UNITED STATES DEPARTMENT OF STATE
FISCAL YEAR 2012 Agency Financial Report

Delivering Results for the American People

ABOUT THIS REPORT

The United States Department of State's *Agency Financial Report* (AFR) for Fiscal Year (FY) 2012 provides an overview of the Department's financial and performance data to help Congress, the President, and the public assess our stewardship over the resources entrusted to us. See *www.state.gov/s/d/rm/rls/perfrpt/2012/index.htm*.

The AFR is the first of a series of three annual financial and performance reports for Federal agencies choosing to produce a separate AFR, an integrated Performance Budget, and a Summary of Performance and Financial Information. The reporting schedule includes: (1) an *Agency Financial Report* issued in November 2012; (2) a complete agency *Annual Performance Report* (APR) for FY 2012 and *Annual Performance Plan* (APP) for FY 2014 as part of the FY 2014 *Congressional Budget Justification* (CBJ), which is the Department's budget request to Congress, to be issued in February 2013; and (3) a *Summary of Performance and Financial Information*, to be released also in February 2013. The last report will be produced jointly with the United States Agency for International Development (USAID). These reports are available online at *http://www.state.gov/s/d/rm/c6113.htm*.

FY 2012 HIGHLIGHTS *(dollars in millions)*	Percent Change 2012 over 2011	2012	2011 Restated	2010	2009
Balance Sheet Totals as of September 30					
Total Assets	+8%	$ 79,572	$ 73,642	$ 68,334	$ 59,553
Total Liabilities	+5%	25,427	24,124	23,583	22,536
Total Net Position	+9%	54,145	49,518	44,751	37,017
Results of Operations for the Year Ended September 30					
Total Net Cost of Operations	+14%	$ 26,456	$ 23,237	$ 21,548	$ 21,613
Budgetary Resources for the Year Ended September 30					
Total Budgetary Resources	+8%	$ 57,533	$ 53,292	$ 52,581	$ 50,138
Full-time, permanent employees in the Foreign Service	+2%	13,774	13,518	13,008	12,258
Full-time, permanent employees in the Civil Service	+1%	10,760	10,645	10,039	9,614
Full-time Foreign Service Nationals	–7%	5,294	5,669	6,051	6,010
Number of Passports Issued *(books and cards)*	+4%	13.1 million	12.6 million	14.8 million	14.2 million

ABOUT THE COVER

The cover is a montage symbolizing the results the State Department delivers for the American people promoting economic growth; being able to travel abroad and immigrate to the United States; and providing global humanitarian assistance for disaster prevention and as a means of orderly and humane migration. The Special Representative for Commercial and Business Affairs congratulates the Maghreb Entrepreneurship Delegation winner, part of an initiative under the U.S. - North Africa Partnership for Economic Opportunity. Located in Portsmouth, N.H., the National Visa Center houses over 2.6 million immigrant visa files. At the right, a man hoists American wheat destined for Afghanistan. Finally, two passports symbolize Americans' ability to travel abroad and are made possible by the Department's dedicated employees.

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Message from the Secretary

It is my pleasure to present the U.S. Department of State's Agency Financial Report (AFR) for Fiscal Year 2012. In these pages, you will find more than just financial and performance information: you will find evidence of our commitment to keep delivering results for the American people at a time when resources are limited but the stakes remain high. We take seriously our duty to practice fiscal responsibility and transparency as we advance the U.S. foreign policy objectives.

Today, the United States is faced with a range of complex challenges: a transition in Afghanistan; a new relationship with post-war Iraq; revolutions and transitions in the Middle East and North Africa; a weakened but still dangerous al-Qaeda; climate change and resource scarcity; nuclear proliferation; pandemic disease and global hunger; and continued economic difficulties here at home, to name just a few.

To tackle these challenges, we have to act on several fronts at once. U.S. diplomats and development experts across the globe must coordinate and execute effective policies. Leaders must make difficult choices, prioritizing some programs over others. We also require strong management, from hiring and developing talent to using our resources wisely.

On the policy front, we are delivering real results. Our troops are home from Iraq and a transition is underway in Afghanistan – but our diplomats and development experts will remain to stand with our partners and keep America safe. We are renewing our engagement in the Asia-Pacific, ensuring we will continue to play a leading role in the most consequential region of the 21st Century. We are building new alliances and strengthening our relationships with the world's emerging powers, continuing to engage them on issues such as human rights, open government, and free trade. We will continue to disrupt, dismantle, and defeat al-Qaeda in the wake of killing the world's most wanted terrorist. In the Middle East and North Africa, we are supporting unprecedented democratic transitions in previously authoritarian nations.

Across the globe, we are harnessing our economic power to ensure U.S. businesses and industries compete on a level playing field, modernizing our diplomacy to better support our partners' development goals, and finding new ways to elevate the role of women and girls in all that we do. We are achieving all this by making difficult but necessary tradeoffs. We are reducing our assistance to parts of Europe while at the same time expanding the effective development programs that promote our values and our interests, from our food security work to the President's Emergency Plan for AIDS Relief.

We also have achieved a great deal in our efforts to manage our resources effectively and improve the way we work together. Since completing the Quadrennial Diplomacy and Development Review (QDDR) two years ago, we have reorganized the Department of State to better support civilian security, elevate energy issues, and promote economic statecraft. We have given our staff new opportunities to develop their skills and revamped training programs to emphasize interagency coordination. We have reformed our strategic planning processes and program evaluation to make us more forward thinking and accountable.

All of these results are just the beginning; we are now implementing a second wave of QDDR reforms.

In addition, we remain committed to corporate governance and continuing to improve our financial management and internal controls. This AFR is our principal publication and report to the President, Congress, and the American people on our stewardship of the public funds to which we have been entrusted. To ensure this AFR is complete and reliable, we worked with our Independent Auditor on the financial data and with our bureaus and missions on the summary performance data.

In short, the men and women of the State Department are delivering results for the American people. This work is difficult and sometimes dangerous. Still, they press on, because they know a strong America continues to play an essential role in creating the more peaceful and prosperous world we all want. I am deeply proud to represent them.

Hillary Rodham Clinton

Hillary Rodham Clinton
Secretary of State
November 16, 2012

About the Department

OUR MISSION STATEMENT

Advance freedom for the benefit of the American people and the international community by helping to build and sustain a more democratic, secure, and prosperous world composed of well-governed states that respond to the needs of their people, reduce widespread poverty, and act responsibly within the international system.

Our Organization and People

The Department of State is the lead U.S. foreign affairs agency within the Executive Branch and the lead institution for the conduct of American diplomacy. Established by Congress in 1789, the Department is the oldest and most senior executive agency of the U.S. Government. The head of the Department, the Secretary of State, is the President's principal foreign policy advisor. The Secretary carries out the President's foreign policies through the State Department and its employees. Headquartered in Washington, D.C., the Department of State implements U.S. foreign policy worldwide.

