United States Department of State

Performance and Accountability Report
Fiscal Year 2006

Transforming the World through Diplomacy and Development

The U.S. Department of State offers *The Performance and Accountability Report for Fiscal Year 2006* in four products:

- *The Performance and Accountability Report (PAR):* the full report of the Department's annual performance results and financial statements, available on the internet and the PAR CD;
- *The PAR Highlights:* a summary version of the PAR, available on the internet and printed for worldwide distribution;
- *The PAR Brochure:* an eight-page, high-level overview of the PAR, printed for worldwide distribution;
- *The PAR CD:* an interactive CD featuring the full PAR, Department publications and relevant reports, maps, a photo gallery and more.

For copies or to comment on the PAR, please visit *www.state.gov* or contact the U.S. Department of State's Bureau of Resource Management at *PAR@state.gov* or 202-647-0300. The mailing address is: 2201 C Street NW Room 3800, Washington, D.C. 20520.

United States Department of State

Our Mission

Create a more secure, democratic, and prosperous world for the benefit of the American people and the international community.

Our Values

Loyalty

Commitment to the United States and the American people.

Character

Maintenance of high ethical standards and integrity.

Service

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

Accountability

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

Community

Dedication to teamwork, professionalism, and the customer perspective.

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MESSAGE FROM THE SECRETARY

I am pleased to present the U.S. Department of State's Performance and Accountability Report (PAR) for Fiscal Year 2006. American taxpayers are right to expect maximum performance and maximum return on every dollar spent to support U.S. foreign policy and development programs. The PAR provides the financial and performance information Americans deserve as investors in U.S. diplomacy and overseas development.

The Department of State's mission is to create a more secure, democratic, and prosperous world for the benefit of the American people and the international community. President Bush and I have called on America's diplomats to pursue this mission with a bold approach, one that answers the President's charge to support the growth of democratic movements and institutions in every nation and culture with the ultimate goal of ending tyranny in the world. Early on in my tenure as Secretary of State, I called this approach "transformational diplomacy." I am proud to share through this report the innovative, skillful and courageous ways the men and women of the Department of State are bringing this practice to life.

The Transformational diplomacy is about working with our partners around the world to build and sustain democratic, well-governed states that will respond to the needs of their people and conduct themselves responsibly in the international system. It is about using America's diplomatic power and resources to help people across the globe better their own futures, build their own nations, and thrive under an umbrella of security and peace.

As detailed in this report, the Department's work in FY 2006 involved increasingly difficult and dangerous missions, rebuilding operations in Iraq and Afghanistan, expanded reconstruction and stabilization roles, and managing a global presence of more than 260 embassies, consulates and other posts worldwide. We remain engaged in a long conflict against terrorists and violent extremists, but our diplomatic actions over the past year played a vital role in protecting the nation and our allies against this threat. We strengthened relationships with traditional allies and built new partnerships to combat threats to our common security, including the spread of weapons of mass destruction. Most importantly, we continued to work directly with citizens around the world who wish to build free societies based on democratic principles and hope.

The successes we achieved in FY 2006 are strides toward a future of expanded freedom, greater security, sustainable development, and increased diplomatic strength. To realize the President's vision of freedom across the world, the Department is transforming itself and its practices through a series of transformational diplomacy initiatives. For example, we are forward-deploying our people to the cities, countries, and regions where they are needed most. Through the first two phases of Global Diplomatic Repositioning, we have successfully redirected 200 positions to work directly on transformational priorities in strategic countries like China, India,

Nigeria, and Indonesia to name a few. We are giving our diplomats more comprehensive training, including in critical language skills, to engage more effectively with local populations and better communicate America's message overseas.

With the creation of the Office of the Director of U.S. Foreign Assistance, we have fundamentally reorganized the way we plan, budget and manage foreign assistance to increase transparency, accountability, integration, and focus. Our new process establishes clear strategic direction and priorities for foreign assistance. This reform will transform our capability to use foreign assistance more efficiently and more effectively to further our foreign policy goals, bolster our national security, reduce poverty, and improve people's lives around the world. Our effort to improve how foreign assistance dollars are managed and spent reflects the Department's long-standing commitment to being effective and accountable stewards of taxpayer dollars. The high-quality performance data we share with the public and Congress through the PAR, are made possible by a dedicated team of officers working domestically and overseas to support the Department's financial operations, policy and program implementation, and performance and accountability reporting.

My leadership team and I, including Chiefs of Mission overseas, value performance planning as a key component of transformational diplomacy. Performance plans help us maximize the return on resources entrusted to us and show Americans how investing in transformational diplomacy pays dividends, at home and abroad. As our foundation, the Department and the U.S. Agency for International Development (USAID) operate under a joint Strategic Plan that captures and articulates U.S foreign policy objectives shared by both agencies. Close collaboration between State and USAID on setting a long-term strategic vision ensures that foreign policy priorities and assistance programs are fully aligned. By doing so, the Strategic Plan promotes an organizational culture within the Department of State and USAID that values effectiveness and accountability.

The Department of State and USAID work together to meet the global diplomatic and development challenges of the twenty-first century. In this spirit, this report provides a complete and reliable account of the Department's FY 2006 performance results and financial statements, as well as for the first time ever, performance information on select initiatives and programs managed by USAID. In this critical moment in history, the men and women of the Department and USAID are engaged in an extraordinary partnership to transform our world for the better through diplomacy and development. Americans have every reason to be proud, as I am, of their service to secure a future of freedom for all people.

Condoleezza Rice

Secretary of State

November 15, 2006

MESSAGE FROM THE CHIEF FINANCIAL OFFICER

The Performance and Accountability Report for Fiscal Year 2006 (Report) provides meaningful stewardship, program and financial information about the Department of State. Publication of the Report is an integral part of our efforts to improve our accountability to our customers, constituents, and the public. It is our opportunity to review in a comprehensive manner, the many challenges we face today around the globe and what the Department is doing to address them. As you read the Report, you will learn of the exceptional accomplishments of the Department's highly dedicated staff as they seek to meet to the Department's mission to "create a more secure, democratic and prosperous world for the benefit of the American people and the international community".

For the past six years, the President has challenged us to meet rigorous performance standards through the President's Management Agenda (PMA). The Department of State is committed to achieving the goals of the PMA, as evidenced by "green" status scores on the scorecard for all five USG-wide Presidential initiatives at the end of FY 2006. This is a significant accomplishment considering the challenging nature of conducting business in our global, foreign affairs environment. In addition, the Department has demonstrated innovation and leadership in performance management by streamlining performance systems, sharing lessons learned, and working together with other foreign affairs agencies to manage for results.

Very few agencies or corporations have the level of complexity and variety of challenges that the men and women of the Department face daily. The Department operates in over 260 locations in 188 countries, frequently in hostile environments, while conducting business in 150 currencies and an even larger number of languages. Thousands of financial professionals around the globe plan, budget, allocate, obligate, disburse, and account for billions of dollars in annual resources. Despite our worldwide geographic dispersion, the Department operates as one team distinguished by its dedication to strong ethics and corporate governance.

Our strong commitment to corporate governance is evidenced by the priority we place on improving our internal controls. To that end, we made considerable progress in 2006, working closely with the Independent Auditor to address the material weaknesses in accounting for personal property and information systems security reported in their FY 2005 *Independent Auditor's Report*. As a result, the Independent Auditor downgraded these items to a reportable condition, and reported no material weaknesses in internal controls in their FY 2006 *Independent Auditor's Report.* In addition, the Department committed to, and fully implemented, the requirements of Appendix A, Internal Control over Financial Reporting, of OMB Circular A-123. During the implementation of Appendix A, we identified a material weakness related to accounting for real property, and took actions to resolve the deficiencies by September 30, 2006.

Unfortunately, due to the complexity of the matters involved in addressing the real property deficiencies, the accelerated financial reporting requirements, and our commitment and focus to successfully resolve the material weaknesses noted above, we were unable to provide timely financial statements or documentation on the appropriateness of the associated restatement to satisfy the Independent Auditor with regard to the presentation of real property in time for this Report. As a result and as more fully explained in the *Independent Auditor's Report*, the Independent Auditor issued a disclaimer of opinion on our FY 2006 and restated FY 2005 financial statements. We will work with the Independent Auditor on this issue until such time as they can satisfy themselves as to the amounts presented as real property, and other accounts as necessary.

The scale and complexity of the Department's missions that demand effective financial management and control have grown exponentially since 9/11, making the need for more effective financial management even more pronounced. Operating in this environment of expanding mission requirements and significant Federal budget deficits, the pressure to operate more efficiently and reduce costs has never been greater. The hallmark of top financial operations is their ability to not only provide accurate and timely financial data but also to use that data and expertise to provide high-value financial advice to the key decision-makers. The Bureau of Resource Management has built the foundation of solid budgeting and reporting; our mission going forward will be to combine this strong financial information base with a high level of financial advisory expertise as a strategic partner to the Secretary and the Bureaus, to ensure that the Department obtains maximum results from its funding. Congress and the American people should expect nothing less.

Bradford R. Higgins
Assistant Secretary for Resource Management and Chief Financial Officer
November 15, 2006

ABOUT THIS REPORT

The U.S. Department of State's *Performance and Accountability Report for Fiscal Year 2006* (PAR) provides program results and financial information to help Congress, the President, and the public assess the Department's performance relative to its mission and stewardship of financial resources. The PAR also provides readers a sense of the U.S. Government's highest priorities in the conduct of U.S. foreign policy, and the Department's strengths and challenges in implementing programs that pursue the President's foreign policy agenda.

As part of the Department's annual planning cycle, the Department sets specific, outcome-oriented, measurable criteria for self-evaluating its performance under a strategic framework established in the Department's joint Strategic Plan with USAID. The FY 2006 PAR reports on the Department's successes, performance shortfalls and management challenges as measured against the FY 2006 Performance Plan, which the Department developed jointly with the U.S. Agency for International Development (USAID.) The PAR also provides the Department's FY 2006 financial statements and other information pertaining to the Department's financial management.

The PAR satisfies reporting requirements under the following legislation:

- Federal Managers' Financial Integrity Act of 1982
- Chief Financial Officers Act of 1990
- Government Performance and Results Act of 1993
- Government Management Reform Act of 1994
- Reports Consolidation Act of 2000
- Improper Payments Information Act of 2002

The Joint Performance Section

The PAR's Performance Section, developed jointly with USAID, is organized to provide easily accessible, results-oriented performance information on select measures published in the Department and USAID's FY 2006 Joint Performance Plan. Performance measures reported in the PAR are owned and managed separately by the Department of State and USAID. Information on resources invested to achieve the joint strategic goals of the Department of State and USAID was derived from the FY 2007 International Affairs Budget Request (*www.state.gov/s/d/rm/rls/iab/2007/html/60199.htm*) and the FY 2006 Department of State and Foreign Operations appropriations acts (*http://thomas.loc.gov/home/approp/app06.html*). See the Introduction to the Joint Performance Section for more details.

DEPARTMENT OF STATE HISTORY

Why is it called the Department of State?

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

These included:

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

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

Who was the first U.S. Diplomat?

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

When was the first U.S. treaty signed?

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

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

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

Management's Discussion and Analysis

This section provides: a summary of FY 2006 performance results for Department of State and USAID performance measures; a brief analysis of the Department's financial performance, systems, controls, and legal compliance; and information on the Department's progress in implementing the President's Management Agenda. The MD&A also addresses the management challenges identified by the Inspector General. The MD&A is supported by detailed information contained in the joint Performance Section, Financial Section, and Appendices.

MISSION AND ORGANIZATION

MISSION

Create a more secure, democratic, and prosperous world for the benefit of the American people and the international community.

OUR ORGANIZATION

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

State Department/Ann Thomas

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

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

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

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

The Department operates national passport centers in Portsmouth, New Hampshire and Charleston, South Carolina; a national visa center in Portsmouth, New Hampshire and a consular center in Williamsburg, Kentucky; two foreign press centers; one reception center; 13 passport agencies; five offices that provide logistics support for overseas operations; 20 security offices; and two financial service centers.

OUR PEOPLE

In the business of diplomacy, people are critical. The Department's success in achieving its mission is directly tied to the creativity, knowledge, skills and integrity of our dedicated team of employees. The Department's Foreign Service, Civil Service and Foreign Service National employees serve at Headquarters, embassies, consulates, and other posts around the world. Our employees are committed to carrying out the President's foreign policy agenda and to sharing American values with the world.

Secretary Rice announces a new direction for U.S. Foreign Assistance, January 2006 State Department photo

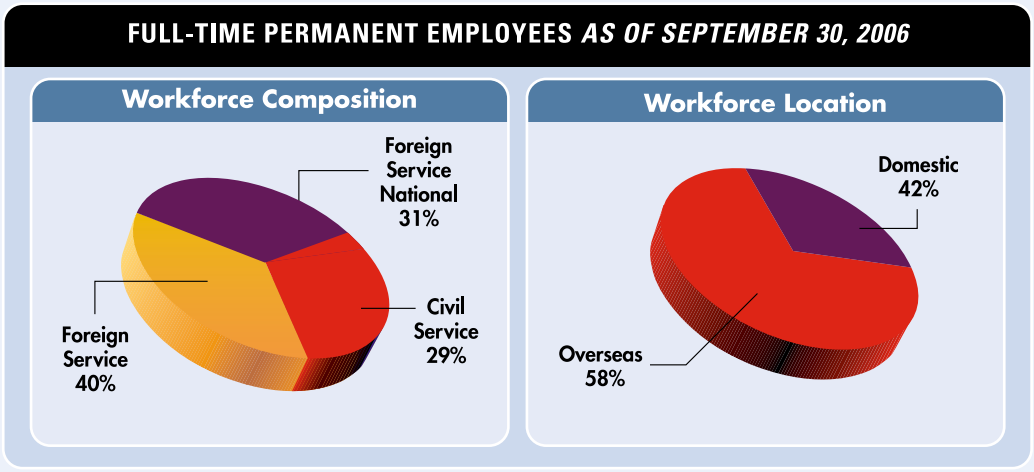
The Foreign Service and the Civil Service in the Department of State and U.S. missions abroad represent the American people. They work together to achieve the goals and implement the initiatives of American foreign policy. The Foreign Service is a corps of over 11,000 employees. Foreign Service Officers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

The Department's Civil Service corps, totaling over 8,000 employees, provides continuity and expertise in accomplishing all aspects of the Department's mission. Civil Service officers, most of whom are headquartered in Washington, D.C., are involved in virtually every policy area of the Department – from democracy and human rights to narcotics control, trade, and environmental issues. They are also the domestic counterpart to consular officers abroad, issuing passports and assisting U.S. citizens overseas.

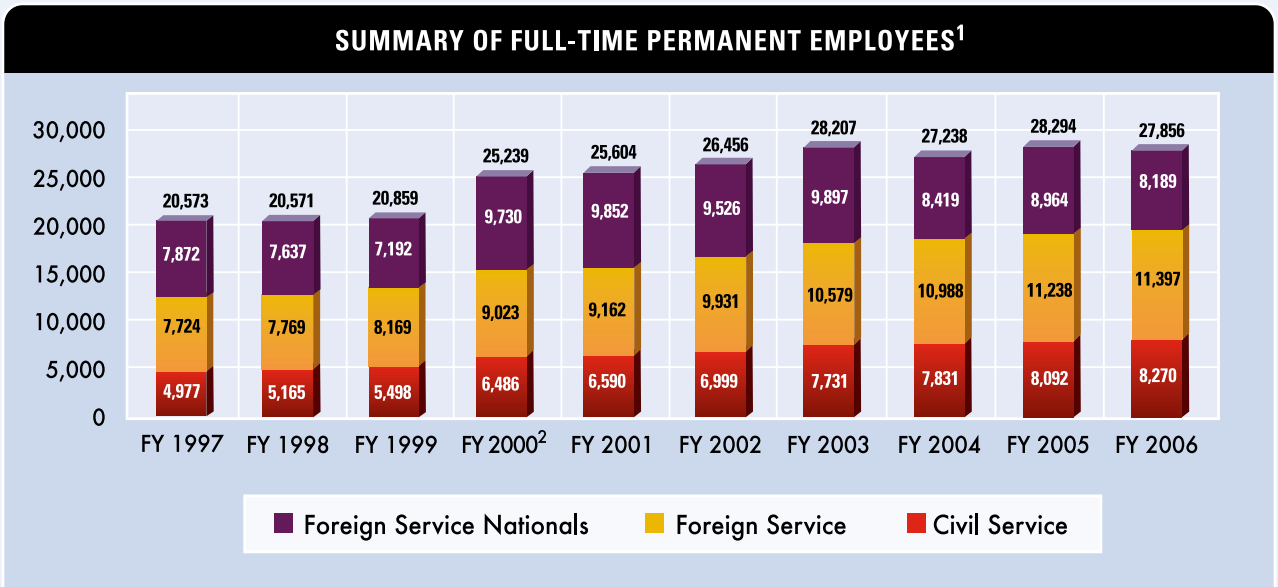
Foreign Service National (host country) employees contribute to advancing the work of the Department overseas. These essential employees contribute local expertise and provide continuity as they work with their American colleagues to perform vital services for U.S. citizens and ensure the effective operation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

EMPLOYEE COMPOSITION AND NUMBERS

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



Since FY 1997, the total number of employees at the Department has increased by 39%, with the greatest increase shown in the Department's Civil Service staff (66%). The Foreign Service staff has increased by 48% over the past decade and the Foreign Service National staff has grown by 4%. This expansion reflects the Department's increased emphasis on security, public diplomacy, counterterrorism, and management reforms.



