Korea, Taiwan, France, Japan, Canada, Czech Republic, Italy, Spain, United Kingdom, Sweden and Peru	9/25/2003	$250,000	—
EDO Corporation	Violations incurred by Condor Systems, Inc. prior to the acquisition of business assets by EDO that included the terms and conditions of the Department's munitions licenses and exporting defense services without munitions licenses or other authorizations	11/24/2003	$1,750,000	$583,334 initially, then $583,333 for two years
TOTAL			**$39,800,000**	

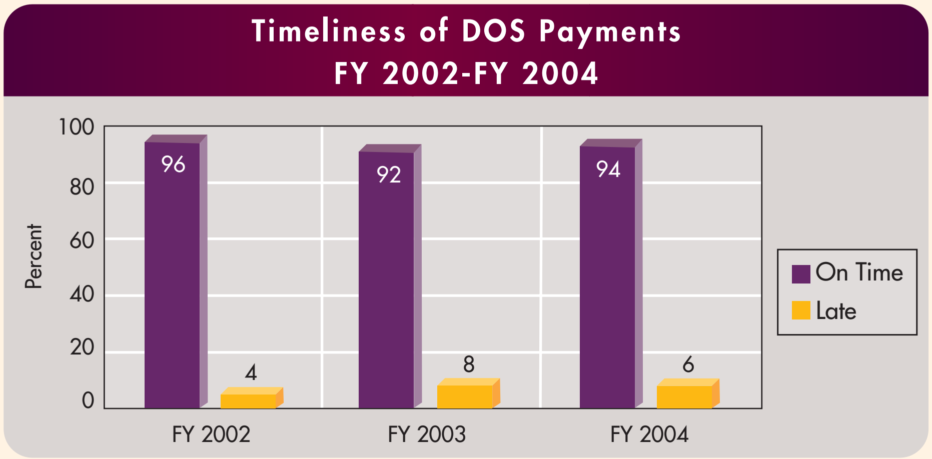
COMPANY NAME	Balance Outstanding September 30, 2003	Fiscal Year 2004 Assessments	Fiscal Year 2004 Collections	Balance Outstanding September 30, 2004
LOCKHEED MARTIN CORPORATION	$ 2,000,000	—	$ 2,000,000	—
BOEING COMPANY	$ 800,000	—	$ 800,000	—
SPACE SYSTEMS/LORAL, INC.	$ 10,114,286	—	— (Chapter 11 Bankruptcy granted January 2004)	$ 10,114,286
HUGHES ELECTRONICS CORP. & BOEING SATELLITE SYSTEMS	$ 10,500,000	—	$ 1,500,000	$ 9,000,000
MULTIGEN-PARADIGM, INC.	$ 250,000	—	$ 250,000	—
EDO Corporation	—	$ 1,750,000	$ 583,334	$ 1,166,666
Total	**$ 23,664,286**	**$ 1,750,000**	**$ 5,133,334**	**$ 20,280,952**

MANAGEMENT OF PAYMENTS

PROMPT PAYMENT ACT

TIMELINESS OF PAYMENTS

The Prompt Payment Act (PPA) requires Federal agencies to pay their bills on time or an interest penalty must be paid to vendors. During FY 2004, 94% of invoices were paid on time. Presented below is a chart that reflects the timeliness of the Department's payments from FY 2002 through FY 2004.



During FY 2004, 2% of invoices required interest penalties compared to 3% for FY 2003.

SELECTED PAYMENT DATA

	2004	2003	2002
Interest Paid ($000)	431	396	443
Interest Under $1 Not Due ($000)	—	—	4
Interest Due But Not Paid ($000)	—	—	—
Number of Procurement Card Transactions			
Domestic	61,838	57,312	53,379
Overseas	66,416	112,766	46,297

ELECTRONIC PAYMENTS

The Department successfully increased the percentage of payments it makes electronically. In 2004, 80% of all payments were made by electronic funds transfer (EFT). Domestically, 96% of payments were made electronically. The Department processed 67% of its 2003 overseas payments by EFT, a 2% increase from 2003.