The Department of State 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; and
- Bringing nations together and forging partnerships to address global problems, such as climate change and resource scarcity, nuclear proliferation, terrorism, the spread of communicable diseases, cross-border pollution, humanitarian crises, nuclear smuggling, and narcotics trafficking.

The Department operates more than 270 embassies, consulates, and other posts worldwide staffed by Locally Employed (LE) Staff and more than 13,700 Foreign Service officers. Secretary Clinton laid out a multi-year hiring plan, Diplomacy 3.0, which envisions increasing the Department's Foreign Service by 25 percent to ensure that diplomacy is again ready and able to address our nation's growing and increasingly complex foreign policy challenges. Since 2008, the Department has increased the Foreign Service by over

OUR VALUES

LOYALTY

Commitment to the United States and the American people.

CHARACTER

Maintenance of high ethical standards and integrity.

SERVICE

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

ACCOUNTABILITY

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

COMMUNITY

Dedication to teamwork, professionalism, and the customer perspective.

DIVERSITY

Commitment to having a workforce that represents the diversity of America.

18 percent. In each Embassy, the Chief of Mission (usually an Ambassador) is responsible for executing U.S. foreign policy goals and for coordinating and managing all U.S. Government functions in the host country. Increasingly, our ambassadors are taking the role akin to a Chief Executive Officer (CEO) to manage the multi-agency mission that falls under their leadership. The President appoints each Ambassador, who is then confirmed by the Senate. Chiefs of Mission report directly to the President through the Secretary. The U.S. Mission is also the primary U.S. Government point of contact for Americans overseas and foreign nationals of the host country. The Mission serves the needs of Americans traveling, working, and studying abroad, and supports presidential and congressional delegations visiting the country.

A Civil Service corps of over 10,700 employees provides continuity and expertise in performing all aspects of the Department's mission. The Department's mission is supported through its regional, functional, and management bureaus and offices. The regional bureaus, each of which is responsible for a specific geographic region of the world, work in conjunction with subject matter experts for other bureaus and offices to develop policies and implement programs that achieve the Department's goals and foreign policy priorities. These bureaus and offices provide policy guidance, program management, administrative support, and in-depth expertise in matters, such as:

- law enforcement and counternarcotics
- economic diplomacy
- the environment
- intelligence
- arms control
- human rights
- counterterrorism
- public diplomacy
- humanitarian assistance
- security
- conflict stabilization
- nonproliferation
- consular services
- empowering women and girls

In carrying out these responsibilities, the Department of State consults with Congress about foreign policy initiatives and programs, and works in close coordination with other Federal agencies, including the Department of Defense, the U.S. Agency for International Development (USAID), the Department of the Treasury, the Department of Commerce, and the Department of Agriculture, among others. The National Security Strategy, the Quadrennial Diplomacy and Development Review (QDDR), and the Presidential Policy Directive on Global Development define the strategic goals and priorities that guide U.S. global engagement and identify the diplomatic and development capabilities that the Department of State and USAID need to advance U.S. interests. See State and USAID Joint Strategic Goal Framework on page 12. The Department of State and USAID carry out their joint mission in a worldwide workplace, focusing their energies and resources wherever they are most needed to best serve the American people and the world.

The Department's organizational chart appears on page 7 and a map of the Department's locations appears on pages 8-9.

In line with QDDR recommendations, the following Bureaus, Special Advisors, Coordinators Offices, and Under Secretaries were either established or renamed in FY 2012:

Established:

- Bureau of Budget and Planning
- Bureau of Conflict and Stabilization Operations
- Bureau of Counterterrorism
- Bureau of Economic and Business Affairs
- Bureau of Energy Resources
- Bureau of the Comptroller and Global Financial Services
- Office of the Chief Economist
- Senior Advisor to the Secretary for Development
- Special Advisor to the Secretary for Implementation of the Quadrennial Diplomacy and Development Review

Renamed:

- Office of U.S. Foreign Assistance Resources (F) – formerly Office of the Director of U.S. Foreign Assistance (F)
- Office of Global Criminal Justice (J/GCJ) – formerly Office of War Crimes Issues (S/WCI)
- Under Secretary for Civilian Security, Democracy and Human Rights (J) – formerly Under Secretary for Democracy and Global Affairs (G)

Internationally, the Department built four new Embassy Compounds in Kyiv, Djibouti, Monrovia, and Libreville, and also completed construction of two new consulates in Mumbai and Surabaya in FY 2012. Additionally, the Department added USAID annexes to its existing Department of State presence in Kyiv and Islamabad.

EMPLOYEE COMPOSITION AND NUMBERS

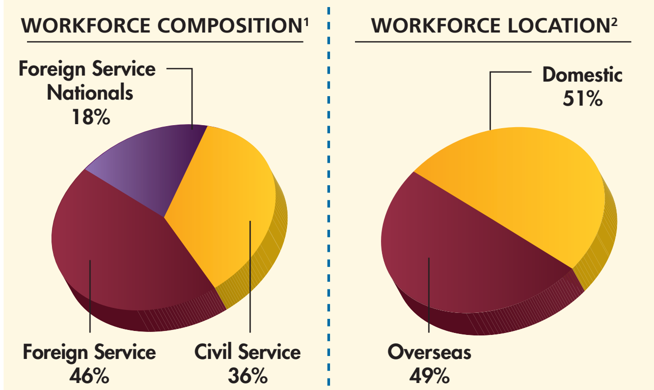
The Foreign Service Officers and Civil Service staff in the Department of State and U.S. missions abroad represent the American people. They work together to achieve the goals and implement the initiatives of American foreign policy. The Foreign Service is dedicated to representing America and to responding to the needs of American citizens living and traveling around the world. They are also America's first line of defense in a complex and often dangerous world. A Foreign Service career is a way of life that requires uncommon commitment, yet also offers unique rewards, opportunities, and sometimes presents 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, most of whom are headquartered in Washington, D.C., are involved in virtually every policy and management area – from democracy and human rights to narcotics control, trade, and environmental issues. Civil Service employees also serve as the domestic counterpart to Foreign Service consular officers who issue passports and assist U.S. citizens overseas.