[1] *These numbers do not include FSNs employed under personal service agreements or as personal service contractors.*
[2] *Reflects integration of employees of the United States Information Agency (USIA) and the Arms Control and Disarmament Agency (ACDA).*

DIRECTORY OF KEY OFFICIALS AND SENIOR MANAGEMENT

Condoleezza Rice – Secretary of State
Vacant – Deputy Secretary of State
Randall Tobias – Director of U.S. Foreign Assistance and USAID Administrator
John Bolton – United States Permanent Representative to the United Nations

Arms Control and International Security Affairs

Robert Joseph – *Under Secretary*

- Bureau of International Security and Nonproliferation – *John Rood*
- Bureau of Political-Military Affairs – *John Hillen*
- Bureau of Verification, Compliance, and Implementation – *Paula DeSutter*

Economic, Energy and Agricultural Affairs

Josette Sheeran – *Under Secretary*

- Bureau of Economic, Energy and Business Affairs – *Daniel Sullivan*

Democracy and Global Affairs

Paula J. Dobriansky – *Under Secretary*

- Bureau of Democracy, Human Rights and Labor – *Barry Lowenkron*
- Bureau of Oceans and International Environmental and Scientific Affairs – *Claudia McMurray*
- Bureau of Population, Refugees, and Migration – *Ellen Sauerbrey*

Management

Henrietta H. Fore – *Under Secretary*

- Director General of the Foreign Service and Director of Human Resources – *George Staples*
- Bureau of Administration – *Rajkumar Chellaraj*
- Bureau of Consular Affairs – *Maura Harty*
- Bureau of Diplomatic Security – *Richard Griffin*
- Overseas Buildings Operations – *Charles Williams*
- Foreign Service Institute – *Ruth Whiteside*
- Bureau of Information Resource Management and Chief Information Officer – *James VanDerhoff*
- Bureau of Medical Services – *Laurence Brown, MD*

Political Affairs

R. Nicholas Burns – *Under Secretary*

- Bureau of African Affairs – *Jendayi Frazer*
- Bureau of East Asian and Pacific Affairs – *Christopher R. Hill*
- Bureau of European and Eurasian Affairs – *Daniel Fried*
- Bureau of International Organizational Affairs – *Kristen Silverberg*
- Bureau of Near Eastern Affairs – *C. David Welch*
- Bureau of South and Central Asian Affairs – *Richard Boucher*
- Bureau of Western Hemisphere Affairs – *Thomas Shannon, Jr.*

Public Diplomacy and Public Affairs

Karen P. Hughes – *Under Secretary*

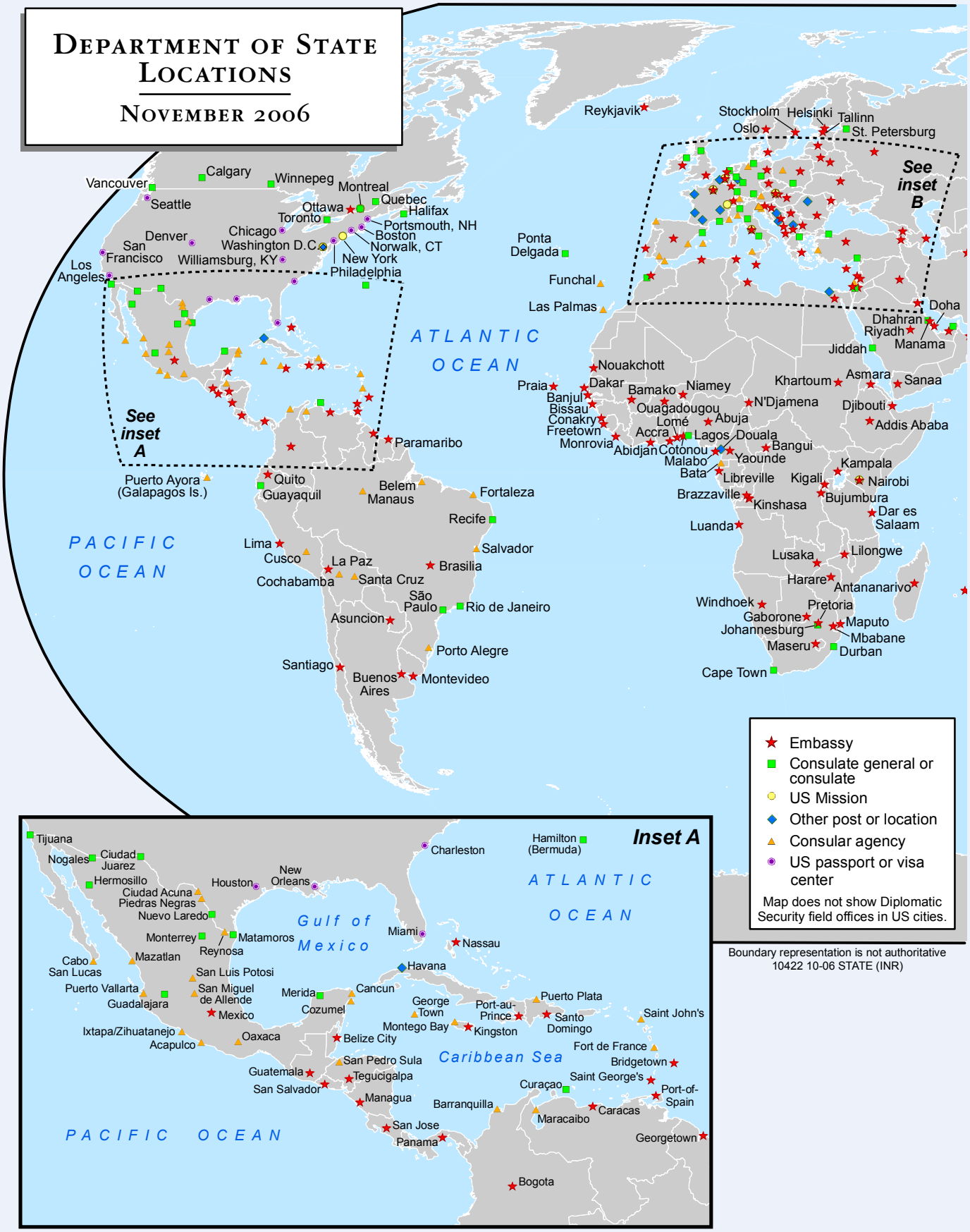
- Bureau of Public Affairs – *Sean McCormack*
- Bureau of Educational and Cultural Affairs – *Dina Habib Powell*
- Bureau of International Information Programs – *Jeremy Curtin, Acting Coordinator*

Other Senior Officials

- Chief of Staff to the Secretary of State– *Brian Gunderson*
- Executive Secretary – *Harry Thomas, Jr.*
- Counselor of the Department – *Philip Zelikow*
- Director, Policy Planning Staff – *Stephen Krasner*
- Assistant Secretary for Resource Management and Chief Financial Officer – *Bradford Higgins*
- Legal Adviser – *John Bellinger III*
- Inspector General – *Howard Krongard*
- Director, Office of Civil Rights – *Barry Wells*
- Assistant Secretary, Legislative Affairs – *Jeffrey Bergner*
- Assistant Secretary, Intelligence and Research – *Randall Fort*
- Chief of Protocol – *Donald Ensenat*
- Counterterrorism Coordinator – *Henry Crumpton*
- Director, Office to Monitor and Combat Trafficking in Persons – *John Miller*
- Global AIDS Coordinator – *Mark Dybul*
- Reconstruction and Stabilization Coordinator – *John Herbst*

Department of State Locations

November 2006



Boundary representation is not authoritative
10422 10-06 STATE (INR)

Cities with multiple Department of State facilities

Brussels:
Embassy Brussels
US Mission to European Union
US Mission to NATO

Paris:
Embassy Paris
US Mission to OECD
US Mission to UNESCO

Montreal:
Consulate General Montreal
US Mission to ICAO

Nairobi:
Embassy Nairobi
US Mission to UNEP and Habitat

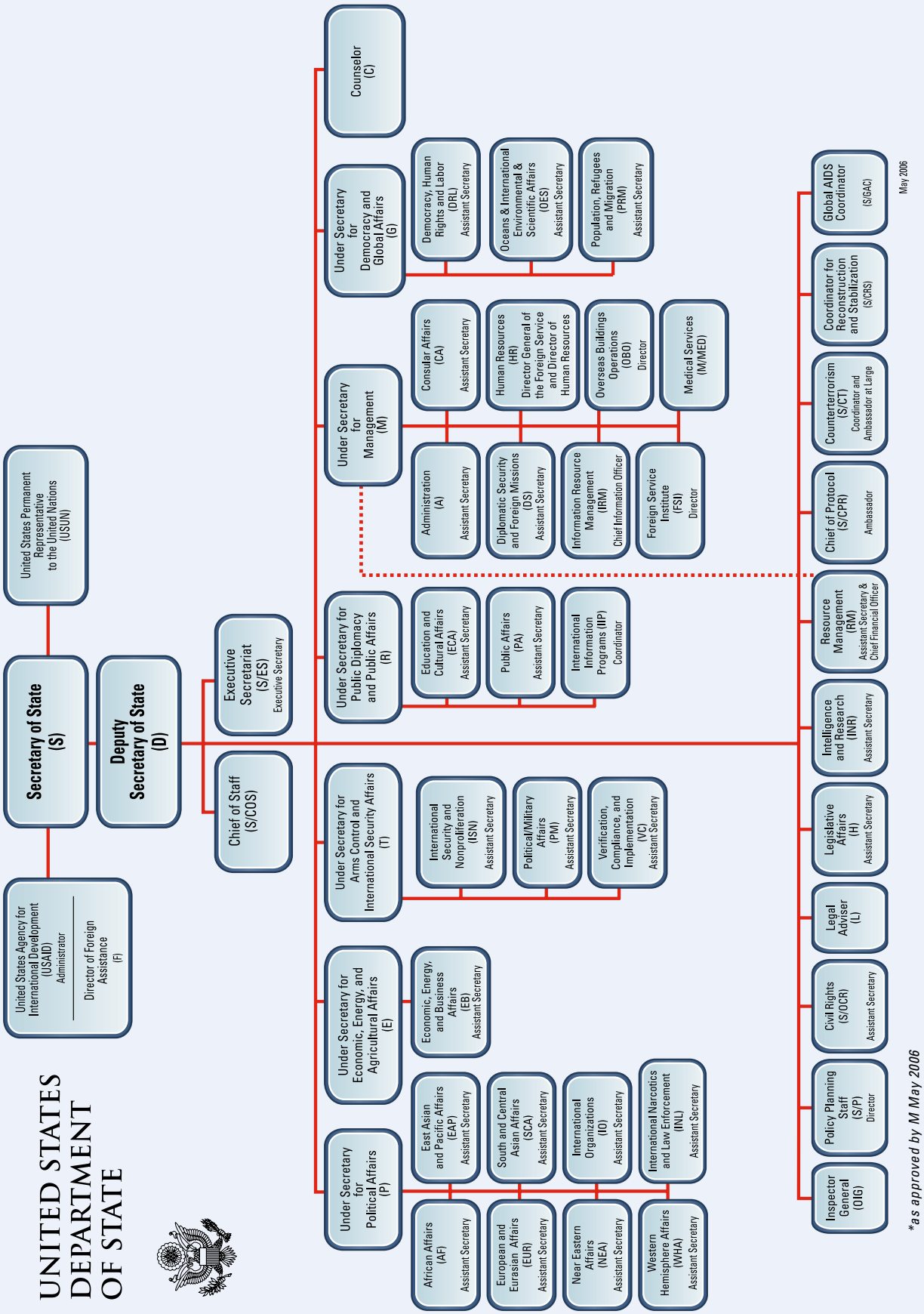
New York:
US Mission to UN
New York Passport Center

Portsmouth, NH:
National Passport Center
National Visa Center

Rome:
Embassy Rome
Embassy Holy See
US Mission to FAO

Vienna:
Embassy Vienna
US Mission to OSCE
US Mission to UNVIE

Washington, DC:
Department of State
US Mission to OAS
Washington Passport Agency


UNITED STATES DEPARTMENT OF STATE
United States Agency for International Development (USAID) Administrator
Director of Foreign Assistance (F)
Secretary of State (S)
United States Permanent Representative to the United Nations (USUN)
Deputy Secretary of State (D)
Chief of Staff (S/COS)
Executive Secretariat (S/ES) Executive Secretary
Counselor (C)
Under Secretary for Democracy and Global Affairs (G)
Democracy, Human Rights and Labor (DRL) Assistant Secretary
Oceans & International Environmental & Scientific Affairs (OES) Assistant Secretary
Population, Refugees and Migration (PRM) Assistant Secretary
Under Secretary for Management (M)
Consular Affairs (CA) Assistant Secretary
Human Resources (HR) Director General of the Foreign Service and Director of Human Resources
Overseas Buildings Operations (OBO) Director
Medical Services (M/MED)
Administration (A) Assistant Secretary
Diplomatic Security and Foreign Missions (DS) Assistant Secretary
Information Resource Management (IRM) Chief Information Officer
Foreign Service Institute (FSI) Director
Under Secretary for Public Diplomacy and Public Affairs (R)
Education and Cultural Affairs (ECA) Assistant Secretary
Public Affairs (PA) Assistant Secretary
International Information Programs (IIP) Coordinator
Under Secretary for Arms Control and International Security Affairs (T)
International Security and Nonproliferation (ISN) Assistant Secretary
Political/Military Affairs (PM) Assistant Secretary
Verification, Compliance, and Implementation (VC) Assistant Secretary
Under Secretary for Economic, Energy, and Agricultural Affairs (E)
Economic, Energy, and Business Affairs (EB) Assistant Secretary
Under Secretary for Political Affairs (P)
East Asian and Pacific Affairs (EAP) Assistant Secretary
South and Central Asian Affairs (SCA) Assistant Secretary
International Organizations (IO) Assistant Secretary
International Narcotics and Law Enforcement (INL) Assistant Secretary
African Affairs (AF) Assistant Secretary
European and Eurasian Affairs (EUR) Assistant Secretary
Near Eastern Affairs (NEA) Assistant Secretary
Western Hemisphere Affairs (WHA) Assistant Secretary
Global AIDS Coordinator (S/GAC)
Coordinator for Reconstruction and Stabilization (S/CRS)
Counterterrorism (S/CT) Coordinator and Ambassador at Large
Chief of Protocol (S/CPR) Ambassador
Resource Management (RM) Assistant Secretary & Chief Financial Officer
Intelligence and Research (INR) Assistant Secretary
Legislative Affairs (H) Assistant Secretary
Legal Adviser (L)
Civil Rights (S/OCR) Assistant Secretary
Policy Planning Staff (S/P) Director
Inspector General (OIG)
May 2006
*as approved by M May 2006

PERFORMANCE SUMMARY AND HIGHLIGHTS

FY 2006 KEY FOREIGN POLICY ACHIEVEMENTS

In FY 2006, the Department of State made significant strides toward a more secure, democratic, and prosperous world for the benefit of the American people and the international community. Through the Secretary's vision of transformational diplomacy, these achievements contribute to the President's National Security Strategy objectives by furthering democracy, advancing economic prosperity, and promoting religious and human rights around the world – especially in states transitioning toward democracy.

In the Middle East and North Africa, U.S. foreign policies and programs bolstered momentum for democratic change in the region. In Iraq, the United States made progress on the three tracks -- political, security, and economic. The three tracks are fundamental to our efforts to help Iraqis build a democratic, stable and prosperous country that is a partner in the war against terrorism.

AP/Wide World

The United States, along with the United Nations, the European Union and the Russian Federation (the Quartet), reaffirmed a shared commitment to the "Road Map" as the means to realize the goal of two democratic States – Israel and Palestine – living side by side in peace and security. The U.S. and our allies continued to stress the need for a credible political process in order to make progress toward a two-State solution. Our goals remain to support a peaceful negotiated solution to the Israeli-Palestinian conflict; support the humanitarian needs of the Palestinian people and encourage popular support for moderate, democratic, pro-peace Palestinian leadership; and encourage broad regional support for peace with Israel.

Through the Middle East Partnership Initiative and other bilateral assistance programs, the United States supported people in the broader Middle East who are seeking greater freedom and opportunity to build a more peaceful and prosperous region. The U.S. Government spoke out against abuses of human rights by undemocratic governments in the region, publicly supporting democratic reformers in repressive nations, and using foreign assistance to support the development of free and fair elections, rule of law, civil society, human rights, free media, and religious freedom.