EFT and Check Payment Volumes

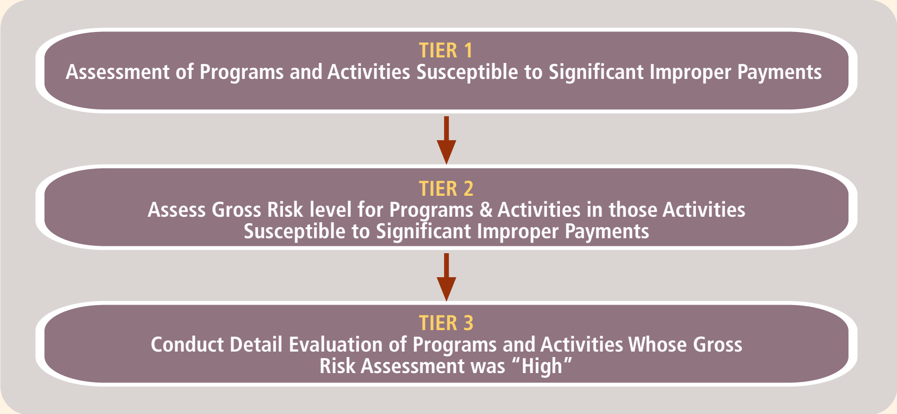
	2004		2003		2002	
Payment Type	**Number**	**Percent**	**Number**	**Percent**	**Number**	**Percent**
EFT:						
Domestic	981,427		1,248,335		1,210,054	
Overseas	885,623		988,329		841,050	
EFT Subtotal	1,867,050	80	2,236,664	79	2,051,104	77
Checks:						
Domestic	26,012		47,043		56,668	
Overseas	440,394		531,046		560,026	
Checks Subtotal	466,406	20	578,089	21	616,694	23
Total Payments	**2,333,456**	**100**	**2,814,753**	**100**	**2,667,798**	**100**

IMPROPER PAYMENTS INFORMATION ACT

The Improper Payments Information Act of 2002 (Public Law No.107-300) (IPIA) requires agencies to annually review their programs and activities to identify those susceptible to significant improper payments. OMB Memorandum M-04-20, *FY 2004 Performance and Accountability Reports and Reporting Requirements for the Financial Report of the United States Government,* requires a brief summary of actual and planned accomplishments towards implementing the IPIA, which is presented in the Management's Discussion and Analysis section of this Report. OMB also requires more detailed information relating to IPIA, which is provided below.

Risk Assessment Procedures and Processes.

For the identification and determination of significant improper payments, the Department has implemented a three-tier approach as follows.



The first tier identifies the types of payments made by the Department. The second tier assesses the risk of these types of payments. The final tier relates to the testing of a sample of transactions for the payment classifications considered high-risk for significant improper payments and the identification of corrective actions needed to prevent and detect improper payments.

TIER 1- PROGRAM ASSESSMENT. The first tier provides an initial assessment of payments made at the object class level (e.g., payroll, travel, contracts, federal financial assistance). Payments are grouped into three categories: employee pay such as payroll, benefits and travel, vendor payments, and federal financial assistance, such as grants. These three payment groups are assessed for susceptibility to significant improper payments. This assessment is based on the institutional knowledge of the payment process for each type, as well as information contained in recent reports issued by the Office of Inspector General (OIG) and independent auditor's reports. As a result of this assessment, two types of payment were identified as having a potential high risk for significant improper payments—Federal Financial Assistance Programs and Vendor Pay.

TIER 2- GROSS RISK ASSESSMENT. The second tier provides an assessment of gross risk for programs and activities that have federal financial assistance and vendor payments by bureau, and by specific programs within a bureau. The assessment consists of a review of controls, policies and procedures for the individual programs, and interviews with personnel familiar with these programs. Based on this assessment, individual federal financial assistance programs and vendor payment categories are assigned a rating of high, moderate or low risk of having significant improper payments.

TIER 3 - DETAILED EVALUATION OF HIGH-RISK PROGRAMS. The third tier involves detailed testing of the individual federal financial assistance and vendor payment categories classified as highly susceptible to improper payments. Testing is conducted based on a statistical sample to determine if the transactions are proper. Improper transactions are reported as an error. Total errors are then statistically projected to the population.

Preliminary List of High-Risk Programs

Based on the risk assessment conducted in Tier Two, the following programs were considered at high-risk for significant improper payments during FY 2002 when our initial assessments were performed.

Federal Financial Assistance

- International Information Program (IIP) – U.S. Speaker and Specialist Program
- Population, Refugee and Migration (PRM) – Refugees Assistance Programs
- PRM – Contributions to International Organizations
- Education and Cultural Affairs (ECA) – Fulbright Program
- ECA – Citizen Exchange Program
- International Narcotics and Law Enforcement (INL) – Narcotics Program
- Assistance to Overseas Schools

Vendor Pay

- Other Contractual Services
- Structures and Equipment

Based on these assessments, the Department began reviews of the high-risk programs using FY 2002 payment data. The first review was conducted on PRM—Contributions to International Organization. Lessons learned from this review and additional information obtained as part of the Department's IPIA implementation efforts in FY 2004, led to a reassessment of programs with a high-susceptibility of improper payment. The results of this reassessment are as follows:

- **PRM** - Contributions to International Organizations was reassessed as moderate risk based on our FY 2003 IPIA review. We found no improper payments in the program. We plan to review this program again in FY 2005.