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

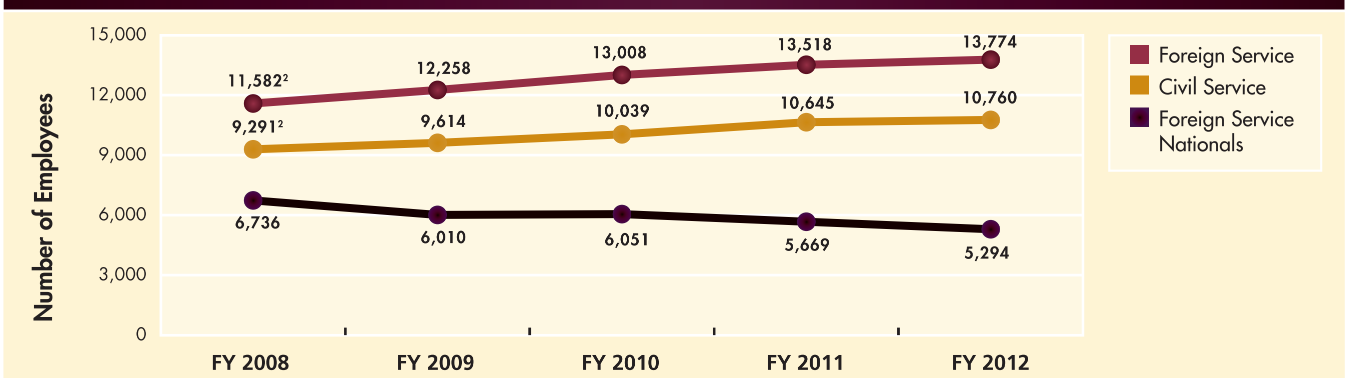
Figure 1 shows the distribution of the Department's workforce by employment category as well as the proportion of the workforce located overseas. At the close of FY 2012, without Personal Services Contractors (PSCs) and/or PSAs, the Department was comprised of 29,828 full-time permanent employees as shown in Figure 2.

Figure 1: Full-time Permanent Employees
(As of September 30, 2012)



[1] PSCs and PSAs are not included in FSN count. *[2] Overseas number includes FSNs.*

Figure 2: Summary of Full-time Permanent Employees[1]



[1] These numbers do not reflect position base numbers; only full-time employee base numbers. These numbers also do not include FSNs employed under Personal Services Agreements or as Personal Services Contractors. As full-time Foreign Service National employees leave, new employees for these positions are being hired through Personal Services Agreements, reducing the number of direct-hire appointments.

[2] Data as of August 31, 2008.

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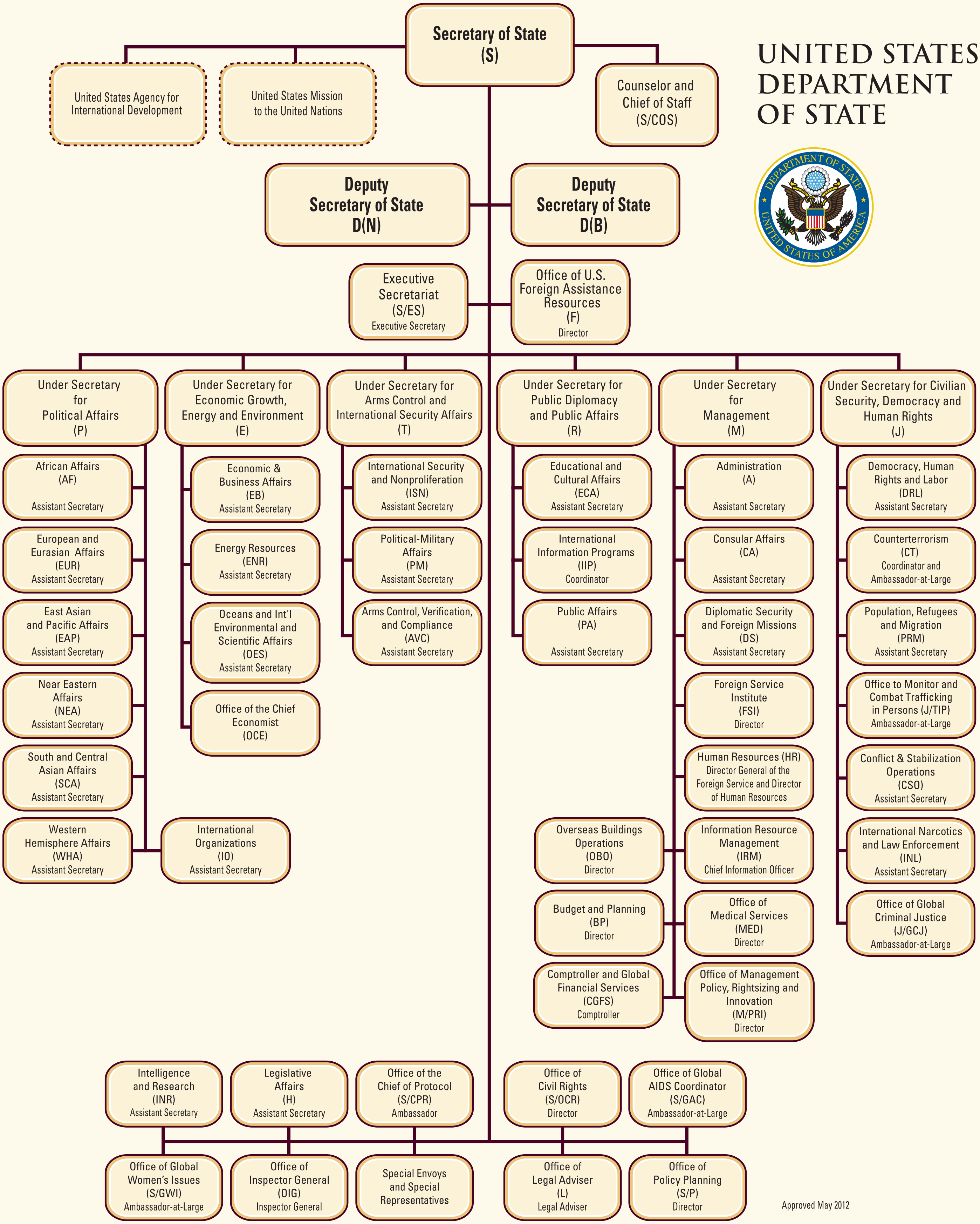
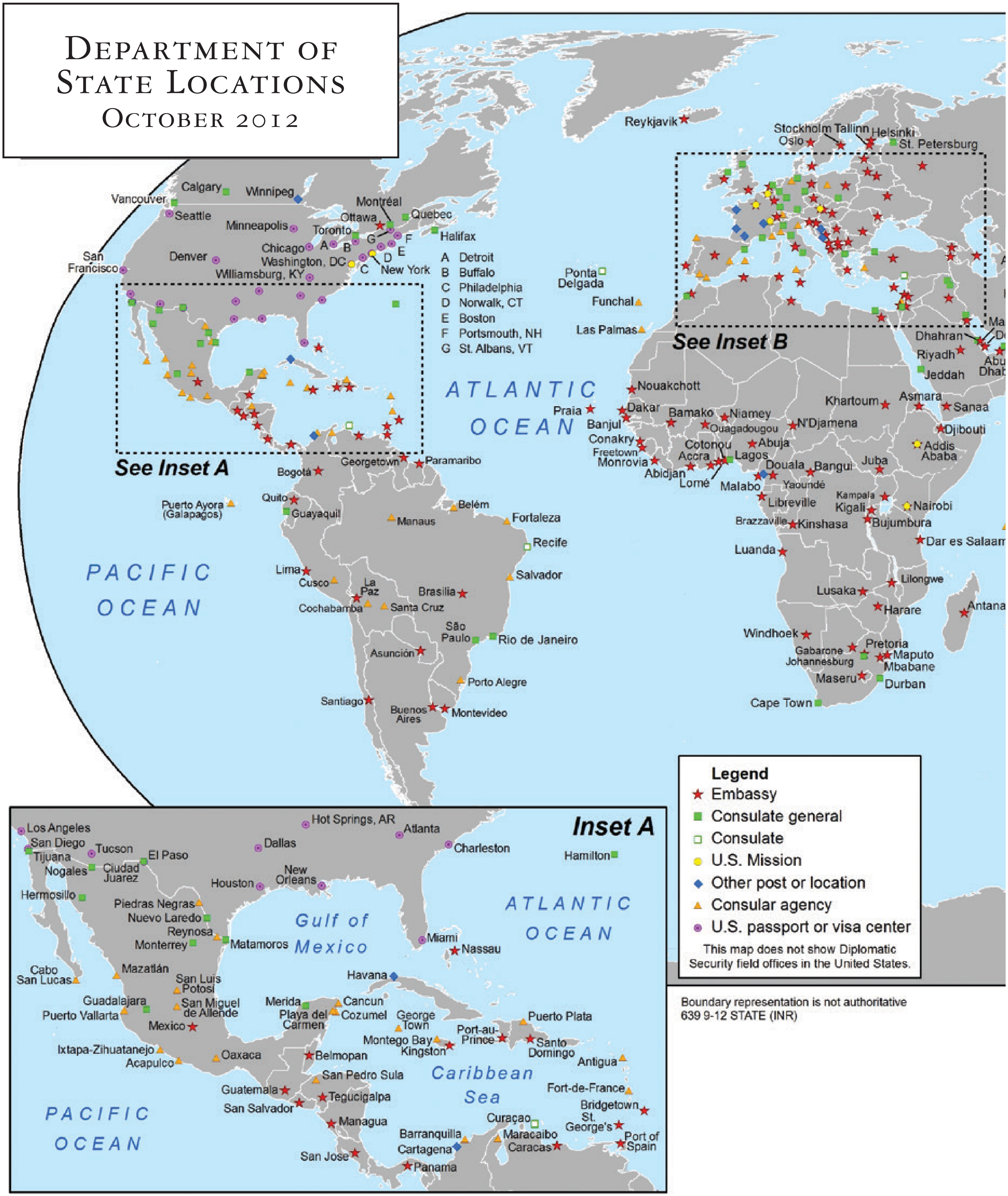