In South Asia, NATO assumed operational command of Allied forces assisting the government in Afghanistan. The seven newest members of NATO committed to the shared values of freedom and democracy that are the foundation of the alliance and have already contributed to NATO operations in Afghanistan. In addition, the U.S. and India made great progress in advancing a historic partnership to meet the global challenges of the 21st century. The U.S.-India strategic partnership was enhanced by India's efforts to strengthen export controls and prevent the onward proliferation of sensitive materials and technologies.

The United States faced challenges posed by North Korea and Iran's pursuit of nuclear weapons capability and North Korea's nuclear weapons test. Working with the United Nations, the U.S. sought and obtained strong Security Council Resolutions under Chapter VII condemning these actions and demanding North Korea and Iran suspend nuclear programs. As part of the U.S. Government's ongoing response to the proliferation threat, the U.S. and other members of the international community gathered in Warsaw, Poland, in June 2006

to expand cooperation under the Proliferation Security Initiative (PSI). The PSI is dedicated to stopping all aspects of the proliferation trade and to denying terrorists, rogue states, and their supplier networks access to WMD-related materials and delivery systems. In FY 2006, the PSI worked to disrupt the financial activities of networks that support proliferation and interdict cargo containing dangerous materials. The U.S. continued to expand participation in the PSI, with more than seventy nations now supporting the initiative.

In the Western hemisphere, the U.S. worked with partners in the region to create a community of nations characterized by democratic institutions, respect for individual freedoms and human rights, market-oriented economic institutions, and cooperation against terrorism and crime. As Haiti's largest bilateral assistance donor, the U.S. concentrated FY 2006 programs in the areas of health, democracy, education and economic growth. U.S. assistance helped facilitate the transparent administration of Haiti's 2006 national elections, as well as provided support for political parties, free media, and voter education. In Colombia, U.S. assistance has helped change the political, military, economic, and counternarcotics environment. Colombian security forces have made impressive progress in regaining control of national territory and important gains have been made in areas of democracy, human rights, development, justice sector reform, and humanitarian assistance. In Nicaragua, the U.S. successfully supported a credible election process, fostered anti-corruption and accountability measures within the government, and strengthened civic programs. Additionally, the U.S. advanced implementation of the Central American Free Trade Agreement, which will be the second largest free trade zone in the Americas and the 10th largest U.S. export market in the world.

In East Asia and the Pacific, the United States enhanced regional cooperation on a broad range of economic and security goals through the Asia-Pacific Economic Cooperation (APEC) forum and the Association of Southeast Asian Nations (ASEAN). The United States joined with other Asia-Pacific countries in calling for reform and democratization in Burma and an end to North Korea's nuclear weapons program. U.S. programs increased capacity of key partners including Indonesia, the Philippines and Mongolia to pursue stability, security and peace, as well as strengthened ties with allies such as Japan, South Korea, Australia, Thailand, Singapore and Malaysia. The U.S. built cooperative ties with a reforming, dynamic Vietnam, as well as encouraged China to be a responsible participant in the international system.

The United States continued its strong commitment to peace and stability in Africa. The May 2006 conclusion of the Darfur Peace Agreement in Abuja, Nigeria represented an important step toward peace in Darfur and flowed from the sustained efforts of Nigerian President Obasanjo, the African Union, the U.S. and other facilitators. The U.S. led efforts to gain UN Security Council approval in August 2006 to extend UN peacekeeping into the Darfur region, but the effort was hampered by the Government of Sudan's refusal to accept a UN peacekeeping force. The U.S. continues to work diligently with our international partners to end the violence in Darfur, to hold accountable those individuals responsible for atrocities, and to ensure the delivery of humanitarian relief. In the Democratic Republic of Congo (DRC), the United States worked closely with the United Nations, African partners and other members of the international community to help the DRC emerge from violence and humanitarian crisis, providing assistance to support the DRC's first competitive national elections since 1960, held in July 2006. The United States and Ghana signed the largest Millennium Challenge Corporation compact to date on August 1, 2006, predicated on Ghana's strong record of good governance and pro-growth policies; compact agreements have also been signed with Benin, Cape Verde and Madagascar.

The Department also had significant achievements in a number of Presidential initiatives. The President's Emergency Plan for AIDS Relief, a five-year, $15 billion initiative designed to turn the tide in combating the HIV/AIDS pandemic, delivered HIV/AIDS assistance through bilateral programs in over 120 countries, with a special emphasis on 15 countries in Africa, Asia and the Caribbean. The President's initiative to create the International Partnership on Avian and Pandemic Influenza galvanized governments around the world, and led to over 175 countries establishing pandemic preparedness plans. Finally, the Department promoted opening markets for trade and investment throughout the world to create new opportunities and greater prosperity for American families, farmers, manufacturers, workers, consumers, and businesses.

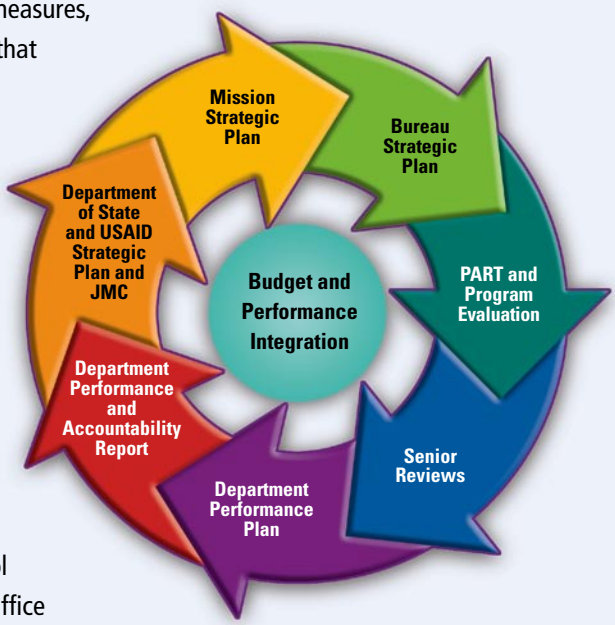
PERFORMANCE MANAGEMENT - A LEADERSHIP PRIORITY

The Department of State and the U.S. Agency for International Development (USAID) are finding innovative, effective ways to secure resources by backing requests with reliable data, proven efficiency and program results. Performance planning helps maximize the return on resources entrusted to foreign affairs agencies and shows Americans how investing in transformational diplomacy pays dividends, at home and abroad.

The Department and USAID are improving the way they set priorities, track program performance, and communicate progress and shortfalls to stakeholders. Like the best run organizations, the Department of State and USAID operate under a Joint Strategic Plan that guides the activities of both agencies. Close collaboration between State and USAID on setting a long-term strategic vision ensures that foreign policy priorities and assistance programs are fully aligned. By doing so, the Joint Strategic Plan promotes an organizational culture within the Department of State and USAID that values effectiveness and accountability.

The Joint Strategic Plan serves as the basis for the Department's annual planning cycle. Diplomatic missions and Washington-based bureaus engage in annual planning exercises that define policy and program goals by country and region, and also by crosscutting, global issues such as democracy, economic prosperity, counterterrorism, health and environment.

For example, each year overseas missions develop an individual strategic plan that sets country-level U.S. foreign policy goals, resource requests, performance measures, and targets. The Mission Strategic Plan is a concise, streamlined document that facilitates long-term diplomatic and assistance planning. Washington-based bureaus draw on Mission Strategic Plans to gauge the effectiveness of policies and programs in the field and formulate requests for resources. Through annual Senior Policy, Performance and Resource Reviews, the Secretary and Director of Foreign Assistance vet plans and resource requests to ensure bureau and mission activities are aligned with the Department's strategic objectives and priorities. The Department's Chief Financial Officer plays a prominent role in Senior Reviews to make recommendations on the efficient use of resources and guard against duplicative requests.



To evaluate the effectiveness and efficiency of our programs, the Department has fully integrated and institutionalized the Program Assessment Rating Tool (PART) into budget and planning processes. The PART was developed by the Office of Management and Budget as an instrument to help Congress, federal managers and the public assess program performance and drive improvements. The PART employs a series of diagnostic questions to evaluate programs across a set of performance-related criteria, including program design and purpose, strategic planning, program management, and results. PART efficiency measures, listed in an appendix to this report, enable program managers to monitor the administrative cost of achieving a given outcome and evaluate how program outcomes might change based on adjustments to funding levels.

The Department 's annual Performance Plan describes how the Department will define success, measure progress, and verify results. The Performance Plan is forward-looking and sets the indicators and targets that will be reported on in the Performance and Accountability Report (PAR). For FY 2006, the Department of State and USAID developed a Joint Performance Plan which formed the basis for the FY 2006 PAR's Joint Performance Section. The Performance Plan is an integral part of the President's budget request and meets the requirements of the Government Performance and Results Act.

Since the President's Management Agenda (PMA) was initiated in 2001, the Department has measurably improved performance on the PMA's five government-wide initiatives: human capital; e-government; competitive sourcing; financial performance; and budget and performance integration. The Department is proud to be green for status on all five PMA initiatives and is committed to maintaining its strong performance. The Undersecretary for Management receives a weekly update on PMA initiatives and chairs a monthly briefing with PMA initiative owners to monitor performance and plan follow-up actions. The Department is able to match personnel and financial requirements against policy objectives better than ever and continues to deliver services to employees and the public in ways that are faster, cheaper, and more effective.

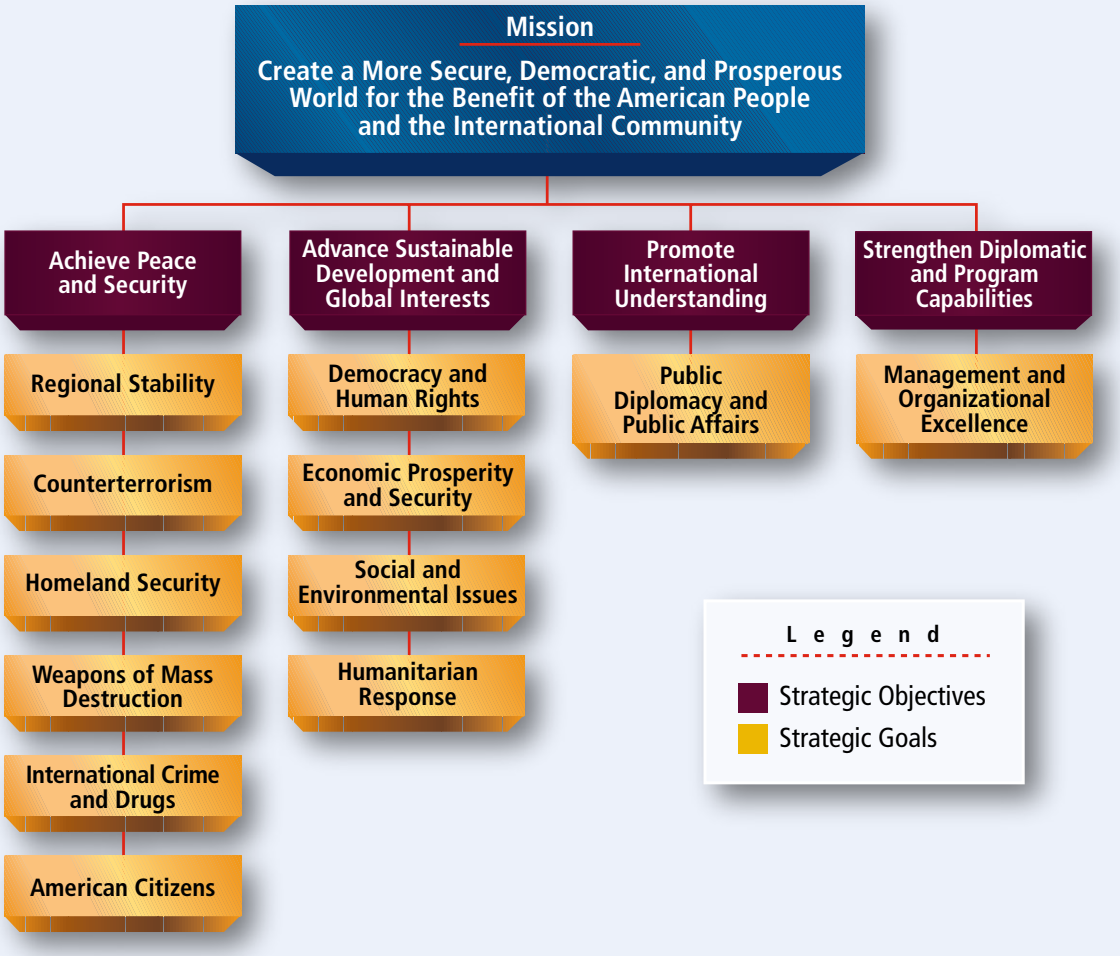
At all levels of annual performance planning – mission, bureau and agency – Department senior managers are mindful of the link between resource decisions and performance. Linking resources to performance improves decision-making because program managers justify budget requests based on demonstrated achievements and expected return. These justifications help Congress and the public understand the results their tax dollars will buy and the trade-offs that come with funding shortfalls. For this reason, the Department's annual budget submission to Congress features performance measures and targets, as well as information on program effectiveness and efficiency.

Americans invest in transformational diplomacy not only because it fits with their principles and values, but because foreign affairs agencies are getting better at showing how their investment pays off. The Department of State and USAID make the case for investing in transformational diplomacy by integrating budget and performance and by managing for results. Performance planning helps align interagency cooperation, promote a strong management culture and ensure responsible stewardship of resources. Solid performance plans and proven results help build confidence among Americans and their representatives in Congress that transformational diplomacy is a wise investment, with payoffs that lead to outcomes like greater peace and security, sustainable development, international understanding, and increased diplomatic strength.

FY 2006 STRATEGIC PLANNING FRAMEWORK

Strategic Objectives and Strategic Goals

In FY 2006, the Department and USAID structured their work around twelve strategic goals that captured both the breadth of their mission and specific responsibilities. The twelve strategic goals centered on four core strategic objectives , as shown in the diagram below.



FY 2006 PERFORMANCE MANAGEMENT METHODOLOGY

To measure progress and assess performance, the Department and USAID employed the performance measurement methodology depicted in the pyramid below. Each component of the pyramid is defined as follows:

Strategic Objectives High-level, broad categories of action through which the Department and USAID carried out strategic and performance goals.

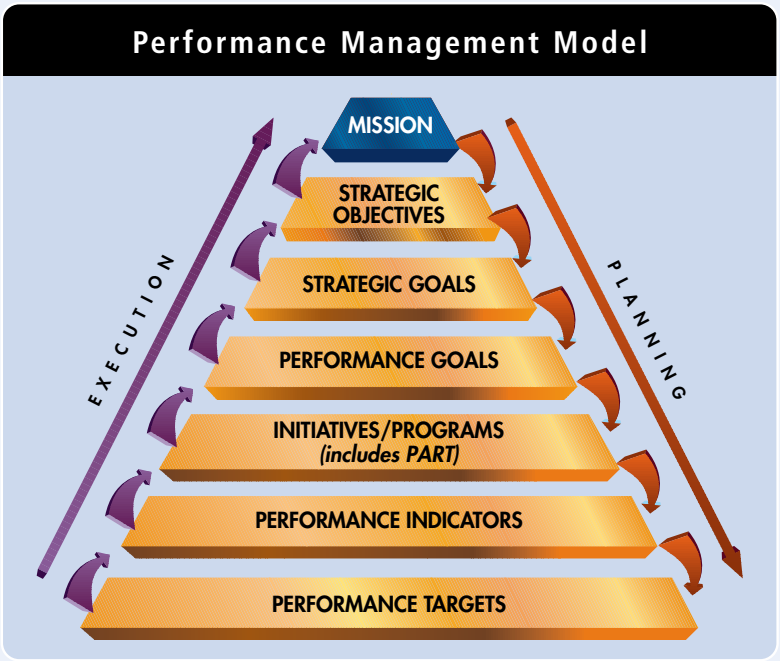
Strategic Goals The Department and USAID's long-term goals as detailed in the Strategic Plan.

Performance Goals The desired outcomes the Department and USAID planned to achieve in order to attain strategic goals.

Initiatives/Programs Specific functional and/or policy areas, including programs as defined by the OMB Program Assessment Rating Tool (PART), which contributed to the achievement of performance and strategic goals and to which the Department and USAID devoted significant attention.

Performance Indicators Values or characteristics that the Department and USAID used to measure progress toward annual performance goals. Indicators were drawn from bureau and mission performance plans.

Performance Targets Expressions of desired performance levels or specific desired results targeted for a given fiscal year. Where possible, targets were expressed in quantifiable terms.