- **PRM** - Refugees Assistance Program was lowered to a moderate risk. This program provides $800 million in contributions to International Organizations that participate in refugee services. We reviewed payments to two International Organizations that receive approximately 80 percent of the program's funds and found no exceptions. This program will be reviewed in FY 2005.
- **ECA** - Citizen Exchange Program was lowered to a moderate risk because FY 2004 expenditures decreased to less than $20 million.
- **ECA** - Fulbright Program is still considered as a high-risk program. Supporting documentation has been requested from grantees and sub-grantees but it is not yet available. This information will be collected and analyzed in FY 2005.
- Assistance to Overseas Schools Program was lowered to moderate risk because its FY 2004 expenditures of $9 million dollars were below the $10 million threshold.

Revised List of High-Risk Programs

The following programs were tested for potential improper payments in FY 2004:

Federal Financial Assistance Area

- IIP – U.S. Speaker and Specialist Program
- INL – Narcotics Program

Vendor Pay Area

- Other Contractual Services

Structures and Equipment remain a type of payment susceptible to significant improper payments. This area will be tested during FY 2005.

Statistical Sampling Process

The federal financial assistance programs were grouped into three different populations based on the type of assistance being provided. Using OMB guidance, the Department assumed a 2.5% or less rate of error for each of the programs sample since the Department had no historical error rate to use in calculating the sample sizes of the different populations. Listed below are the three populations and anticipated error rate.

Program	Anticipated Error Rate
Federal Financial Assistance:	
IIP - U.S. Speaker and Specialist Program	2.5% or less
INL-Narcotics Program	2.5% or less
Vendor Payments – Other Contractual Services	2.5% or less

Results

Based on the Department's testing of sampled transactions, the actual error rate and the amount of error were determined to be low with the exception of the IIP-U.S. Speakers and Specialist Program. This program advances America's interests by informing and influencing international publics about U.S. policy and society. IIP sends out nearly a thousand speakers annually to discuss with foreign audiences issues identified by U.S. embassies. Participants in this program have not been required to complete and submit vouchers at the completion of their travel making most travel reimbursement payments "improper" under IPIA. Travel reimbursement payments under this program are high in volume yet small in terms of dollars. As a result, the improper payment error rate for this program is high at 81.18%, while the estimated amount of improper payments is low at $1.4 million, which is less than the $10 million statutory and regulatory definition of significant improper payments. Refer to the table under Improvement Targets for actual FY 2004 sample results.

Future Corrective Action

The potential for the Department making improper payments is low based on preliminary risk assessments and the FY 2004 review of high-risk programs, except for IIP's U.S. Speaker and Specialist Program where the error rate was high. IIP is planning to modify its policies and procedures to ensure that adequate documentation is generated and retained to support travel expenses in accordance with Department standards. These changes also will include training for administrative officers and regional bureau and post personnel involved with this program.

Program (Dollars in Millions)	First Nine Months FY 2004			Projected FY 2005		Projected FY 2006		Projected FY 2007	
	Outlays	IP %	IP $	Outlays	IP %	Outlays	IP %	Outlays	IP %
Federal Financial Assistance Prgrams									
INL-Narcotics Program	$ 313	0.87%	$ 1.7	$434	<1%	$451	<1%	$469	<1%
IIP-U.S. Speaker and Specialist Program	$ 30	81.18%	$ 1.4	$40	70%	$41	35%	$41	5%
Vendor Payments									
Other Contractual Services	$ 1,534	2%	$ .78	$2,363	2%	$2,457	2%	$2,556	2%

Audit Recovery Program

A key part of the Department's program to identify improper payments is to recover amounts erroneously paid. During the fourth quarter of FY 2004, the Department obtained the services of a contractor to perform recovery audits. Under contingency-based contract, the contractor is paid based on a percentage of the amount of erroneous payments identified and successfully collected. A work plan detailing the scope of this effort is currently being developed with audit recovery work expected to begin in FY 2005.

Accountability

The Department is committed to reducing erroneous payments issued domestically and overseas. Programs and procedures have been instituted that will strengthen agency management and internal control procedures for prevention, detection and recovery of erroneous payments. The following improvements are being undertaken:

- Issue updated guidance for performing program reviews and risk assessments
- Strengthen payment and debt management programs polices and practices that will improve detection, referral and recovery efforts
- Report information on improper payments in the annual Performance and Accountability Report, starting with this Report.