Department of State Locations
October 2012



Boundary representation is not authoritative
639 9-12 STATE (INR)


Cities with multiple Department of State facilities
Addis Ababa:
Embassy Addis Ababa
US Mission to the African Union
Brussels:
Embassy Brussels
US Mission to European Union
US Mission to NATO
Geneva:
US Mission Geneva
Consular Agency Geneva
Paris:
Embassy Paris
US Mission to OECD
US Mission to UNESCO
Montréal:
Consulate General Montréal
US Mission to ICAO
Jakarta:
Embassy Jakarta
US Mission to ASEAN
Nairobi:
Embassy Nairobi
US Mission to UNEP and Habitat
New York:
US Mission to UN
New York Passport Center
Portsmouth, NH:
National Passport Center
National Visa Center
Rome:
Embassy Rome
Embassy Holy See
US Mission to FAO
Vienna:
Embassy Vienna
US Mission to OSCE
US Mission to UNVIE
Washington, DC:
Department of State
US Mission to OAS
Washington Passport Agency
ARCTIC OCEAN
PACIFIC OCEAN
INDIAN OCEAN
Yekaterinburg
Astana
Ulaanbaatar
Bishkek
Almaty
Tashkent
Ashgabat
Dushanbe
Mazar-e Sharif
Peshawar
Islamabad
Herat
Kabul
Lahore
New Delhi
Manama
Doha
Dubai
Abu Dhabi
Muscat
Karachi
Kathmandu
Kolkata
Dhaka
Mumbai
Hyderabad
Chennai
Colombo
Vladivostok
Shenyang
Beijing
Yuzhno-Sakhalinsk
Sapporo
Seoul
Busan
Fukuoka
Tokyo
Nagoya
Osaka-Kobe
Chengdu
Wuhan
Shanghai
Naha (Okinawa)
Guangzhou
Hong Kong
Chiang Mai
Hanoi
Rangoon
Vientiane
Bangkok
Phnom Penh
Ho Chi Minh City
Manila
Cebu
Koror
Kolonia
Majuro
Honolulu
Kuala Lumpur
Bandar Seri Begawan
Medan
Singapore
Jakarta
Surabaya
Bali (Denpasar)
Dili
Port Moresby
Honiara
Apia
Suva
Papeete (French Polynesia)
Victoria
Salaam
Antananarivo
Port Louis
Perth
Canberra
Sydney
Melbourne
Auckland
Wellington
Inset B
North Sea
ATLANTIC OCEAN
Black Sea
Caspian Sea
Mediterranean Sea
Edinburgh
Belfast
Dublin
London
Copenhagen
Riga
Vilnius
Moscow
Minsk
Bremen
Hamburg
The Hague
Amsterdam
Berlin
Warsaw
Poznan
Dusseldorf
Leipzig
Brussels
Luxembourg
Frankfurt
Prague
Krakow
Kyiv
Paris
Strasbourg
Munich
Vienna
Budapest
Rennes
Zurich
Bern
Bratislava
Chisinau
Geneva
Lyon
Milan
Ljubljana
Zagreb
Belgrade
Bordeaux
Genoa
Venice
Banja Luka
Bucharest
Toulouse
Nice
Marseille
Florence
Sarajevo
Mostar
Pristina
Sofia
A Coruña
Rome
Holy See
Podgorica
Skopje
Tirana
Tbilisi
Istanbul
Barcelona
Thessaloniki
Madrid
Naples
Yerevan
Baku
Ankara
Valencia
Palma de Mallorca
Lisbon
Palermo
Izmir
Athens
Sevilla
Adana
Fuengirola (Malaga)
Algiers
Tunis
Valletta
Erbil
Kirkuk
Nicosia
Rabat
Casablanca
Tripoli
Beirut
Damascus
Haifa
Baghdad
Tel Aviv
Amman
Jerusalem
Alexandria
Cairo
Al Basrah
Kuwait

THE DEPARTMENT OF STATE'S BUREAU OF ENERGY RESOURCES: SHAPING AMERICA'S GLOBAL ENERGY POLICY

Why a Bureau of Energy Resources?