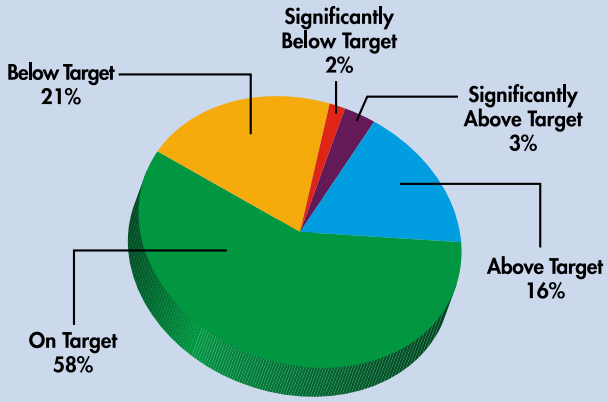
FY 2006 STRATEGIC PLANNING FRAMEWORK QUICK REFERENCE GUIDE

Strategic Objectives	Strategic Goals	Performance Goals
Achieve Peace and Security	Regional Stability	Close ties with allies and friends
		Resolution of regional conflicts
	Counterterrorism	Active anti-terrorist coalitions
		Frozen terrorist financing
		Prevention and response to terrorism
		Stable conditions in fragile/failing states
	Homeland Security	Proper visa adjudication
		Border agreements
		Infrastructure network protection
	Weapons of Mass Destruction	Bilateral measures
		Multilateral agreements and nuclear safety
		Verification and compliance
	International Crime and Drugs	Disruption of criminal organizations
		Law enforcement and judicial systems
	American Citizens	Assistance for U.S. citizens abroad
		Passport issuance and integrity
Advance Sustainable Development and Global Interests	Democracy and Human Rights	Democratic systems and practices
		Universal human rights standards
	Economic Prosperity and Security	Economic growth and development
		Trade and investment
		Secure and stable markets
		Food security and agricultural development
	Social and Environmental Issues	Global health
		Environmental protection
		Access to quality education
		Migration policies and systems
	Humanitarian Response	Assistance for refugees and other victims
		Disaster prevention/response via capacity building
Promote International Understanding	Public Diplomacy and Public Affairs	International public opinion
		Mutual understanding
		American values respected abroad
		Domestic understanding of foreign policy
Strengthen Diplomatic and Program Capabilities	Management and Organizational Excellence	Human resources and training
		Information technology
		Diplomatic security
		Overseas and domestic facilities
		Resource management
		Administrative services

SUMMARY OF FY 2006 PERFORMANCE

The pie chart below shows the ratings distribution for Department and USAID performance indicators reported in the Joint Performance Section. As shown, 78% of the ratings were "On Target" or above, meaning that these initiatives or programs met or exceeded performance targets.

Summary of FY 2006 Performance Results



RATINGS DISTRIBUTION

Significantly Above Target	4
Above Target	21
On Target	75
Below Target	27
Significantly Below Target	2
Total Number of Ratings	**129**

The table below shows allocated resources and the average of performance ratings under each strategic goal. Positions are U.S. direct hire only.

SUMMARY BUDGET AUTHORITY AND HUMAN RESOURCES BY STRATEGIC GOAL

	FY 2005			FY 2006			Change
	Positions	Dollars	Performance Rating	Positions	Dollars	Performance Rating	Performance Rating
1 Regional Stability	1,282	$ 7,092	On Target	1,295	$ 6,761	On Target	↔
2 Counterterrorism	906	1,768	On Target	916	1,659	On Target	↔
3 Homeland Security	567	262	On Target	573	163	On Target	↔
4 Weapons of Mass Destruction	519	422	On Target	525	433	On Target	↔
5 International Crime and Drugs	702	1,918	On Target	709	1,659	On Target	↔
6 American Citizens	556	66	On Target	562	73	On Target	↔
7 Democracy and Human Rights	830	1,500	On Target	839	1,871	On Target	↔
8 Economic Prosperity and Security	1,553	2,654	On Target	1,570	3,000	On Target	↔
9 Social and Environmental Issues	284	2,306	On Target	287	3,542	On Target	↔
10 Humanitarian Response	552	1,179	On Target	558	1,163	On Target	↔
11 Public Diplomacy and Public Affairs	2,251	597	On Target	2,275	868	On Target	↔
12 Management and Organizational Excellence	9,675	5,415	On Target	9,778	5,225	On Target	↔
Total	**19,677**	**$ 25,179**		**19,887**	**$ 26,417**		**No Change**

SUMMARY OF PERFORMANCE GOAL RESULTS

The chart below displays FY 2006 results and ratings for Department and USAID performance indicators in the Joint Performance Section. Each graph shows by performance goal the number of indicators assigned to each rating category. The inverted black triangle marks the average of all performance ratings under each performance goal.

Strategic Goal	Performance Goal	Average Performance Rating and Number of Reported Results				
		Significantly Below Target	Below Target	On Target	Above Target	Significantly Above Target
Regional Stability	Close, strong, and effective U.S. ties with allies, friends, partners and regional organizations. *3 Indicators*	0	1	2	0	0
	Existing and emergent regional conflicts are contained or resolved. *8 Indicators*	1	4	2	0	1
Counterterrorism	Coalition partners identify, deter, apprehend, and prosecute terrorists. *3 Indicators*	0	0	2	1	0
	U.S. and foreign governments actively combat terrorist financing. *1 Indicator*	0	1	0	0	0
	Coordinated international prevention and response to terrorism, including bioterrorism. *3 Indicators*	0	2	1	0	0
	Stable political and economic conditions that prevent terrorism from flourishing in fragile or failing states. *1 Indicator*	0	0	0	1	0
Homeland Security	Denial of visas to foreign citizens who would abuse or threaten the U.S. while facilitating entry of legitimate applicants. *1 Indicator*	0	0	1	0	0
	Implemented international agreements to stop the entry of goods that could harm the U.S., while ensuring the transfer of bona fide materials. *1 Indicator*	0	0	1	0	0
	Protection of critical physical and cyber infrastructure networks through agreements and enhanced cooperation. *2 Indicators*	0	0	2	0	0

Strategic Goal	Performance Goal	Average Performance Rating and Number of Reported Results				
		Significantly Below Target	Below Target	On Target	Above Target	Significantly Above Target
Weapons of Mass Destruction	Bilateral measures, including the promotion of new technologies, combat the proliferation of WMD and reduce stockpiles. *4 Indicators*	0	2	0	1	1
	Strengthened multilateral WMD agreements and nuclear energy cooperation under appropriate conditions. *3 Indicators*	0	0	2	1	0
	Verification integrated throughout the negotiation and implementation of arms control, nonproliferation, and disarmament treaties, agreements and commitments, and rigorous enforcement of compliance with implementation and inspection regimes. *2 Indicators*	0	1	1	0	0
International Crime and Drugs	International trafficking in drugs, persons, and other illicit goods disrupted and criminal organizations dismantled. *5 Indicators*	0	1	2	1	1
	States cooperate internationally to set and implement anti-drug and anti-crime standards, share financial and political burdens, and close off safe-havens through justice systems and related institution building. *2 Indicators*	0	0	1	1	0
American Citizens	U.S. citizens have the consular information, services, and protection they need to reside, conduct business, or travel abroad. *2 Indicators*	0	0	2	0	0
	Effective and timely passport issuance, with document integrity assured. *1 Indicator*	0	1	0	0	0
Democracy and Human Rights	Measures adopted to develop transparent and accountable democratic institutions, laws, and economic and political processes and practices. *6 Indicators*	0	1	5	0	0
	Universal standards protect human rights, including the rights of women and ethnic minorities, religious freedom, worker rights, and the reduction of child labor. *3 Indicators*	0	1	2	0	0

Strategic Goal	Performance Goal	Average Performance Rating and Number of Reported Results				
		Significantly Below Target	Below Target	On Target	Above Target	Significantly Above Target
Economic Prosperity and Security	Institutions, laws, and policies foster private sector-led economic growth, macroeconomic stability, and poverty reduction. *4 Indicators*	0	0	3	1	0
	Increased trade and investment achieved through market-opening international agreements and further integration of developing countries into the trading system. *4 Indicators*	0	2	2	0	0
	Secure and stable financial and energy markets. *3 Indicators*	0	0	3	0	0
	Enhanced food security and agricultural development. *1 Indicator*	0	0	0	0	1
Social and Environmental Issues	Improved global health, including child, maternal, and reproductive health, and the reduction of abortion and disease, especially HIV/AIDS, malaria, and tuberculosis. *17 Indicators*	0	3	13	1	0
	Partnerships, initiatives, and implemented international treaties and agreements that protect the environment and promote efficient energy use and resource management. *7 Indicators*	0	1	5	1	0
	Broader access to quality education with emphasis on primary school completion. *2 Indicators*	1	0	1	0	0
	Effective and humane international migration policies and systems. *1 Indicator*	0	0	0	1	0
Humanitarian Response	Effective protection, assistance, and durable solutions for refugees, internally displaced persons, and conflict victims. *8 Indicators*	0	3	2	3	0
	Improved capacity of host countries and the international community to reduce vulnerabilities to disasters and anticipate and respond to humanitarian emergencies. *1 Indicator*	0	0	1	0	0

Strategic Goal	Performance Goal	Average Performance Rating and Number of Reported Results				
		Significantly Below Target	Below Target	On Target	Above Target	Significantly Above Target
Public Diplomacy and Public Affairs	Public diplomacy influences global public opinion and decision-making consistent with U.S national interests. *2 Indicators*	0	0	2	0	0
	International exchanges increase mutual understanding and build trust between Americans and people and institutions around the world. *6 Indicators*	0	0	4	2	0
	American understanding and support for U.S. foreign policy, development programs, the Department of State, and the U.S. Agency for International Development. *2 Indicators*	0	0	1	1	0
Management and Organizational Excellence	A high performing, well-trained, and diverse workforce aligned with mission requirements. *6 Indicators*	0	1	4	1	0
	Modernized, secure, and high quality information technology management and infrastructure that meet critical business requirements. *4 Indicators*	0	0	3	1	0
	Personnel are safe from physical harm and national security information is safe from compromise. *2 Indicators*	0	0	1	1	0
	Secure, safe, and functional facilities serving domestic and overseas staff. *5 Indicators*	0	1	3	1	0
	Integrated budgeting, planning and performance management; effective financial management; and demonstrated financial accountability. *1 Indicator*	0	0	1	0	0
	Customer-oriented, innovative delivery of administrative and information services, acquisitions, and assistance. *2 Indicators*	0	1	0	1	0

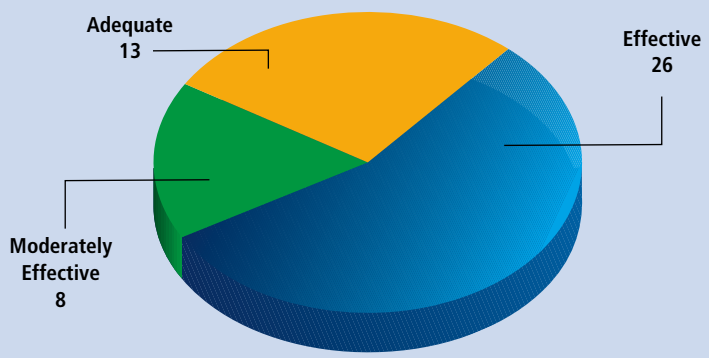
PROGRAM ASSESSMENT RATING TOOL (PART) STATUS

A key element of the President's Management Agenda is the effort to determine whether or not federal programs are achieving desired results at an acceptable cost to taxpayers. The Office of Management and Budget (OMB) uses the Program Assessment Rating Tool (PART) to evaluate programs across a set of performance-related criteria, including program design, strategic planning, program management, and results. Programs are assessed and assigned numeric scores, which correspond to qualitative ratings of Effective, Moderately Effective, Adequate, Ineffective, and Results Not Demonstrated. PART scores and findings are used to inform the budget process and drive improvements.

Since 2002, the Department and OMB have used the PART to review 47 programs, covering nearly 80% of the Department's appropriations. In 2006, State and OMB collaborated on eight new PART reviews and three PART reassessments in preparation for the President's FY 2008 budget submission to Congress. All 2006 PART programs were rated "Effective," "Moderately Effective" or "Adequate" and none of the Department's PART programs was rated "Results Not Demonstrated" as of November 15, 2006.

A complete list of the Department's 2002-2006 PART assessments, scores and ratings, as well as information on PART improvement plans, are presented in the Appendices. For more information on PART, please visit www.omb.gov/part

2002 - 2006 PART Ratings



OMB PART Ratings

Effective	26
Moderately Effective	8
Adequate	13
Total Number of Programs Assessed	**47**

THE PRESIDENT'S MANAGEMENT AGENDA

The President's Management Agenda (PMA) is the President's strategy for improving the management and performance of the federal government, with a focus on results. The PMA contains five government-wide and nine agency-specific initiatives that hold federal agencies to a standard of excellence for achieving results that matter to the American people. Since the PMA was launched in 2001, the Department of State has made substantial progress on the agenda's five government-wide initiatives: human capital; e-government; competitive sourcing; financial performance; and budget and performance integration.

On an annual basis, the Department works with the Office of Management and Budget (OMB) to set a vision for where the agency would be "Proud To Be" the following year on PMA goals. The Department and OMB then strategize on how best to accomplish "Proud To Be" goals through incremental progress on each initiative. OMB tracks agency activities and issues a PMA executive scorecard on a quarterly basis. The scorecard rates the Department's progress and overall status for each of the PMA initiatives using a color-coded grading scale of red, yellow, and green.

The Department's FY 2006 Fourth Quarter Scorecard is provided below. For more information on the PMA and the executive scorecard, please visit *www.whitehouse.gov/results/*.

Progress	STRATEGIC MANAGEMENT OF HUMAN CAPITAL	Status
	Goal • Build, sustain, and deploy effectively a skilled, knowledgeable, diverse, and high-performing workforce aligned with mission objectives and goals.	
	Progress • Finalized a succession plan that was approved by the Office of Personnel Management. • Completed a pilot of a new civil service performance appraisal system. • Finalized human resources skill gap analysis and plan for closing skill gaps. • Implemented a pilot to consolidate human resource functions in Centers of Excellence. • The Office of Personnel Management approved State's accountability system in June 2006.	
	Upcoming Actions • Update implementation results of the first two biennial human resource demand studies and report findings on third study. • Submit results of the pilot civil service performance appraisal system and update implementation plan for communicating with employees. • Report on language gap analysis, SES 30-working day hiring goal implementation plan, and leadership and management training program. • Provide final mission critical occupation targets for the period ending June 2007. • Submit information technology hiring plan and status of gap closure plan. • Conduct quality control review of personnel actions.	

Progress	IMPROVED FINANCIAL PERFORMANCE	Status

Goal

- World-class financial services that support strategic decision-making, mission performance, and improved accountability to the American people.

Progress

- Continued implementing corrective action plans addressing systems security and personal property material weaknesses.
- Enhanced Diplomatic and Consular Programs initiative on cost accounting of overseas posts, and briefed OMB on the effort and next steps.
- Finalized a managerial cost accounting concept paper.
- Issued preliminary FMFIA assurance statement with draft results from the FY 2006 A-123 Appendix A assessment.

Upcoming Actions

- Issue PAR by November 15 with audited financial statements and issue first statement of assurance of controls over financial reporting.
- Update and report on status of corrective action plans for all material weaknesses, including development and implementation of plans for any new material weaknesses identified in the audit.

Progress	COMPETITIVE SOURCING	Status

Goal

- Achieve efficient, effective competition between public and private sources and establish infrastructure to support competitions.

Progress

- Competed the human resources assignment technicians function in the Bureau of Human Resources, Office of Career Development and Assignments (HR/CDA).
- Received and addressed industry questions on motorpool operations.
- Completed multimedia services performance decision on September 29, 2006.
- Awarded a contract to help determine the scope of an IT support competition.
- Submitted a revised plan identifying new opportunities for additional competitions.

Upcoming Actions

- Initiate business case analysis for Information Resource Management functions.
- Complete evaluation of human resources assignment technicians bids in HR/CDA.
- Announce decision for motorpool competition.
- Continue to work with OMB on approval of FY 2006 FAIR ACT inventory.
- Submit summary on results of independent validations conducted to date.

Progress	BUDGET AND PERFORMANCE INTEGRATION	Status

Goal

- Improve the performance and management of the federal government by linking performance to budget decisions and improve performance tracking and management. The ultimate goal is better control of resources and greater accountability over results.

Progress

- Updated improvement plans for Program Assessment Rating Tool (PART) programs.
- Submitted efficiency measures report.
- Submitted top-line FY 2008 budget request amounts and supporting budget submission justification material for State Operations and the draft annual performance summary.
- Worked with OMB to draft summaries and improvement plans for 2006 PART assessments.
- Submitted broad goal framework for Joint State/USAID Strategic Plan.

Upcoming Actions

- Submit complete draft Joint State/USAID Strategic Plan. Finalize for distribution in February 2007.
- Submit Performance and Accountability Report, incorporating Joint State/USAID Performance Section based on FY 2006 Joint Performance Plan.
- Deliver performance management workshops for planners, program managers and budget planners.
- Submit draft foreign assistance Congressional Budget Justification materials to OMB.

Progress	EXPANDED ELECTRONIC GOVERNMENT	Status

Goal

- Expand the federal government's use of electronic technologies (such as e-procurements, e-grants, and e-regulation) so that Americans can receive high-quality government service.