Issues

In implementing the IPIA, the Department identified several potential opportunities to use the Single Audit Act (PL104-056), as amended, to assist in implementing the IPIA. For instance, if auditors conducting single audits projected error rates for each of the federal assistance programs tested at the grantee-level, agencies could rely more extensively on that process to implement the IPIA.

The Department also experienced difficulty in FY 2004 obtaining supporting documentation for grantee expenditures. We are working to develop a contemporaneous sampling plan for FY 2005 whereby grant payments will be selected for sampling throughout the year as draw-downs are processed.

State is not providing targeted reductions in over and underpayment at this time. This is State's first improper payment review and it was limited to only certain high-risk programs. Because of this limited information we feel that we could not provide a meaningful target estimate on the reduction of over and underpayments. In FY 2005, with improvements made in the Department's IPIA program, we plan to provide this type of information.

The Department of State Charleston Financial Service Center.
Department of State Photo

MANAGEMENT OF AUDIT FOLLOW-UP

The information on the Department's follow-up on audit recommendations covers 2004. It includes information on the status of recommendations more than one year old without final management decisions, and the dollar value of those reports in which funds could be put to better use or costs could be disallowed.

During 2004, the Department of State tracked 17 audit reports that were more than one year old and included a total of 61 recommendations in which final action was not taken, which would have brought closure to the reports. These audits contain over $110,851 in disallowed costs. The Department is working to bring closure to the 17 audits and recognizes that the follow-up actions and compliance to the recommendations are essential to improving the effectiveness and efficiency of program operations.

Management Statistical Summary
17 Audits Over One Year Old Requiring Final Action

Program Area	Number of Audit Reports	Recommendations
Financial Management	10	45
Information Management	3	12
Security Oversight	1	1
Support Programs	1	1
Property Management and Procurement	1	1
Contracts and Grants	1	1
TOTALS	**17**	**61**

Status of Audits with Recommendations that Funds Be Put to Better Use

On October 1, 2003, there were no audits with recommendations to put funds to better use and there was no activity during the year. The balance on September 30, 2004 remained at zero.

Status of Audits of Disallowed Costs

On October 1, 2003, there were three audits with management decisions on which final actions had not been taken with a dollar value of disallowed costs totaling $10,581,619. During the year, these three audits were resolved and one audit was completed that included disallowed costs of $110,851. Therefore, the resulting balance on September 30, 2004 was $110,851.

Funds Put to Better Use and Disallowed Costs in Audit Reports

	Number of Audit Reports Identifying Amount of Funds Put to BetterUse	Amount of Funds Put to Better Use	Number of Audit Reports Identifying Disallowed Costs	Disallowed Costs
Beginning Balance	-	$ -	3	$ 10,581,619
New Audits	-	-	1	110,851
Implemented Actions	-	-	(3)	(10,581,619)
Ending Balance	-	$ -	1	$ 110,851

Ribbon cutting ceremony from the dedication of the Department's Charleston Financial Service Center on June 28, 2004. Pictured are Grant Green, Jr., Under Secretary for Management; Senator Fritz Hollings (SC); Jim Millette, Deputy Assistant Secretary Global Financial Services; and Christopher B. Burnham, Assistant Secretary for Resource Management and Chief Financial Officer.

INTERESTING HISTORICAL NOTES

Diplomacy's Best Deal

In 1803, two U.S. diplomats, American Minister to France Robert Livingston and Special Negotiator James Monroe, concluded the largest real estate transaction ever when they secured the entire territory of Louisiana for the United States. Although Livingston and Monroe exceeded the orders of President Thomas Jefferson—and their spending limit—the deal was too good to pass up. As Livingston reported, the French Treasury Secretary urged him to "Consider…the importance of having no neighbors to dispute you, no war to dread." The Americans did, and two weeks later on April 30, 1803, the French agreed to sell the entire territory for the bargain price of $15 million.

Diplomacy and the Telegraph

At the end of the Civil War in 1865, diplomatic reports to and from our missions abroad moved at the pace of ships crossing the ocean. But everything changed the following year with the completion of the transatlantic cable linking the United States and Europe. Just a few months later, the Department of State established a telegraphic office to handle the important new messages. Although diplomats learned to write more concisely, the Department warned that it was expensive and not to be used "except when justified by the importance and urgency of the case…" Diplomats took the message to heart and trimmed their prose accordingly. In 1881, the U.S. Minister to Russia, John W. Foster, earned the distinction of sending the shortest diplomatic dispatch. "Emperor Dead," he wrote. No one since has crafted a more concise cable.