The world runs on energy and people need affordable, reliable, and sustainable energy supplies. Energy provides for our most basic needs and fuels the technologies that can secure our futures. But over one billion of the world's people still do not have access to electricity. If we ignore their needs, we entrench their poverty. If we expand their access to energy without making it sustainable, we accelerate environmental impacts and the competition for scarce resources.

The Department is charged with shaping U.S. international energy engagement, influencing how nations move to a cleaner energy future, and protecting our energy infrastructure and transit routes. This effort requires strong diplomatic relationships with major consumers and suppliers. We must anticipate changes in energy markets, and work with international organizations to stabilize markets and build capacity to manage them. Investments in secure, expanding, and ever-cleaner sources of energy will translate into improved health, greater economic sustainability, safer living environments, and enhanced U.S. national security.

The Bureau's Core Goals

- Manage the geopolitics of today's energy economy through vigorous diplomacy with producers and consumers. *This is critical to promote adequate and affordable supplies of energy and to keep energy markets stable.*

> "With a growing global population and a finite supply of fossil fuels, the need to diversify our energy supply is urgent. We need to engage traditional exporters and emerging economies alike, to bolster international energy security, and ensure that countries' natural wealth results in inclusive growth."
>
> *— Secretary of State, Hillary Rodham Clinton*

- Stimulate market forces for transformational policies in alternative energy, electricity, development and reconstruction. *This creates market demand for green technologies and products where the United States has a competitive advantage.*
- Increase access to energy in developing countries, expand good governance, and deepen transparency. *This helps developing economies find commercially and environmentally sustainable paths out of poverty.*

New Solutions for Old Resources

A balanced approach requires a mix of old and new energy sources. Traditional sources like oil and gas continue to be essential but all countries must promote responsible use and diversification of those supplies. Meanwhile the search for long-term substitutes must continue. The Bureau of Energy Resources works closely with key actors in the energy sector – oil and gas producers, developers of renewable technologies, and NGOs – to spur innovation and unleash private capital in environmentally and commercially sustainable ways.

PERFORMANCE SUMMARY AND HIGHLIGHTS

PERFORMANCE MANAGEMENT OF DIPLOMACY AND DEVELOPMENT PROGRAMS

Employees at the State Department and USAID solve complex problems by managing competing priorities and working effectively and efficiently to maximize our impact around the world. The Department and USAID are committed to using performance management best practices to meet these challenges in order to ensure the most effective U.S. foreign policy outcomes and greater accountability to our primary stakeholders – the American people.

Strategic planning and performance management, including evaluation, are guided in the Department and USAID by the Quadrennial Diplomacy and Development Review (QDDR) and the Government Performance and Results Act Modernization Act of 2010 (GPRAMA). In addition, the Department and USAID share a Joint Strategic Goal Framework organized around seven strategic goals. The QDDR serves as the Department of State-USAID Joint Strategic Plan, which is anchored in the National Security Strategy's objectives for U.S. foreign policy and development assistance. Figure 3 on the next page, entitled *"Old to New" Department of State-USAID Joint Strategic Goal Framework* is a graphic that depicts the State Department and USAID's new Strategic Goals in comparison to the previous Strategic Goal Framework. Beginning in FY 2013, the Department of State and USAID will measure progress, results, and report performance against the new Joint Strategic Goal Framework. In accordance with GPRAMA, both State and USAID are updating the agencies' Joint Strategic Plan.

Since 2007, the Department of State has chosen to produce an *Agency Financial Report (AFR)*, an alternative to the *Performance and Accountability Report*, and included its *Annual Performance Report* and *Annual Performance Plan* within its *Congressional Budget Justification* (CBJ). The AFR is released and available to the public 45 days after the new fiscal year. The CBJ is released to the public upon release of the President's budget in February of every calendar year. Additionally, the Department and USAID produce jointly a *Summary of Performance and Financial Information* in mid-February of every calendar year. Budget, performance reports and plans,

Secretary of State Clinton, accompanied by USAID Administrator Rajiv Shah (left), waves upon their arrival at the USAID Child Survival Forum at Georgetown University in Washington, D.C., June 14, 2012. *©AP Image*

and financial reports are posted on the Department's website at *http://www.state.gov/s/d/rm/c6113.htm* and on USAID's website at: *http://www.usaid.gov/results-and-data/progress-data*.

Additionally, per the GPRA Modernization Act requirement to address Cross-Agency Priority Goals in the agency strategic plan, the annual performance plan, and the annual performance report, please refer to *http://www.performance.gov/*. This website provides the agency contributions to those goals and progress, where applicable. The Department of State currently contributes to the following Cross-Agency Priority Goals:

- Closing Skills Gap
- Exports
- Cybersecurity
- Sustainability
- Real Property
- Data Center Consolidation
- Strategic Sourcing

Figure 3: "Old to New" Department of State-USAID Joint Strategic Goal Framework

FY 2007 – FY 2012

Strategic Goal (SG) 1: Achieving peace and security
Strategic Priorities (SP): Counterterrorism • Conflict prevention, mitigation and response • Weapons of mass destruction and destabilizing weapons • Transnational crime and narcotics • Homeland security • Security cooperation and security sector reform

SG2: Governing justly and democratically
SP: Rule of law and human rights • Political competition and consensus building • Good governance • Civil society

SG3: Investing in people
SP: Health • Social services and protection for vulnerable populations • Education

SG4: Promoting economic growth and prosperity
SP: Private markets • Agriculture • Trade and markets • Economic opportunity and growth • Energy security • Environment • Infrastructure

SG5: Providing humanitarian assistance
SP: Protection, assistance and solutions • Orderly humane means for migration management • Disaster prevention and mitigation

SG6: Promoting international understanding
SP: Offer a positive vision • Nurture common interests and values • Marginalize extremism

SG7: Strengthening consular and management capabilities
SP: Consular services (visas, passports, American citizen services) • Major management functions

* Strategic Goal (SG); Strategic Priorities (SP)

FY 2013 – FY 2018

SG1: Counter threats to the U.S. and the international order, and advance civilian security around the world
SP: Weapons of mass destruction and destabilizing conventional weapons • Conflict prevention, mitigation and response • Security cooperation and security sector reform

SG2: Effectively manage transitions in the frontline states
SP: Economic growth • Civil society • Rule of law and human rights · Security cooperation and security sector reform • Good governance • Political competition and consensus building • Global health • Counterterrorism • Education