Progress

- Submitted quarterly Federal Information Security Management Act (FISMA) update and Corrective Action Plan.
- Conducted internal Major Business Case reviews.
- Completed Privacy Impact Assessments on new investments and re-certified assessments for existing investments to meet FY 2008 Capital Planning and Investment Control (CPIC) requirements.
- Continued work on a Foreign Affairs Manual article and a Department of State Acquisition Regulations update concerning contractor system compliance with FISMA requirements.
- Submitted quarterly progress reports on E-Gov Implementation Plan and Enterprise Architecture milestones; the Department has no IT acquisitions duplicative of E-Gov initiatives.
- Developed Governance Structure and Communications Plan for the new Joint Management Council optimization process.

Upcoming Actions

- Post FY 2007 and FY 2008 Privacy Impact Assessments, and FY 2009 IT Capital Planning data call schedule on the web.
- Compare system lists to ensure CPIC and FISMA reporting tools and the IT Asset Baseline have a Privacy Impact Assessment.
- Submit FY 2007 first quarter progress report on E-Gov Implementation Plan milestones, FISMA Report & Corrective Action Plan and annual FISMA Report.
- Submit results of internal baseline review of State Messaging and Archive Retrieval Toolset (SMART) by Oct. 31 2006.

Progress	FEDERAL REAL PROPERTY ASSET MANAGEMENT INITIATIVE	Status

Goal

- To promote the efficient and economical use of America's real property assets.

Progress

- Made enhancements to Real Property System to incorporate Federal Real Property Council 2006 Inventory Guidance.
- Marketed 100% of identified properties and decommissioned identified properties.
- Completed operations and maintenance benchmarking for 82 posts.
- Began development of initiatives to ensure that minimizing operations and maintenance costs are considered in the design of New Embassy Compounds.
- Aligned major long-range rehabilitation projects with capital security project timelines.

Upcoming Actions

- Identify and complete remaining non-inventory and performance measures changes to the asset management plan and submit updated plan to OMB.
- Submit State and USAID data to the Federal Real Property Profile database by December 15, 2006.
- Provide update on efforts to ensure that minimizing operations and maintenance costs are considered in the design of New Embassy Compounds.
- Complete next phase of Operation and Maintenance benchmarking (additional 24 posts; 41% of total).

Progress	RIGHT-SIZED OVERSEAS PRESENCE (OMB LEAD)	Status

Goal

- Reconfigure U.S. Government overseas staff allocation to the minimum necessary to meet U.S. foreign policy goals.
- Have a government-wide comprehensive accounting of total overseas personnel costs and accurate mission, budget, and staffing information.
- Ensure that accurate projected staffing patterns determine embassy construction needs.

Progress

- For all agencies, personnel reports show that 5,374 overseas positions were abolished in FY 2006 and 2,984 were established, with a total of 75,542 authorized positions overseas. (This includes a 16% vacancy rate.)
- 19 of 20 non-New Embassy Construction rightsizing reviews submitted for review.
- Bureau of Overseas Buildings Operations submitted FY 2008 request for New Embassy Construction projects based on right-sized staffing review numbers.
- Guidance was sent to posts from the Joint Management Council on a three-tiered implementation for consolidating State and USAID administrative platforms overseas.

Upcoming Actions

- Summarize agency personnel and cost data collected in overseas staffing Budget Data Request.
- Provide overseas staffing numbers on a rolling basis to agencies for validation. Establish validation process.
- Demonstrate progress on consolidation of State/USAID administrative platforms at co-located posts.
- Clearly define regionalization and centralization strategy.

INTERNAL CONTROLS, FINANCIAL MANAGEMENT SYSTEMS AND COMPLIANCE WITH LAWS AND REGULATIONS

MANAGEMENT ASSURANCES

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT

The Department of State's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). The Department conducted its assessment of the effectiveness of internal control over the efficiency and effectiveness of operation and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, the Department can provide reasonable assurance that its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations and financial management systems meet the objectives of FMFIA as of September 30, 2006.

In addition, the Department of State's management is also responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The Department of State conducted its assessment of the effectiveness of the Department's internal control over financial reporting in accordance with Appendix A of OMB Circular A-123. Based on the results of this assessment, the Department of State is reporting material weaknesses concerning the accounting for personal property and real property in its internal control over financial reporting as of June 30, 2006. Deficiencies existed in the controls over accounting for contractor-held property, aircraft and vehicles and controls over accounting for real property – specifically Construction-in-Progress. However, corrective actions were taken, and the material weaknesses have been resolved as of September 30, 2006 as described in the exhibit on page 31. Other than the exceptions noted, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal control over financial reporting.

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

Condoleezza Rice

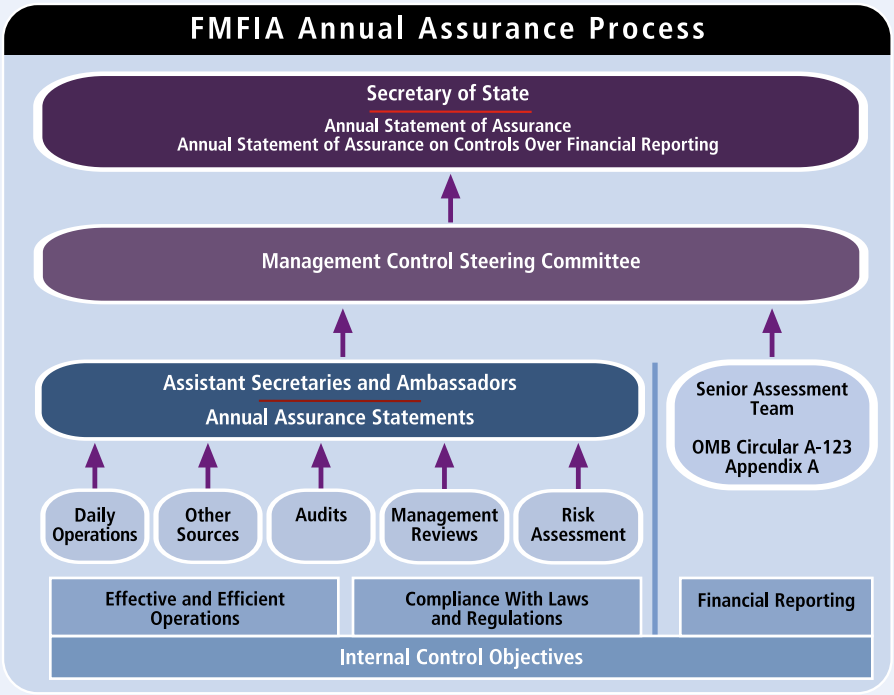
Secretary of State

November 15, 2006

DEPARTMENTAL GOVERNANCE

Management Control Program

The Federal Managers' Financial Integrity Act (FMFIA) requires agencies to establish internal control and financial systems that provide reasonable assurance that the integrity of federal programs and operations are protected. It also requires that the head of the agency, based on an evaluation, provide an annual Statement of Assurance on whether the agency has met this requirement. Additionally, OMB Circular A-123, *Management's Responsibility for Internal Control*, defines management's responsibility for internal control in Federal agencies.



In December 2004, OMB revised A-123 in light of the internal control requirements for publicly-traded companies contained in the Sarbanes-Oxley Act of 2002. The new Appendix A, *Internal Control Over Financial Reporting*, of the revised A-123 serves to improve governance and accountability for internal controls over financial reporting. The revised circular is effective for FY 2006 and requires that the agency head also provide an assurance statement on the effectiveness of internal control over financial reporting, which is an addition to and also a component of the overall FMFIA assurance statement. The Secretary of State's 2006 Annual Assurance Statement is provided on the preceding page.

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

It is the Department's policy that any organization with a material weakness or reportable condition is required to submit a plan to correct the weakness to the MCSC or the senior assessment team (SAT) for review and approval (see description of the SAT's role in the Appendix A section). The plan, combined with the individual assurance statements, provide the framework for monitoring and improving the Department's management controls on a continuous basis.

Status of Management Controls and Financial Management Systems

The Department evaluated its management controls and financial management systems for the fiscal year ending September 30, 2006. This evaluation provided reasonable assurance that as of September 30, 2006, the objectives of the FMFIA were achieved. As a result, the Secretary has provided an unqualified Statement of Assurance. In addition, there are no items specific to the Department on the Government Accountability Office's High Risk List, and there have not been any since 1995. Additional information concerning the controls over financial reporting is contained in the next section.

Appendix A: Internal Control Over Financial Reporting

The Department's management control program expanded during 2006 to address the new requirement for management's assessment of the effectiveness of internal control over financial reporting, contained in Appendix A of the revised OMB Circular A-123. The MCSC voted to expand its membership to include offices with material impact on the Department's financial resources and to establish a senior assessment team (SAT) to oversee the implementation of Appendix A, as recommended in the revised Circular. The senior assessment team (SAT) reports to the Management Control Steering Committee and is comprised of 11 senior executives from bureaus that have significant impact on the Department's financial statements and financial processes. To ensure a successful implementation of Appendix A and to encourage department-wide participation, other bureaus participated on issues of relevance to their operations. To effectively communicate the Appendix A initiative, the Department held a training workshop on the revised Circular A-123 and the Department's plans for implementation.

The Department performed the Appendix A implementation in three phases: planning, assessment and testing, and conclusion and reporting. The Department defined the scope of financial reporting as the financial statements, identified thirteen significant financial processes, and determined the materiality threshold. The Department documented the key financial processes and controls as well as evaluated and tested the controls. By the completion of the Appendix A implementation, the SAT confirmed that significant control deficiencies existed relating to personal property, which was identified as a material weakness in the FY 2005 financial statement audit. The Department also identified a significant deficiency in the accounting for construction-in-progress for real property. As a result, the Department is reporting both property issues as a material weakness as of June 30, 2006 with regard to the assessment of the effectiveness of internal controls over financial reporting. However, the SAT monitored the progress of corrective actions for both of these issues, which were undertaken in 2006, and as of September 30, 2006, reported to the MCSC that corrective actions were taken and the material weaknesses were resolved. The SAT recommended to MCSC that the Secretary provide a qualified assurance as of June 30, 2006 and an unqualified assurance as of September 30, 2006.

APPENDIX A MATERIAL WEAKNESSES RESOLVED AS OF SEPTEMBER 30, 2006*	
Material Weaknesses Resolved as of September 30, 2006	**Corrective Actions Taken**
Accounting for Personal Property As of June 30, 2006, deficiencies existed in the controls over accounting for personal property. Specifically, the Department did not have a system to identify and record property in the hands of contractors. The controls over accounting for aircraft, vehicles, and other personal property were not fully effective.	The Department implemented procedures to provide for the reporting of contractor-held property. It also tightened controls over the existing processes for accounting for aircraft, vehicles and other personal property.
Accounting for Real Property – Construction-in-Progress As of June 30, 2006, controls over accounting for real property – construction in progress were ineffective. Not all projects that should have been capitalized were capitalized, and there was a failure to report project completions on a timely basis.	Controls were implemented and/or strengthened to ensure the proper identification of capitalized projects in the accounting system and timely reporting of project completion.

** The material weaknesses were downgraded to reportable conditions as of September 30, 2006. In accordance with Appendix A to OMB Circular A-123, a material weakness in internal control over financial reporting, is a reportable condition, or combination of reportable conditions, that results in a reasonable possibility that a material misstatement of the financial statements, or other significant financial reports, will not be prevented or detected. A reportable condition for financial reporting is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with Generally Accepted Accounting Principles such that there is a reasonable possibility that a misstatement of the entity's financial statements, or other significant financial reports, that is more than inconsequential will not be prevented or detected.*

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

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

To assess conformance with FFMIA, the Department uses OMB Circular A-127 survey results, FFMIA implementation guidance issued by OMB (January 2001 Memorandum to Executive Department Heads, Chief Financial Officers, and Inspectors General), results of OIG and GAO audit reports, annual financial statement audits, the Department's annual Federal Information Security Management Act (FISMA) Report, and other relevant information. The Department's assessment also relies a great deal upon evaluations and assurances under the FMFIA, with particular importance attached to any reported material weaknesses and material non-conformances.

The Department has made it a priority to meet the objectives of the FFMIA. In November 2004, the Department conducted a comprehensive OMB Circular A-127 assessment. The assessment included (among other things) a collection of the various background materials, reference documents, and supporting details that document how the Department meets the applicable A-127 requirements and OMB FFMIA implementation guidance. Based on the results of this assessment, along with information contained in the Department's FY 2005 FISMA Report and evaluations and assurances provided under FMFIA, the Department affirmed its determination of substantial compliance with FFMIA in its FY 2005 Management Representation Letter provided to the Independent Auditor. Further reinforcing FFMIA substantial compliance, the Department's Management Control Steering Committee voted in September 2006 to classify the Department's Financial and Accounting Systems as a financial system deficiency (versus reportable condition or material non-conformance). Since the financial management systems substantially comply with the requirements of the FFMIA, the Department has provided an unqualified assurance with regard to Section 4 of the Federal Manager's Financial Integrity Act.

FEDERAL INFORMATION SECURITY MANAGEMENT ACT

The Department of State 2006 Federal Information Security Management Act (FISMA) and Privacy Management Report presented continued improvement in IT security, as well as a road map for 2007 initiatives. The Department is dedicated to protecting information and information systems with a comprehensive Information Security Program that continues to integrate operational security and information assurance programs monitored by performance metrics that are continually improving.

Over the past year, the Department streamlined processes, eliminated duplicative initiatives, focusing on its Agency-wide Information Security Program, Configuration Management, Risk Management, and Plans of Actions & Milestones (POA&Ms). To further accelerate the integration of IT security within the Department, the Under Secretary of Management officially established the Information Systems Security Committee (ISSC). This past year, the CIO reassigned governance of the Department's IT systems and applications inventory (Information Technology Asset Baseline - ITAB) to the Enterprise Architecture and Planning office that is charged with responsibility for eGovernment and Capital Planning, thus strengthening the connections between these essential business processes.

The recategorization of the unclassified systems in the Department's inventory was completed bringing the Department into full compliance with the FIPS 199 / NIST SP 800-60 standard. Furthermore, a comprehensive strategy to establish a methodology for compliance with FIPS Pub 200 by March 2007 will be instituted to ensure sustained compliance. The Department instituted a Bureau-level scorecard measuring the level of success with annual Contingency Plan testing, monthly patch management monitoring, Enhanced Validation and Verification testing (E&V), and capturing an expanded set of information in the Department's POA&M and Inventory system including official Privacy Impact Assessments (PIA).

The Department, issued *"The Plan to Capture Contractor Systems in the Department of State's Inventory of Information Systems"* to the OIG and OMB with an implementation plan for ensuring the appropriate level of security of all contractor connections, extensions and systems. A Procurement Information Bulletin (PIB) concerning information security imposed upon contractor services and products was also finalized and issued.

These aforementioned accomplishments are key indicators of the Department's forward momentum. The Department begins fiscal year 2007 with renewed confidence that the constant security challenges facing any global enterprise will be planned for, addressed and resolved in a timely and comprehensive manner and realize substantial progress on all the initiatives started in FY2006.

There are no significant deficiencies under FISMA. In the 2006 audit of the Department's financial statements the independent auditor concluded that the Information system security material weakness identified in the FY 2005 audit was considered resolved and downgraded to a reportable condition.

IMPROPER PAYMENTS INFORMATION ACT

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

Summarized below are the Department's IPIA accomplishments and future plans for identifying improper payments as provided for in OMB Circular A-136, Financial Reporting Requirements. Additional IPIA reporting details are provided in the *Supplemental Information and Other Reporting Requirement* section of this report.

Summary IPIA accomplishments

In FY 2005, the Department reviewed the high-risk programs that were not reviewed in FY 2004 and performed a reassessment of risk for all payment categories (i.e., Federal Financial Assistance, Vendor Pay and Employee Pay). The FY 2005 results reflected in the table below, show that the programs reviewed were of low risk of being susceptible to significant improper payments.

FY 2005 MODERATE RISK PROGRAMS	FY 2005 ERROR RATE
Federal Financial Assistance	
Population, Refugee and Migration (PRM) – Refugee Assistance	0%
Educational and Cultural Affairs (ECA) – Fulbright Program	0%
*INL – Law Enforcement, Eradication, Aviation Support and Support to the Military Programs	Completed in FY 2006
International Organizations (IO) – Voluntary Contributions and Peacekeeping	0%

**INL testing was started in FY 2005 and completed in FY 2006*

In FY 2006, a random sample of the detailed payment transaction data was selected for the International Narcotics and Law Enforcement (INL) - Law Enforcement, Eradication, Aviation and Support to the Military and International Information Program-U.S. Speaker and Specialist Program (IIP). Both programs were identified as high-risk and tested in FY 2004. In the table below, the FY 2006 test results found improper payments in both programs. The projected error rate and dollar amount of improper payments in the population sampled range from approximately 3.97% and $180,340 thousand to 23.97% and $348,567 thousand. The projected improper payment amount is a result of the average dollar amount per improper item multiplied by the projected number of improper items in the population. The information in the table below is a statistically valid projection with a confidence level of +/-2.5%. Testing for INL started in FY 2005 and was completed in FY2006 covering the last quarter of FY 2004 and first three quarters of FY 2005 and IIP testing covered the last three quarters of FY 2006.