SG3: Expand and sustain the ranks of prosperous, stable and democratic states by promoting effective, accountable, democratic governance; respect for human rights, sustainable, broad-based economic growth, and well-being
SP: Rule of law and human rights • Peace, security and opportunity in the Greater Middle East · Good governance • Political competition and consensus building • Economic growth • Environment/climate change • Civil society • Global health • Food security/agriculture • Empowering women and children

SG4: Support disaster mitigation
SP: Protection, assistance and solutions • Orderly and humane means for migration management • Disaster prevention and mitigation

SG5: Support American prosperity through economic diplomacy
SP: Energy security • Open markets and create opportunities • Promote exports and support U.S. business

SG6: Advance U.S. interests and universal values through public diplomacy and programs that connect the United States and Americans to the world
SP: Shape the narrative • Counter violent extremist voices • Expand and strengthen people to people relationships

SG7: Build a 21st Century workforce; achieve U.S. Government operational and consular efficiency and effectiveness, transparency and accountability; and a secure U.S. Government presence internationally
SP: Visa services • Passport services • American citizen services • Human resources • Information technology • Rightsizing the U.S. Government presence • Diplomatic security • Facilities • Planning and accountability through QDDR implementation • Management services

Figure 4: Managing for Results Framework

The QDDR is a comprehensive assessment of the capabilities needed to strengthen and elevate diplomacy and development as key pillars of the national security strategy, alongside defense. The QDDR sets institutional priorities and provides strategic guidance as a framework for the most efficient allocation of resources. It provides the blueprint for elevating American "civilian power" to better advance U.S. national interests and to better partner with the U.S. military.

The QDDR currently serves as the new Department of State-USAID Joint Strategic Plan, and continues to address key U.S. foreign policy and national security priorities. This new Strategic Goal Framework is depicted in Figure 3, with a cross-walk from the strategic goals of our previous strategic plan.

Day-to-day, performance management at the Department is guided by the new QDDR ***Managing for Results Framework*** (Figure 4) that integrates strategic planning, budgeting, program management, and performance management.

To more effectively advance their shared diplomatic, development and security objectives, the Department and USAID rely on the integrated processes in the above framework to plan, execute, and report on programs, projects and activities carried out by both State and USAID, Washington-based bureaus and posts and missions overseas. The Framework was developed in response to the QDDR recommendations to better align planning and budgeting to ensure that the Department of State and USAID's highest strategic priorities are funded, and to produce the evidence needed to make smart investments.

The Department and USAID launched a high-level strategic planning process, strategies for regional and functional Bureaus, and Integrated Country Strategies that bring together all country-level planning for diplomacy, development, and broader foreign assistance into a single, overarching strategy. The multi-year strategies are completed separately from the annual budget formulation process. The intent is to ensure bureaus and missions have more time to design their strategies, and ensure the strategies articulate policy and establish programmatic direction by country, region, strategic goal and strategic priorities including, but not limited to: rule of law and human rights; energy security; counterterrorism; economic diplomacy; visa services; and global health.

The Department and USAID have developed eight joint Agency Priority Goals (APGs). The Joint State-USAID themes for the APGs are listed below. For further information, please see the Agency Priority Goals section on page 14 and/or visit *www.performance.gov*.

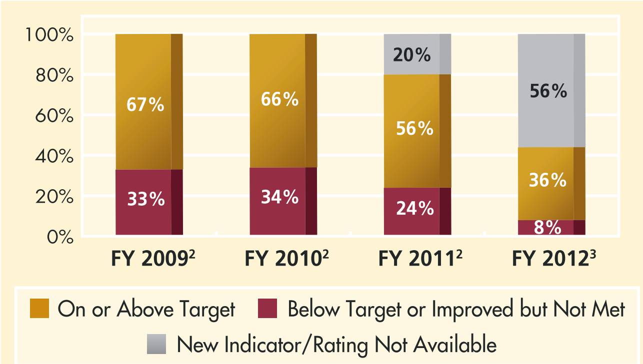
- Afghanistan
- Democracy, Good Governance, and Human Rights
- Climate Change
- Food Security
- Global Health
- Economic Statecraft
- Management
- Procurement Management/Local Development Partners

The APGs are measurable, near-term goals that align with the long-term strategic goals and priorities of the Department and USAID through FY 2013. In the Strategic Goals and Results section of this MD&A, two of eight APGs are featured as illustrative indicators for two of the seven joint strategic goals. Starting in FY 2012, the Department and USAID's Performance Improvement Officers have implemented quarterly data-driven reviews of APGs led by the Department of State's Chief Operating Officer. In FY 2013, the Department and USAID will develop new APGs that are outcome-based goals that reflect the Secretary and Administrator's highest priorities through FY 2015.

Using Performance Information to Inform Budget Formulation and Achieve Results

To assess FY 2012 results, program managers examined quantitative and qualitative indicators to determine whether indicators met previously established annual targets. Managers also considered how the results impact the achievement of the Department and USAID's strategic goals. A rating was then assigned to each indicator based on the analysis. In the Strategic Goals and Results section that follows, eight illustrative indicators are highlighted and accompanied by key achievements and a summary and analysis of performance trends. Since the Agency Financial Report is an FY 2012 report, State decided to also illustrate joint State and USAID forward looking indicators and provide the reader timely data and analysis, which complements the key achievements reported during FY 2012. Some of these illustrative indicators include Agency Priority Goal and bureau-specific performance indicators. In Figure 5, the bar graph shows collective

Figure 5: Performance Indicator Ratings FY 2009 - FY 2012[1]



[1] Data Sources: FY 2009, FY 2010, and FY 2011 - *Joint Summary of Performance and Financial Information* reports; and FY 2012 - Bureau Budget and Planning's Planning and Performance System. FY 2009 - FY 2011 performance ratings calculated from performance data provided in Department reports at the time of publication.

[2] The Department of State and USAID jointly reported indicators in the FY 2009, FY 2010, and FY 2011 *Joint Summary of Performance and Financial Information* reports. As a result, FY 2009, FY 2010, and FY 2011 indicator ratings featured in this bar graph include USAID indicators.

[3] FY 2012 ratings are not available for indicators that are new or for which result data are not yet available as of September 30, 2012. The Department will report FY 2012 ratings of Foreign Assistance indicators for programs managed by State and/or shared with USAID in the FY 2014 *Congressional Budget Justification* and FY 2012 *Joint Summary of Performance and Financial Information* scheduled for release in early 2013.

ratings for the Department and USAID's performance indicators at the time of this Report's publication. For FY 2012, updated performance information will be made available in the FY 2012 *Joint Summary of Performance and Financial Information Report* scheduled for release to the public in mid-February 2013.

Since the passing of GPRAMA, the Department implemented a number of efforts to strengthen performance measurement practices and to increase the use of performance information, including evaluation information, to support our programmatic and budgetary decisions. First, in the area of performance metrics, the Department streamlined and reengineered indicators associated with Foreign Assistance and State Operations-funded activities to better tie indicators to budgetary and programmatic decisions, and to develop a governance process to make additional updates and corrections to indicators. Second, each year, all bureaus and posts requesting $1 million or more in Foreign Assistance resources are required to complete a narrative providing specific examples of their tactical use of performance information; the narrative is now included in the Foreign Operations volume of the Congressional Budget Justification. Third, the Department of State began implementing a quarterly data-driven review process of our highest priority goals, further emphasizing the use of performance data as a management tool. Last, in February 2012, the Department put in place a new evaluation policy that mandates conducting program evaluations of all "large" State Department-funded programs, projects, and activities, and emphasizes using evaluation information and sharing evaluation results. The Department and USAID have made major progress in the collection and analysis of country and program performance information to feed evidence-based analysis, including evaluations. The evaluations are used to determine what is working and what is not, and, in turn, provide evidence to inform programmatic and budgetary decisions. In the Department's forthcoming FY 2014 Congressional Budget Justification, both planned and reported evaluations will be included.

Data Quality Assessment

The Department requires bureaus and missions to conduct data quality assessments for performance data reported to Congress and stakeholders, including the American public once every two years. Data sources include primary data that are collected by the Department directly; partner data compiled by implementing partners but collected from other sources; and third-party data from other government agencies or organizations. Data quality assessments examine the quality of performance results for potential limitations that might compromise the confidence of the data. The Department continues to make great strides to identify and use indicators that are useful for decision-making, are of high quality, and are most representative of our goals and strategic priorities. While many complex diplomatic issues lend themselves to qualitative analysis, the Department has developed new indicators and quantitative indicators whenever possible because they offer the opportunity to analyze important trends and examine empirical evidence when reviewing policy, planning strategy, and setting resource levels. By working with bureaus and missions, the summary of performance data included in this AFR is as complete and reliable as possible at the time this Report is published.

Agency Priority Goals (APGs)

Under the leadership of Secretary Clinton, the Department of State and USAID developed a new strategic approach to accomplishing their shared mission, focusing on robust diplomacy and development as central components to address global challenges through eight outcome-focused Agency Priority Goals (APGs) that reflect the Secretary and the USAID Administrator's highest priorities through FY 2013. For more information on the APGs, visit *http://www.performance.gov/*. In FY 2014, the Department and USAID will develop new outcome-based APGs through FY 2015.

In addition to quarterly reporting to OMB on the status of meeting key milestones and performance targets for each APG, GPRAMA requires that APG goal owners meet with its senior leadership to assess performance data, discuss successes and challenges, and identify any actions necessary to ensure goal achievement. A process has been developed for conducting joint data-driven reviews for Department of State-USAID APGs that brings together goal leaders with the Deputy Secretary of State and the USAID Assistant Administrator. Goal owners are assisted in the preparation of presentation materials with feedback from the Department of State and USAID Performance Improvement Officers as well as by a support team comprised of staff from the Office of U.S. Foreign Assistance Resources and the Bureau of Budget and Planning.

Looking Ahead and Addressing Challenges

The Department of State has advanced U.S. leadership by building and cultivating the sources of our strength and influence to deliver results for the American people. Our strength and influence is rooted in our military might, economic competitiveness, moral leadership, global engagement, and efforts to shape an international system that serves the mutual interests of nations and peoples. As noted in the message from the Secretary, U.S. diplomats and development experts across the globe are tackling complex challenges that include a difficult mission in Afghanistan; post-war Iraq; the Arab Awakening; a weakened but still dangerous al-Qaeda; emerging political and economic powers; climate change and resource scarcity; nuclear proliferation; pandemic disease and global hunger; and a continued economic downturn here at home. Looking ahead, overcoming these and other challenges will require difficult choices and tradeoffs in a time of scarce resources.

Continuing to successfully deliver the results that the American people demand and deserve and build a safe, prosperous world presents us with the opportunity to reaffirm our commitment to rigorous planning and performance management that will maximize the effect of every American tax dollar spent. As discussed earlier, per GPRAMA, the Department of State and USAID will develop the next joint agency strategic plan to cover the period from FY 2014 through FY 2017 and deliver it to Congress in conjunction with the Congressional Budget Justification in February 2014. By the end of 2014, the Department and USAID will roll out the final phase of multi-year strategic plans for State and USAID bureaus and missions that reflect priorities and guide resource requests and decisions. Through the high-level State and USAID joint strategic planning process, the development of strategies for regional and functional Bureaus, and the Integrated Country Strategies, State and USAID will link planning for diplomacy, development, and broader foreign assistance into a single, overarching strategy.

Chief of Staff Cheryl Mills speaks to Chiefs of Mission on the future of the QDDR at the second annual Global Chief of Mission Conference in Washington, D.C., March 13, 2012. ***Department of State***

We will continue implementing the first QDDR through 2014 and plan for the next one to enhance civilian leadership and advance our national interests. The next phase of QDDR implementation will be focused on these ten priority areas that we highlighted at the 2012 Chiefs of Mission Conference:

1) QDDR Institutionalization
2) Improve Sanctions Coordination
3) Further Budget and Planning Reform
4) International Operational Response Framework (IORF)
5) Security and Justice Sector Reform
6) Risk Management Framework
7) Recruitment & Workforce Flexibility
8) Transform Development to Deliver Results
9) Gender Equality/Status of Women and Girls
10) Chief of Mission Oversight

The Department is also addressing challenges raised by the Office of Inspector General (OIG) on pages 156-168. OIG considers the most serious management and performance challenges for the Department to be in the following areas: Protection of People and Facilities; Contract and Procurement Management; Information Security and Information Management; Financial Management; Military to Civilian-Led Transitions—Iraq and Afghanistan; Foreign Assistance Coordination and Oversight; Diplomacy with Fewer Resources; Public Diplomacy; Effective Embassy Leadership; and Consular Operations.