	Transactions in		Dollars in		Projected	
Program	Population	Sample	Population	Sample	Error Rate	Improper Payments
International Narcotics and Law Enforcement	4315	126	$313,078,592	$2,366,056	3.97%	$180,340
International Information Program- U.S. Speaker and Specialist Program	741	126	$28,822,489	$288,548	23.81%	$348,567

Calculation of error rate and payment amounts based on sample results

Future plans

Future plans provide for expanding the IPIA program to include programs assessed as having a low susceptibility to significant improper payments. We do not expect to find significant improper payments in these programs; however, we will seek to identify opportunities to strengthen internal control.

FINANCIAL STATEMENTS AND RESULTS

The Government Management Reform Act (GMRA) of 1994 amended the requirements of the Chief Financial Officers (CFO) Act of 1990 by requiring an annual preparation and audit of agency-wide financial statements from the 24 major executive departments and agencies. The statements are to be audited by the Inspector General (IG), or an independent auditor at the direction of the IG. An audit report on the principal financial statements, internal controls, and compliance with laws and regulations is prepared after the audit is completed.

The Department's financial statements, which appear in the Financial Section of this Report, are audited by the independent accounting firm of Leonard G. Birnbaum and Company, LLP. Preparing the statements is part of the Department's goal to improve financial management and to provide accurate and reliable information that is useful for assessing performance and allocating resources. Department management is responsible for the integrity and objectivity of the financial information presented in the financial statements.

The financial statements and financial data presented in this Report have been prepared from the accounting records of the Department of State in conformity with accounting principles generally accepted in the United States of America (GAAP). GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB).

AUDIT RESULTS

The Department has a proud tradition of unqualified opinions on our annual financial statements from our independent auditors for the better part of the last decade. Late in FY 2005, the Department became aware of large amounts of personal property, including aircraft and vehicles held by host countries and contractors, which had not been reflected in our financial statements. In December 2005, the independent auditors were able to satisfy themselves about the amounts presented as personal property in our FY 2005 and FY 2004 financial statements and issued an unqualified opinion thereon, dated December 14, 2005. In their report, the independent auditor cited the accounting for personal property, along with information systems security, as material weaknesses in internal controls.

The Department recognizes the importance of effective internal controls and committed to resolve the material weaknesses in 2006. Working closely with the independent auditor throughout the year, the Department took a number of corrective actions to address the most serious deficiencies in controls for the material weaknesses. As a result, and as reflected in their Report, the Independent Auditor downgraded these items to a reportable condition in connection with the audit of the Department's 2006 Principal Financial Statements.

To further strengthen internal controls in 2006, the Department also committed to fully implement the requirements of Appendix A, Internal Control Over Financial Reporting, of OMB Circular A-123. During the implementation of Appendix A specifically, and other work during FY 2006, Department management identified a material weakness related to accounting for real property construction-in-progress. The Department's controls related to the recording of real property and related depreciation expense and accumulated depreciation, during the majority of FY 2006 and all of FY 2005, were inadequate, resulting in (1) significant amounts of construction costs being expensed rather than capitalized, and (2) costs of completed projects not being moved from construction-in-progress on a timely basis.

Recognizing the severity of the deficiency, the Department developed more detailed procedural guidance for establishing projects to ensure construction costs are properly capitalized and implemented monitoring controls for both project establishment and project completion. As a result of the corrective actions taken, the material weakness was resolved by September 30, 2006. However, due to complexity of the matters involved, and the accelerated financial reporting requirements, the Department was unable to provide timely financial statements or documentation on the appropriateness of the associated restatement to satisfy our independent auditors with regard to the presentation of real property in time for this report. As a result, and as more fully explained in the Independent Auditor's Report, the independent auditors issued a disclaimer of opinion on our FY 2006 and restated FY 2005 financial statements.

In relation to internal control, the Independent Auditor's Report cites as reportable conditions the recording and related depreciation of personal property and Department's security of information systems networks. The report also cites as reportable conditions: (1) the inadequacy of the Department's financial management systems, (2) the management of unliquidated obligations, (3) the implementation of Managerial Cost Accounting Standards, and (4) the recording and related depreciation for real property. 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 following tables summarize the weaknesses in internal control and compliance with laws and regulations cited in the FY 2006 Independent Auditor's Report, as well as the actions taken or planned to resolve the problems. All of the findings relate to the Department's strategic goal for Management and Organizational Excellence.

SUMMARY OF INDEPENDENT AUDITOR'S REPORT FINDINGS
(Refer to Independent Auditor's Report Section)

Reportable Condition	Corrective Actions	Target Correction Date
Information Systems Security Information system networks for domestic operations are vulnerable to unauthorized access. Consequently, systems, including the Department's financial management system, that process data using these networks may also be vulnerable. These deficiencies were cited as a material weakness in the Independent Auditor's Report on the Department's 2005 Financial Statements.	The Department remains acutely aware of the value and sensitivity of its information and information systems and is dedicated to the vigilance required to ensure their adequate protection. In response, the Department initiated a program to assess its information systems security on a comprehensive and continuing basis, and developed a Corrective Action Plan to address the material weakness identified in the FY 2005 financial statement audit. The 2006 FISMA Report presents major accomplishments, as well as specific metrics upon which performance is assessed. For FY 2006, the Information Security Program (ISP) focused on addressing identified shortfalls in assessing information system security. Actions included creating an Information Security Steering Committee, creating a certification and accreditation working group, enhancing the Site Evaluation and Verification Program, improved contractor oversight, implementing Personnel Identity Verification, and integrating information security costs into the IT investment process. In addition, the Department accelerated the use of an internal bureau scorecard, which highlights each bureau's needed improvements in the areas of systems authorization, role based training, patch management, and Plans of Actions and Milestones (POA&M). As a result, the Independent Auditor downgraded this deficiency to a reportable condition in connection with the audit of the Department's 2006 Principal Financial Statements. In FY 2007, efforts will continue to strengthen the ISP along with addressing new OMB and NIST system requirements.	2007

(continued)

SUMMARY OF INDEPENDENT AUDITOR'S REPORT FINDINGS
(Refer to Independent Auditor's Report Section)

Reportable Condition	Corrective Actions	Target Correction Date
Recording of Personal Property The Department does not have a system of controls to account for personal property. Deficiencies exist in the controls over accounting for contractor-held property, aircraft, vehicles, and other personal property. These deficiencies were identified as a material weakness in the Independent Auditor's Report on the Department's 2005 Financial Statements.	In recognition of the deficiencies with respect to personal property, the Department's Management Control Steering Committee (MCSC) created a subcommittee to address these weaknesses. The subcommittee developed a Corrective Action Plan to address each of the matters identified in the Independent Auditor's Report on the FY 2005 financial statements. In 2006, improvements were implemented in the methods used to identify and report armored vehicle costs, aircraft, property held by contractors, and Department-owned vehicles. As a result, the Independent Auditor downgraded this deficiency to a reportable condition in connection with the audit of the Department's 2006 Principal Financial Statements. In FY 2007, efforts will continue to strengthen the controls over the accounting for personal property.	2007
Recording of Real Property The Department's controls related to the recording of real property and related depreciation expense and accumulated depreciation, during the majority of FY 2006 and all of FY 2005, were inadequate, resulting in (1) significant amounts of construction costs being expensed rather than capitalized, and (2) costs of completed projects not being moved from construction-in-progress on a timely basis.	During the implementation of OMB Circular A-123, Appendix A, and other work during FY 2006, Department management noted problems related to accounting for construction-in-progress. As a result, the Department developed more detailed procedural guidance for establishing projects to ensure construction costs are properly capitalized and implemented monitoring controls for both project establishment and project completion. In FY 2007, the Senior Assessment team will continue to monitor this issue and test the controls to ensure they are operating effectively. The Department will also look for opportunities to further strengthen controls over accounting for real property.	2007
Management of Unliquidated Obligations The Department's internal control process related to managing undelivered orders is inadequate. It lacks a structured process for reconciling and deobligating funds in a timely manner, which may result in the loss of those funds.	Strengthening the management of unliquidated obligations (UDOs) is an important financial management initiative, and the Independent Auditor's Report notes that there have been improvements in this area. New capabilities were installed in the Department's Central Financial Management System that allow for the automatic deobligation of UDOs based on a wide range of criteria (e.g., age, object class, dollar amount). The new capabilities were used to deobligate funds totaling over $200 million. As part of the President's Management Agenda Initiative for Improved Financial Performance, the Department prepares quarterly reports for OMB and senior management. Beginning with the March 2005 report, and all subsequent reports, the quarterly reports include a chart that identifies by bureau the percentage of UDOs with no activity for the past 12 months. This analysis is used to focus improvement efforts on those bureaus with the higher percentages of no activity. The Department will continue to develop reports and processes to improve the management of UDOs.	2007

(continued)

SUMMARY OF INDEPENDENT AUDITOR'S REPORT FINDINGS
(Refer to Independent Auditor's Report Section)

Reportable Condition	Corrective Actions	Target Correction Date
Compliance with Managerial Cost Accounting Standards While the Department complies with certain aspects of the Statement of Federal Financial Accounting Standards #4, it does not have an effective process to routinely collect managerial cost accounting information, establish outputs for each responsibility segment, or allocate all support costs.	To address MCAS requirements, the Department developed an automated Statement of Net Cost that enables reporting of cost information by strategic objects and goals, along with responsibility center. It also allows for the allocation of support costs. In FY 2005, the Department established a project team, which includes consultants with experience implementing Cost Accounting Systems, and project plan to implement the MCA initiative. The team: • surveyed other agencies and organizations for lessons learned and best practices; • conducted an assessment of offices to determine business needs for cost information, current cost accounting practices, outputs and outcomes, and unmet needs; • evaluated a managerial cost software module and confirmed usability; and • developed a strategic approach and implementation strategy. In 2007, the team will conduct several pilots to test strategy, to be followed by a phased implementation Departmentwide.	2008
Financial and Accounting Systems (See Nonconformance below)	See discussion below.	2007
Nonconformance with Laws and Regulations	**Corrective Actions**	**Target Correction Date**
Financial and Accounting Systems The Department's financial and accounting system, as of September 30, 2006, was inadequate. 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. During 2006, the Department used several systems for the management of grants and other types of financial assistance. The Department's financial system (1) does not provide effective control over personal property, and (2) is unable to issue year-end financial data to be included in its PAR in a timely manner.	Significant progress has been made over the past few years to improve financial management systems worldwide. The Department has reduced the number of financial systems from six to two, and the number of post-level financial systems from nine to two. In 2005, the overseas Regional Financial Management System was upgraded to the most current version of commercial off-the-shelf (COTS) software used by this system. In 2006, the Department expanded the number of on-line overseas users, and added and enhanced a number of interfaces. Also in 2006, improvements were made to enhance the usefulness of financial information through the implementation of improved reporting capabilities for overseas users. In 2007, domestic users will be converted to the same platform and software services overseas users thereby establishing the Global Financial Management System (GFMS). As part of the GFMS implementation, the most up-to-date module for accounting for fixed assets will be installed, and a new data warehouse is being built that will provide for better reporting capabilities for users. To improve the management of grants and other types of financial assistance, the Department is developing, in collaboration with USAID, the Joint Assistance Management System (JAMS). Once implemented, JAMS will provide the capability to centrally track and manage Federal financial assistance issued by the Department. The Department plans to conduct a pilot phase in 2007, followed by deployment through 2008.	2007

2005 RESTATEMENT

The FY 2005 financial statements, which appear in the Financial Section of this Report, have been restated to correct errors with respect to the accounting for certain real property transactions. The effect of the restatement was to decrease Total Net Cost for 2005 by $160.7 million, and increase Property and Equipment, Total Assets, Cumulative Results of Operations and Total Net Position by $617.6 million. Cumulative Results of Operations at the beginning of 2005 has been adjusted by $457 million for the effects of the restatement on prior years. The restatement had no effect on the Statement of Budgetary Resources or the President's Budget. Additional information on the restatement is provided in Note 20, Restatements, of the accompanying FY 2006 and FY 2005 financial statements.

In the course of the Department's first-year efforts to implement Appendix A, Internal Control Over Financial Reporting, of OMB's Circular A-123, *Management's Responsibility for Internal Control*, we identified errors in previously reported amounts for real property and associated depreciation and operating expenses as follows.

- Not identifying and adjusting completed capital projects in a timely manner.
  - Amounts reported as construction-in-progress where the projects had been completed and should have been reclassified to Buildings and Structures and the associated depreciation expense recorded.

- Expensing capital project costs.
  - Amounts reported as expense for capital projects that should have been recorded to construction-in-progress.

Significant awareness was raised about the importance of the internal controls related to these activities, and a number of actions were taken to strengthen processes and controls to preclude future errors of this nature. For example, procedural guidance was developed, documented and implemented. In addition, processes were established to monitor outstanding projects on a periodic basis for the purpose of identifying any projects that are being improperly expensed, or that are complete but not reclassified to buildings and structures. Also, as part of the Department's on-going A-123 Appendix A program, the controls related to these activities will be tested annually to ensure they are in place and operating effectively.

OVERVIEW OF FINANCIAL POSITION

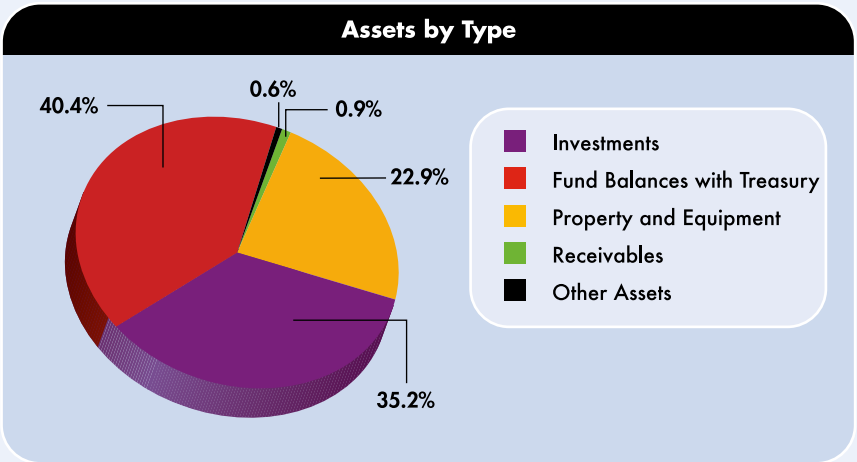
Assets. The Consolidated Balance Sheet shows the Department had total assets of $40.1 billion at the end of 2006. This represents an increase of $3.8 billion (10.5%) over the previous year's total assets of $36.4 billion. The increase is primarily the result of increases of $2.1 billion in Fund Balances with Treasury, $1.3 billion in property and equipment, and $528 million in investments in the Foreign Service Retirement and Disability Fund (FSRDF). The increase in Fund Balances with Treasury primarily resulted from a $1.8 billion increase in unexpended appropriations.

The Department's assets reflected in the Consolidated Balance Sheet are summarized in the following table *(dollars in thousands)*:

	2006	2005 Restated
Investment, Net	$ 14,101,765	$ 13,389,090
Fund Balances with Treasury	16,170,761	14,023,542
Property and Equipment, Net	9,175,917	7,862,612
Accounts, Loans & Interest Receivable, Net	378,357	854,315
Other Assets	235,652	225,434
Total Assets	$ 40,062,452	$ 36,354,993

Investments, Fund Balances with Treasury and Property and Equipment comprise approximately 98% of total assets for 2006 and 2005. Investments consist almost entirely of U.S. Government Securities held in the FSRDF.

Information on Heritage Assets, which consists of art furnishings held for public exhibition, education and official entertainment, is provided in the RSI section of this report.

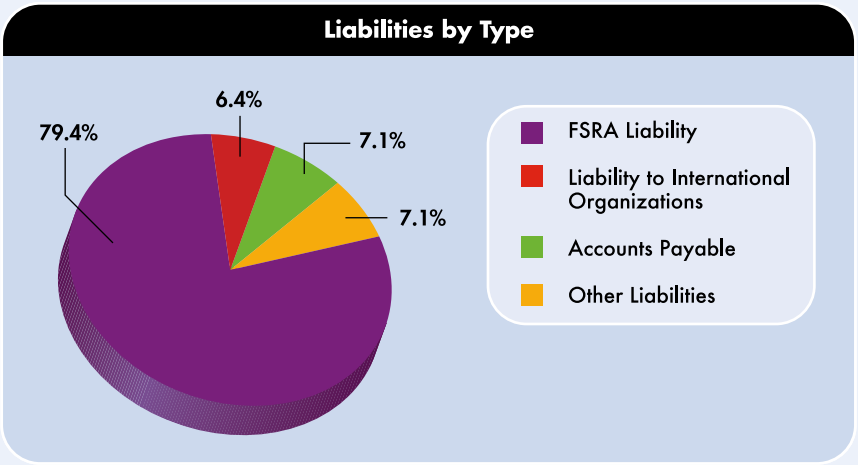


Liabilities. The Department had total liabilities of $17.9 billion at the end of 2006, which is reported on the Consolidated Balance Sheet and summarized in the following table *(dollars in thousands)*:

	2006	2005
Foreign Service Retirement Actuarial Liability	$ 14,215,300	$ 13,429,300
Liability to International Organizations	1,155,344	1,178,130
Accounts Payable	1,253,677	1,269,794
Other Liabilities	1,268,726	1,202,774
Total Liabilities	$ 17,893,047	$ 17,079,998

The Foreign Service Retirement Actuarial (FSRA) Liability of $14.2 billion and the Liability to International Organizations of $1.2 billion comprise 86% of the Department's total liabilities at the end of 2006.

Of the total liabilities, $2.1 billion were unfunded, i.e., budgetary resources were not available to cover these liabilities. The $2.1 billion is primarily comprised of the $1.2 billion Liability to International Organizations, and the unfunded portion of the Environmental Liabilities of $392.3 million.



The $1.2 billion Liability to International Organizations consists of $1.1 billion in calendar year 2006 annual assessments, and $60 million in accumulated arrears assessed by the UN, its affiliated agencies and other international organizations. These financial commitments mature into obligations only when funds are authorized and appropriated by Congress.

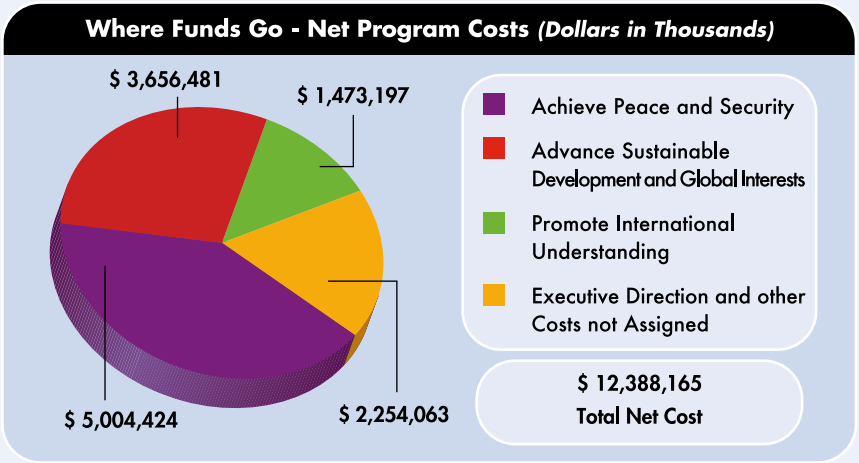
Ending Net Position. The Department's Net Position at the end of 2006 on the Consolidated Balance Sheet and the Consolidated Statement of Changes in Net Position is $22.1 billion, a $2.9 billion (15%) increase from the previous fiscal year. Net Position is the sum of the Unexpended Appropriations and Cumulative Results of Operations.

The growth in Unexpended Appropriations is due principally to the continued increase in budget authority received to provide funding for embassy security, international narcotics control, and the Global HIV/AIDS initiative. The increase in Cumulative Results of Operations resulted mainly from the $1.3 million increase in property and equipment.

RESULTS OF OPERATIONS

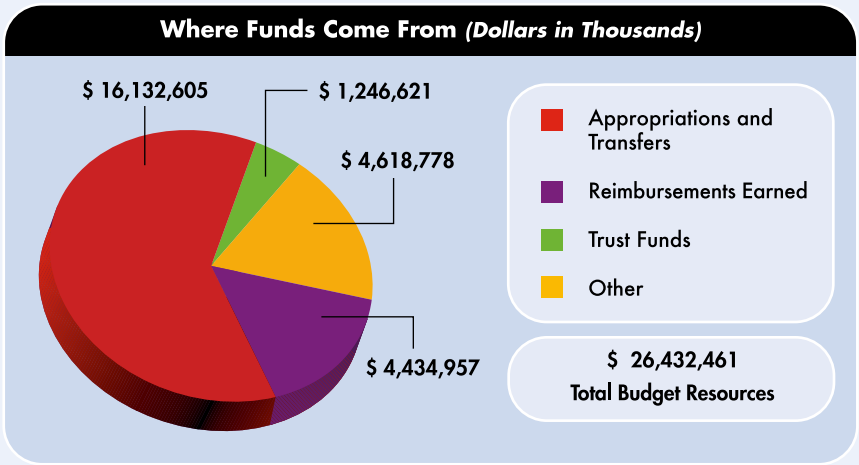
The results of operations are reported in the Consolidated Statement of Net Cost and the Consolidated Statement of Changes in Net Position.

The Consolidated Statement of Net Cost presents 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). Information on the Bureaus (or equivalent) that report to each Under Secretary can be found on the Organization Chart for the Department provided earlier in 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.

The Department's total net cost of operations for 2006, after intra-departmental eliminations, was $12.4 billion. The strategic objective to "Achieve Peace and Security" represents the largest investment for the Department at 40.4% of the Department's net cost of operations. The net cost of operations for the remaining strategic objectives varies from 11.9% to 29.5%.



The Consolidated Statement of Changes in Net Position presents the accounting items that caused the net position section of the balance sheet to change since the beginning of the fiscal year. Appropriations Used totaled $14.3 billion, comprising 93% of the Department's total budgetary financing sources.

The charts on this and the previous page reflect the funds that the Department received during 2006 and how these funds were used.

The Combined Statement of Budgetary Resources provides information on how budgetary resources were made available to the Department for the year and their status at fiscal year-end. For the fiscal year, the Department had total budgetary resources of $26.4 billion, an increase of 5.9% from 2005 levels. Budget Authority of $21.8 billion – which consists of $16.1 billion for appropriations (direct, related, and supplemental) and transfers, and $1.3 billion financed from trust funds – comprise 65.9% of the total budgetary resources. The Department incurred obligations of $21.1 billion for the year, a 1.9% increase over the $20.7 billion of obligations incurred during 2005. Outlays reflect the actual cash disbursed against the Department's obligations.

The Combined Statement of Financing reconciles the resources available to the Department to finance operations with the net costs of operating the Department's programs. Some operating costs, such as depreciation, do not require direct financing sources.

BUDGETARY POSITION

The FY 2006 budget for the Department of State totaled $10.468 billion. It included appropriations for the Administration of Foreign Affairs ($7.985 billion), contributions to international organizations and international peacekeeping activities ($2.303 billion), international commissions ($67 million), and related programs ($113 million). These amounts do not include foreign assistance funding.

The Department's FY 2006 budget was funded through the *Science, State, Justice, Commerce, and Related Agencies Appropriations Act, 2006*. The budget also reflected supplemental funding provided through the *Emergency Supplemental Appropriations Act to Address Hurricanes in the Gulf of Mexico and Pandemic Influenza, 2006* and the *Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006*. Supplemental funding was required

primarily to address the extraordinary costs of security and operations of the U.S. Missions in Iraq and Afghanistan, as well as the U.S. assessed costs of United Nations peacekeeping missions.

In addition to appropriated funds, the Department continued to rely on revenue from user fees – Machine Readable Visa fees, Enhanced Border Security Program fees, the Western Hemisphere Travel Surcharge, and other fees – for the Border Security Program. The fee revenue supported program requirements to protect American citizens and safeguard the nation's borders. These requirements included increased consular workloads and the national security mandate to collect biometric data for U.S. passports and visas.

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

For FY 2006, the Department's principal operating appropriation – Diplomatic and Consular Programs (D&CP) – was funded at $5.711 billion. This funding sustained critical diplomatic and consular operations and enabled the Department to meet the new demands of transformational diplomacy. D&CP funding included $731 million for Worldwide Security Upgrades to increase security for diplomatic personnel and facilities under threat from terrorism and $330 million for vigorous public diplomacy to inform foreign opinion and gain support for U.S. policies abroad. The funding also included resources to further the Government-wide reforms of the President's Management Agenda and agency-specific initiatives on rightsizing the U.S. Government presence overseas and Federal real property asset management.

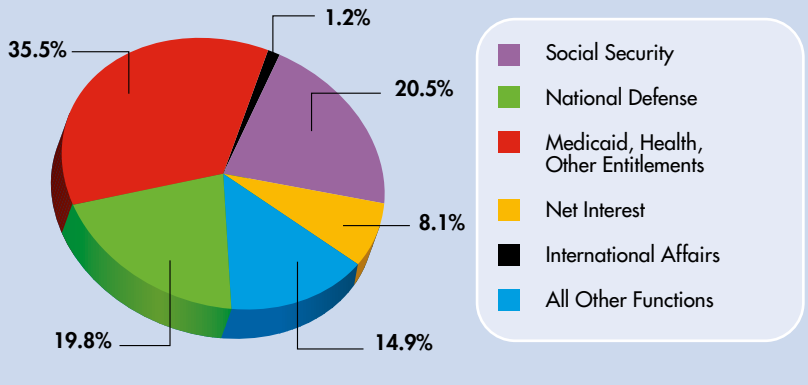
The Department's appropriations for information technology (IT) initiatives totaled $126 million – $58 million in the Capital Investment Fund (CIF) and $68 million in the Centralized Information Technology Modernization Program. Revenue from Expedited Passport fees provided additional funding for IT Central Fund investments. These investments helped modernize the Department's global IT infrastructure and provide ready access to foreign affairs applications and information. FY 2006 investments in IT also supported e-Government initiatives of the President's Management Agenda. The Department's infrastructure and mission-oriented application systems supported approximately 46,000 users, at over 390 locations worldwide, for both classified and unclassified processing.

The Embassy Security, Construction, and Maintenance (ESCM) appropriation was funded at $1.490 billion. This funding helped provide U.S. missions overseas with secure, safe, and functional facilities. The funding also supported management of the Department's real estate portfolio, which exceeds $14 billion in value and includes over 15,000 properties. From the appropriation total, $899 million supported capital security construction and compound security projects. Under the Capital Security Cost Sharing program, all agencies with overseas staff under Chief of Mission authority contributed an additional $200 million to the construction costs of new diplomatic facilities.

The Educational and Cultural Exchange Programs (ECE) appropriation was funded at $431 million. These strategic activities engaged foreign audiences to develop mutual understanding and build foundations for international cooperation. Aligned with public diplomacy efforts, they reached out to younger and more diverse audiences, especially in the Muslim world. The funding included $243 million for academic exchanges of foreign participants and U.S. citizens, notably through the J. William Fulbright Scholarship Program. The funding also included $150 million for professional and cultural exchanges, such as Citizen Exchanges and the International Visitor Leadership Program, which inaugurated the Edward R. Murrow Journalism Program.

For FY 2007, the Department's budget request (at this date still pending before Congress) totals $9.504 billion. It includes resources to address ongoing foreign policy priorities, particularly to support the global war on terror and advance transformational diplomacy. The request for D&CP is $4.652 billion, including $795 million for upgrades of physical security equipment and technical support, information and systems security, perimeter security, and security training. The request provides $68 million in CIF for information technology investments worldwide. The request for ESCM totals $1.540 billion, including $899 million for design and/or construction of secure facilities, additional site acquisitions, and compound security projects. Finally, the request provides $474 million for ECE to increase the number of participants in exchange programs of proven value, engage key influencers in overseas publics, and support the National Security Language Initiative.

The Federal Government Dollar



Source: Mid-Session Review, Budget of the United States Government, Fiscal Year 2007.

LIMITATION OF FINANCIAL STATEMENTS

Management prepares the accompanying financial statements to report the financial position and results of operations for the Department of State pursuant to the requirements of Chapter 31 of the United States Code section 3515(b). While these statements have been prepared from the books and records of the Department in accordance with OMB Circular A-136, Financial Reporting Requirements, these statements are in addition to the financial reports used to monitor and control the budgetary resources that are prepared from the same books and records. These statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity. One implication of this is that unfunded liabilities reported in the statements cannot be liquidated without the enactment of an appropriation and ongoing operations are subject to the enactment of appropriations. The Department also issues financial statements for its International Cooperative Administrative Support Services (ICASS) and the International Boundary and Water Commission (IBWC). The complete, separately-issued ICASS and IBWC Annual Financial Reports are available from the Department's Bureau of Resource Management, Office of Financial Policy, Reporting and Analysis, 2401 E Street, Room H1500, Washington, DC, 20037; (202) 261-8620.

MESSAGE FROM THE INSPECTOR GENERAL

The *Reports Consolidation Act of 2000* requires that the Department's *Performance and Accountability Report* include a statement by the Inspector General that summarizes the most serious management and performance challenges facing the Department and briefly assesses its progress in addressing those challenges. I am pleased to present this year's statement, reflecting the Department's progress in addressing its current challenges of protecting its people and facilities, strengthening its information security, managing its financial and human resources, combating terrorism and ensuring border security, improving understanding through public diplomacy, and supporting post-conflict reconstruction and stabilization.

I am proud of the contribution OIG makes to helping the Department address its management and performance challenges. The scope of our oversight mandate and the opportunity it offers to make a positive impact in strengthening the management of the Department continue to expand rapidly. During FY 2006, OIG expanded its oversight to encompass new Department initiatives in transformational diplomacy, global repositioning, and public diplomacy, as well as substantial increases in programs for Iraq and Afghanistan, counternarcotics, counterterrorism, embassy construction, and information technology. Significant growth in the number of programs and grants with mandated OIG oversight, congressional and management requests for special reviews and investigations, and opportunities for joint activities with other departments, agencies, and OIGs further enhance both the challenges and the benefits of our work.

The expansive scope of these activities has resulted in substantial benefits to the U.S. Government and the American taxpayer. OIG accomplishments in FY 2006 have supported the Department's strategic goals as well as OIG's vision of promoting effective management, accountability, and positive change in the Department of State and the Broadcasting Board of Governors (BBG). During FY 2006, OIG activities resulted in actual recoveries and identified savings of more than $31.3 million, as well as issuance of nearly 100 reports with recommendations to improve Department and BBG programs and operations. Other substantive outcomes of our work included:

- Actions toward a strategic plan for Embassy Baghdad's rule-of-law programs, which will strengthen the embassy's coordinating role and increase Iraqi participation in project development;
- Improvements to strengthen Iraqi anticorruption programs by increasing the effectiveness of Embassy Baghdad's interagency working group, establishing a strategy for U.S. advisors and trainers to bridge gaps between Iraqi anticorruption institutions, and supporting a training facility for Iraqi anticorruption personnel;
- Strengthened internal management controls at the Global Financial Services Center in Charleston;
- Immediate security improvements and potential cost avoidances for the new embassy construction project in Beijing, China; and
- Corrective actions to improve border security and reduce vulnerabilities from terrorists.

OIG has accomplished a lot this year, but like the Department, we have much to do to meet the management and performance challenges we have set for ourselves. I am committed to restoring OIG's capabilities to provide the oversight and advisory assistance necessary to assure the Department, Congress, and the American taxpayer that the programs and operations we review are as effective, efficient, economical, and accountable as possible.

Howard J. Krongard
Inspector General

MANAGEMENT AND PERFORMANCE CHALLENGES

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

- Protection of People and Facilities
- Information Security
- Financial Management
- Human Resources
- Counterterrorism and Border Security
- Public Diplomacy
- Post-Conflict Stabilization and Reconstruction

Protection of People and Facilities

The protection of people and facilities continues to be one of the Department's highest priorities. The Department has instituted many security countermeasures to terrorist attacks as an interim step toward constructing new embassy compounds with sufficient setback and blast resistant buildings. The challenge remains to complete these measures worldwide and to develop additional countermeasures to stem new innovations in terrorist attacks. Security inspections at 14 overseas missions noted some success in addressing compound security upgrades at existing facilities, but physical and technical security vulnerabilities still accounted for almost half of OIG recommendations, including the need to upgrade access control points at mission compounds. The Department will also need to obtain funding for security upgrades for planned American Presence Posts and Remote Visa Processing Centers.

The Department has made progress in strengthening its domestic protection program during FY 2006, implementing a substantially more robust, post-9/11 emergency preparedness program with regular drills, employee forums, and proactive guidance to improve employee preparedness at work and at home. However, many emergency preparedness efforts still require additional focus and work. A recent audit of domestic emergency preparedness found that 18 of the 40 Washington metropolitan facilities still lack a site-specific emergency action plan, many existing plans were outdated or incomplete, and many employees had not been briefed on their facility's plan and did not have ready access to the plan.

Information Security

The Department continues to make progress on strengthening its information security program and practices and recognizes that more must be done to effectively administer and manage its information security programs. Areas of improvement since OIG's FY 2005 Federal Information Security Management Act (FISMA) review include internal and external reporting of computer security incidents, and significant progress in addressing privacy requirements. A congressionally mandated review of the protection of classified information at Department headquarters and the storage and handling of sensitive compartmented information (SCI) found that the requirements of the directives for personnel and information security were being met, but opportunities still exist to improve management of the intelligence community security program.

During its FY 2006 FISMA reviews and information security inspections, OIG identified several areas that need to be addressed by the Department's Chief Information Officer. For example, the Department needs to maintain its initiative formalizing its Information Systems Security Officer (ISSO) program, including performance assessment and training, until completion. Other areas requiring more coordinated effort and support from Department officials include developing and implementing a system security program plan to administer information security Department-wide, completing inventories of IT assets and contractor systems, verifying security levels assigned to IT applications and systems, identifying the total number of employees requiring IT security awareness training, addressing fragmentation in the Department's certification and accreditation process, and including IT security findings identified by all sources in the Plan of Action and Milestones process.

Financial Management

Financial management continues to be a major management challenge within the Department. During FY 2005, the Department restated its FY 2004 financial statements to correct errors of unrecorded transactions for collections of passport fees ($117 million); receivables for value-added taxes ($20 million); and overseas disbursements ($26 million). The financial statement auditor issued a qualified opinion on the Department's FY 2005 financial statements because the Department's work had not been sufficiently completed to enable the auditor to satisfy itself as to the accuracy of the amounts reported as personal property in time to meet the financial statement deadline imposed by the Office of Management and Budget (OMB).

The Department thereafter completed its work on issues related to personal property and provided documentation to support the amounts reported on the financial statements, and the auditor issued its unqualified opinion on the FY 2005 financial statements. In addition to personal property, the auditor again noted concerns, including inadequate information system security and financial systems, inadequate management of undelivered orders and lack of a managerial cost accounting system. Finally, the auditor noted the Department continues to have difficulty producing year-end financial data in a timely manner.

During FY 2006, the Department has taken steps to address some of these weaknesses. For example, a committee that included OIG as a nonvoting member was created to address weaknesses related to personal property. The committee recommended improvements in the methods used to identify and report armored vehicles, property held by contractors, and Department-owned vehicles. Additionally, the Bureau of International Narcotics and Law Enforcement initiated a review of its aviation programs, structure, and responsibilities with a view toward more centralized management. The Department also implemented new capabilities to allow for automatic deobligation of undelivered orders, and has developed and begun implementing a project plan for a managerial cost accounting system.

Foreign assistance is another area in which the Department continues to face challenges, particularly with respect to the reliability of financial information. A March 2003 OIG audit of the State Department's management of foreign assistance concluded that the Department lacked comprehensive and reliable information on funding provided to nongovernmental organizations. No one office or system within the Department was responsible for or capable of capturing essential statistical data related to Department-wide financial assistance. Additionally, in FYs 2004 and 2005, the financial statement auditor's report stated that the Department's financial and accounting system was inadequate and that there was a risk of materially misstating financial information under the current conditions. In both years the auditor identified as an area of inadequacy that the Department's systems for the management of grants and other types of financial assistance lacked standard data classifications and common processes and were not integrated with the Department's centralized financial management system. Additionally, the Department could not produce reliable financial information that defined the universe of grants and other federal financial assistance.

In January 2006, as a means to better focus foreign assistance funding in support of U.S. interests, the Secretary established the Office of the Director of U.S. Foreign Assistance to create and direct consolidated policy, planning, budget, and implementation mechanisms for the Department and U.S. Agency for International Development (USAID) assistance programs. To addresses deficiencies in financial information related to foreign assistance, the Department also established a Department-wide steering committee, beginning in FY 2005, to oversee and coordinate the award, monitoring, and closure of Department Federal financial assistance of more than $5 billion; and to develop a management information system that would provide comprehensive and reliable information on Federal financial assistance. Under a mandate from OMB, the Department and USAID have been working to build an automated Joint Assistance Management System (JAMS), scheduled for domestic deployment in FY 2008, to streamline and simplify assistance-related business processes. When fully implemented, JAMS will provide consistency in assistance programs within and between the two organizations, improve reporting capabilities, and facilitate compliance with other U.S. government grants initiatives.

To further strengthen financial accountability, the Department has been receptive to OIG investigators and auditors providing fraud prevention and awareness training to Department personnel responsible for financial systems, contracts and grants, and procurement. The OIG fraud prevention and awareness program is presented to relevant bureau personnel and to all General Services Officer courses at the Foreign Service Institute.

Overseas, OIG found that the Department has done a good job of consolidating International Cooperative Administrative Support Services (ICASS) into a single administrative platform on new embassy construction projects, but additional steps are needed in combining ICASS services for those missions that are not scheduled for new construction. OIG inspection reports in FY 2005 and FY 2006 noted that agencies overseas continue to resist subscribing to the full range of administrative services offered by ICASS, instead developing duplicative administrative structures, which increase overall cost to the U.S. government. Without a requirement to subscribe more fully to ICASS, these conditions are unlikely to change.

Human Resources

In an effort to provide the highly skilled, diverse workforce needed to implement the Secretary's transformational diplomacy agenda, the Department has established the Global Repositioning Initiative and plans to shift hundreds of positions from across the world to critical emerging areas in Africa, South Asia, and elsewhere that will shape U.S. interests in the future. As part of this initiative, the Department continues to grapple with how to best meet new security, administrative support, specialized training, and program funding requirements for these positions.

The Department also faces significant challenges in staffing diplomatic missions in Iraq and Afghanistan and equipping employees with skills and administrative support to carry out new responsibilities in war-zones and hardship posts. Staffing and skills gaps at these critical posts undermine programs that are important to the Administration and at high risk for waste, fraud, and mismanagement. OIG found problems related to staffing gaps and personnel shortages in inspections of Embassies Kabul, Riyadh, and Islamabad and of Embassy Baghdad's rule-of-law program.

The Department has instituted significant changes to the promotion, assignments, and career development processes to emphasize service in Iraq and Afghanistan, but it remains to be seen whether these will be effective in meeting long-term needs in those places as well as other hardship posts. Additional steps such as directed assignments of personnel, enhanced benefits packages, and expanded use of contractors may have to be considered.

An OIG review of efforts to rightsize the U.S. government's overseas presence noted that the Department has taken limited but positive steps to address rightsizing issues of importance to the Administration and Congress. The Department is implementing significant rightsizing initiatives—including the Capital Security Cost-Sharing Program, the State-USAID Joint Management Council, periodic rightsizing reviews, expansion of regional service delivery, Foreign Service career development planning, and changes to resource planning processes—that should have positive effects over time.

Counterterrorism and Border Security

The Department continues to play a central role in combating international terrorism, including efforts to stop terrorists before they reach our shores. Posts abroad are encouraged to maintain vigilance in identifying, reporting on, and denying visas to persons engaged or likely to engage in terrorist activity or support. Counterterrorism and border security remain a management and performance challenge for the Department.

The Department continues to work with the intelligence and law enforcement communities to establish a first line of defense to stop or deter terrorists and transnational criminals before they reach U.S. shores. Key to this defense is the overseas adjudication of over 7 million visa applications annually, facilitating the travel of legitimate visitors to the United States while denying entry to non-bona fide travelers, especially those who pose a threat to national security. The Department has shown significant progress in enhancing the training of consular officers in advanced interview techniques and the use of sophisticated databases to improve the screening process. The Department has also made gains in sharing intelligence, particularly with the Department of Homeland Security.

Fraud prevention in both visa and passport processing continues to be a critical challenge. The Department has effectively reorganized and improved fraud prevention programs, resulting in better fraud trend analysis and field support, but personnel shortages have hampered the expansion of the data-mining of visa records for fraud and corruption investigations, and may have a negative effect on the detection of passport fraud at some of the larger regional passport centers. The Department has deployed additional law enforcement personnel to work with consular offices and foreign law enforcement to identify, target, and disrupt travel document vendors and facilitators.

The Office of the Coordinator for Counterterrorism (S/CT) has too often been viewed as marginal to the global war on terror. Reasons identified during OIG's inspection of the office include a lack—until recently—of leadership, insufficient resources, and the difficulty of helping to coordinate the wide scope of counterterrorism efforts. This has eclipsed the hard work of dedicated employees. The new coordinator has recruited an experienced management team that has begun to reinvigorate S/CT and raise morale.

The Department's insufficient ability to monitor compliance or abuse by designated sponsors of exchange visitors within existing regulations, policies and procedures is a reportable condition with the Department's Management Control Steering Committee. The Bureau of Educational and Cultural Affairs, which administers the Exchange Visitors Program, has established a compliance unit to train staff and to provide oversight of this activity, and regulations and policies are being rewritten to provide better guidance and increase the government's enforcement capability.

Public Diplomacy

The Department, as a strategic goal, aims to increase understanding for American values, policies, and initiatives to create a receptive international environment. The Under Secretary for Public Diplomacy and Public Affairs has made clear the importance and urgency of this goal. Last year, OIG identified three areas needing attention: coordination of public diplomacy, performance measurement, and perceptions in the Muslim world. The Department has made progress in improving coordination and performance measurement. Improving the perceptions in the Muslim world still remains a performance challenge.

OIG and the Government Accountability Office (GAO) have previously indicated the need for greater public diplomacy interagency coordination, with the Department playing the lead role. The Department has made important strides forward in this area, establishing a policy coordinating committee, headed by the Under Secretary of Public Diplomacy and Public Affairs, to institutionalize interagency public diplomacy coordination and develop an overarching strategy.

OIG's review of implementation of the Middle East Partnership Initiative (MEPI) found persistent communications problems between the MEPI Office in the Bureau of Near Eastern Affairs and embassies having MEPI programs, which the Department is working diligently to improve. As an example of transformational diplomacy at work, there is general agreement that MEPI works and is a useful tool for diplomats. Its programs support overarching, strategic U.S. policy objectives such as the Administration's freedom strategy of promoting reform and democracy in the Middle East and North Africa, and the objective of addressing Islamic extremism.

Post-Conflict Stabilization and Reconstruction

Basic to the success of all U.S. hopes for democracy and good governance in Iraq is an effective anticorruption regime. Because of the connection between corruption and the insurgency in Iraq and because of corruption's threat to stability and reconstruction in Afghanistan, the U.S. Government has increased its anticorruption efforts in both countries. Following OIG assessments of rule-of-law and anticorruption programs in Iraq, Embassy Baghdad has strengthened and streamlined the management of its rule-of-law programs, expanded interaction with Iraqi agencies, and improved coordination among international donors. The Department has assigned a Foreign Service officer to serve as the embassy's senior rule-of-law coordinator and to increase collaboration with the military command, and a strategic rule-of-law plan has been incorporated into the embassy's Mission Performance Plan. As part of its multi-agency anticorruption program, Embassy Baghdad is working to establish advisors to the Board of Supreme Audit and to the Iraqi Inspectors General, to go along with the advisor to the Commission on Public Integrity, in recognition that these institutions must ultimately be effective in the discharge of their oversight responsibilities if rule of law is to prevail in Iraq. A joint OIG survey with Department of Defense OIG of another element in the rule of law—police forces— identified weaknesses in the Iraqi program for recruiting, vetting, and training candidates, while a similar joint survey in Afghanistan noted deficiencies in the police readiness level as well as in management controls over U.S.-provided equipment.

OIG surveys and assessments in both countries have observed that rule of law includes the entire legal complex of a modern state, from a constitution and a legislature to courts, judges, police, prisons, due process procedures, a commercial code, and anti-corruption mechanisms, and all elements need to progress nonsequentially for the functioning of a safe, secure, and democratic environment where rights and liberties of individuals are protected. In keeping with this viewpoint, Congress has continued to provide substantial funding for agency-operated rule-of-law and anti-corruption programs, including earmarked funds for OIG to continue and expand its work in both countries in FY 2006 and 2007.

OIG FY 2006 PERFORMANCE RESULTS AND ACCOMPLISHMENTS

FY 2006 was a year of both accomplishment and challenge for the Office of Inspector General. The following pages summarize OIG results in addressing its FY 2006 performance goals, as well as key accomplishments.

OIG STRATEGIC AND PERFORMANCE GOALS AND FY 2006 RESULTS

Strategic Goal (SG) Performance Goal (PG)	Measure	FY 2006 Target	FY 2006 Actual	% Above or Below Target
SG1: The Department and the BBG effectively, efficiently, and economically, advance the foreign policy interests of the United States				
PG1: Improve the operations of overseas missions, domestic bureaus, and international broadcasting activities	Missions and bureaus inspected	31	32	3%
	Reports issued on systemic/ regional/policy issues and programs	12	10	-17%
	Recs. resolved within 6 months	80%	65%	-19%
	Significant recs. resolved within 6 months	80%	47%	-41%
SG2: The Department and the BBG adequately protect the people, information, and facilities under their control in the United States and abroad				
PG1: Assess security for personnel, facilities and information	Reports issued on security programs	14	21	50%
	Recs. resolved within 6 months	80%	68%	-15%
	Significant recs. resolved within 6 months	80%	71%	-11%
SG3: The Department and the BBG have the necessary systems and controls to meet legal and operational requirements				
PG1: Identify vulnerabilities in financial and administrative support programs	Reports issued on programs reviewed	24	33	38%
	Recs. resolved within 9 months	80%	70%	-13%
	Significant recs. resolved within 9 months	85%	80%	-6%
PG2: Evaluate progress in addressing priority issues	Major management challenges addressed in OIG reports	80%	100%	25%
SG4: The Department and the BBG ensure accountability and eliminate fraud, waste, abuse, and mismanagement in programs and operations				
PG1: Identify potential monetary and nonmonetary benefits and improve the efficiency of operations and compliance with applicable contracts and grants	Return on Investment for audits	$1.20	$2.06	72%
	Value of cost savings, efficiencies, recoveries, and fines	$8.5 million	$31.3 million	268%
PG2: Promote professional and ethical conduct and accountability; and investigate fraud, waste, abuse, and mismanagement	Activities focused on key vulnerabilities	28	37	32%
	INV reports issued within 6 months	70%	86%	23%
	Investigations focused on management challenges	65%	100%	54%
	Percent of complaints—not investigated by OIG—referred within 21 days	85%	69%	-19%
Management and Organizational Excellence				
Ensure employees have professional skills and expertise necessary to fulfill OIG mission and goals	Percent of staff completing required leadership training	80%	84%	5%
Continuously improve OIG products and processes for maximum impact in meeting customer needs	Average days to issue inspection reports and program reviews	180	171	5%
	Average days to issue audit reports	215	234	-9%

Overall, OIG achieved 55 percent of its FY 2006 performance targets. Results on return on investment for audits and cost efficiencies exceeded targets by nearly 72 percent and 270 percent respectively. Other targets fell short by as much as 41 percent. The performance shortfalls experienced in FY 2006 were primarily the result of funding and staffing shortages that reduced OIG's ability to travel and to staff positions responsible for addressing compliance with OIG recommendations. An expected increase in FY 2007 funding, along with aggressive new recruitment and retention efforts, should enable OIG to better meet its future targets and to achieve those not met in FY 2006.

Key Results and Accomplishments of OIG Work

During FY 2006, OIG findings and recommendations prompted actions taken by the Department and BBG that produced significant results. These results included improvements in verification procedures and quality controls to ensure that only American citizens received U.S. passports; in the protection of classified information and materials; and in the integrity, accuracy, and reliability of financial management and other information systems. OIG audit and investigative activities also improved accountability for Department employees, contractors, and grantees; identified potential cost benefits; and reduced fraud and other violations of law and regulation. Highlights of some of our most important results are shown below by strategic goal.

ACCOMPLISHMENTS AND EXPECTED FUTURE RESULTS IN RESPONSE TO OIG REPORTS AND INVESTIGATIONS

SG1: Foreign Policy

- Establishment of an over-arching strategic plan for Embassy Baghdad's rule-of-law programs
- Strengthened Iraqi anticorruption programs
- Increased management oversight of the $260-million Afghanistan counternarcotics program
- Department actions to address OIG-identified border security vulnerabilities that could be exploited by terrorists
- Improvements to international broadcasting efforts in the Global War on Terror and greater coordination on public diplomacy matters

SG2: Security

- Improvements in the emergency preparedness at BBG's domestic facilities
- Improvements to perimeter security for vehicle access points at overseas missions
- The expedited assignment of a full-time security officer to a critical-threat post
- Improvements in the Department's patch management program to lessen security vulnerabilities
- Elimination of a backlog of over 200 requests from embassies for Dedicated Internet Network waivers

SG3: Financial Management and Administrative Support

- Strengthened controls at the Global Financial Services Center in Charleston
- Improvements in Department controls over the tracking and reporting of aircraft and parts inventories
- Development of an airline travel self-assessment tool for bureaus to determine compliance with air travel policies
- Improvements in quality assurance and identification of potential cost savings by outsourcing specific medical functions

SG4: Accountability

- Identification of questioned costs, recoveries, or funds put to better use totaling $31.3 million
- Development of a fraud-prevention "tool kit" for consular operations
- Termination of an unnecessary warehouse lease by the Department
- Transfer of other administrative activities to the regional center in Singapore
- Action taken by BBG to begin centralizing its management of overseas transmitting stations

Resources Supporting OIG Strategic Goals

OIG strategic goals were supported by an FY 2006 budget of $29.65 million. Budget constraints and recruitment problems limited OIG's on-board staffing to 182 employees as of the end of FY 2006. Allocations of resources to OIG's strategic goals are summarized below.

Budget by Strategic Goal		
SG1:	$9.1 Million	31%
SG2:	$5.7 Million	19%
SG3:	$7.9 Million	27%
SG4:	$6.9 Million	23%

Staffing by Strategic Goal		
SG1:	47	26%
SG2:	35	19%
SG3:	52	29%
SG4:	48	26%

An expanded version of OIG's FY 2006 Program Performance Report can be found online at *www.oigweb.state.gov*.

MILESTONES OF AMERICAN DIPLOMACY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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