IMPLEMENTING THE QUADRENNIAL DIPLOMACY AND DEVELOPMENT REVIEW

In December 2010, the Quadrennial Diplomacy and Development Review (QDDR), developed under the leadership of Secretary Clinton, was completed and disseminated to the Department of State, USAID, and their stakeholders as a blueprint for elevating American "civilian power" to advance U.S. national interests and to better partner with the U.S. military. Two years later, the recommendations made in the QDDR are being implemented to improve the effectiveness of the Department and USAID in four broad areas:

- Adapting to the diplomatic landscape of the 21st Century
- Elevating and modernizing development to deliver results
- Strengthening civilian capacity to prevent and respond to crises and conflict
- Working smarter to deliver results for the American people

In FY 2012, the Department of State concluded the first phase of implementing the QDDR, with significant achievements in the following areas:

- The reorganization of the Under Secretary for Economic Growth, Energy, and the Environment (E) to ensure our economic, energy, and environmental goals serve U.S. national security goals.
- The establishment of the Under Secretary for Civilian Security, Democracy and Human Rights (J) to better coordinate our efforts and resources to advance civilian engagement and human security.
- The establishment of three new bureaus (Bureaus for Conflict and Stabilization Operations, Counterterrorism, and Energy and Resources) to better exercise civilian leadership in preventing conflict, countering terrorism, and advancing our international energy interests.
- Greater integration of women and girls into our policy framework, planning and budgeting, program monitoring and evaluation, and management and officer training.
- The creation of the Joint Management Board to strengthen State and USAID's efforts to coordinate, streamline, and integrate our administrative platforms.
- The establishment of a Chief Economist to advise on economic issues that implicate foreign policy interests and a Coordinator for Cyber Issues to lead our engagement in cyber security and other cyber issues.
- The incorporation of QDDR principles into the selection criteria process for Chief of Missions, Deputy Chiefs of Missions, and other principal officers.

This past year, the Department also launched an implementation plan for the second phase of the QDDR, including focusing the Department's efforts on the following areas of focus:

- Secure QDDR legislation with Congress, similar to that of the Department of Defense.
- Strengthen Chief of Mission (COM) authority and accountability, including facilitating COM input into personnel evaluations of non-State employees serving at overseas missions and formalizing the requirement that all agencies at post provide COMs with fully transparent budgets.
- Further integrate women and girls in all aspects of U.S. foreign policy to ensure a more inclusive, representative, and effective foreign policy consistent with U.S. values and principles.
- Adopt a lead agency framework that will integrate policy planning and crisis response to allow State and USAID to respond more effectively to unforeseen crises around the world.
- Recruit, retain, and train a more flexible, operational and innovative workforce to meet future foreign policy challenges. This includes considering ways to adapt the Foreign Service exam to meet the changing needs of our diplomacy, updating the Foreign Service promotion precepts, and expanding opportunities for Foreign Service and Civil Service to move between position categories.
- Establish a senior Sanctions Coordinator to better coordinate sanctions activities in the Department and amongst the Federal agencies.
- Intensify the incremental roll-out of new planning and budget processes to all bureau and missions resulting in a stronger linkage of expenditures to strategic goals.
- Better evaluate our assistance programs to improve coordination and deepen inter-agency cooperation.

Strategic Goals and Results

In FY 2012, the Department of State and USAID continued to increase analytical rigor in strategic planning and performance management by focusing on entity-level, outcome-oriented performance measures that support their strategic goals and priorities. The following section summarizes performance information for each of the seven Joint Strategic Goals. Each Goal is comprised of a Public Benefit narrative, selected Key Achievements, which occurred in FY 2012, and a forward looking Summary and Analysis of Performance. Joint State-USAID performance and budget information will be featured in the upcoming Joint Summary of Performance and Financial Information, scheduled for release in mid-February 2013.

Secretary of State Clinton delivers remarks at the Global Counterterrorism Forum in Istanbul, Turkey, June 7, 2012.
Department of State

STRATEGIC GOAL 1: ACHIEVING PEACE AND SECURITY

Preserve international peace by preventing regional conflicts and transnational crime, combating terrorism, and weapons of mass destruction, and supporting homeland security, and security cooperation.

Public Benefit. The United States faces a broad and complex array of challenges to our national security. Wars over ideology have given way to wars over religious and ethnic identity; inequality and economic instability have intensified; damage to our environment, food security, and dangers to public health are increasingly shared; and nuclear dangers have proliferated. In 2012, a profound and dramatic wave of change continued to sweep across the Middle East as people courageously stood up to their governments to express their legitimate aspirations for greater political participation and economic opportunity. The Arab Awakening has fundamentally transformed the political landscape of the Middle East. In Iraq, the United States ended a nearly nine-year combat presence, and successfully transitioned the bilateral relationship to a civilian-led partnership. Our close relationship with our interagency partners has enabled the United States to capitalize on the region's multiple democratic transitions to begin building a more stable, peaceful and democratic region.

The U.S. Government responds to these challenges with forward-deployed civilian power – the combined force of women and men across the U.S. Government who are practicing diplomacy, implementing development projects, and working with military services as a unified force to advance America's core interests and build a safer and more secure world. Our priorities include promoting democratic, political and economic reforms across the Middle East and North Africa to support transitions to democracy and equitable economic growth, seeking peace and security and a world without nuclear weapons through arms control and by combating the proliferation of weapons of mass destruction; countering violent extremism and the evolving terrorist threat; and supporting post-conflict stabilization activities.

In FY 2012, we strengthened our national security in a number of ways. We continued to work with other U.S. Government agencies to promote political and economic reform measures throughout the Near East region, pursuing partnerships between Americans and the people of the Middle East and North Africa via the Middle East Partnership Initiative (MEPI). We sustained our efforts to enhance regional counterterrorism cooperation through and in coordination with the Trans-Sahara Counterterrorism Partnership (TSCTP). This initiative seeks to counter the threat of al-Qaeda in the Islamic Maghreb and violent extremism across North Africa. TSCTP also supports regional partner efforts to engage with populations and institutions potentially vulnerable to radicalization and provide targeted assistance to disrupt cross-border flows of weapons and violent extremism between North Africa and Sub-Saharan Africa, which is particularly needful in the wake of Mali's coup and northern collapse. The Department's Quadrennial Diplomacy and Development Review (QDDR) placed a greater emphasis on the role of conflict prevention as a core mission of the Department. As a result, we are extending the reach and effectiveness of the U.S. civilian and military power to prevent and/or respond to conflict and to provide on-the-ground technical support to stabilize conditions pertaining to security, rule of law and economic recovery. Our counterterrorism efforts have focused energies on the creation and implementation of a "Smart Power" approach that we have called "strategic counterterrorism." The United States has worked to create stronger partners who are capable of dealing with threats within their borders, diminish terrorist recruitment by countering violent extremism, and strengthen the global community's will to support this agenda. In the area of proliferation of weapons of mass destruction, high level U.S. attention was focused this year on (a) intensifying sanctions on Iran in the face of continued blatant Iranian refusal to comply with its international nuclear obligations, (b) galvanizing action on nuclear security and in countering nuclear terrorism at the second Nuclear Security Summit, and (c) mobilizing international collaboration to combat biological terrorism, both at the Review Conference of the Biological Weapons Convention and with the G8.

Key Achievements

- The United States has provided equipment, training, logistics, and advisory support to the African Union Mission in Somalia (AMISOM) and the Somalia National Security Forces, which have in turn engaged in successful operations against the violent extremist organization al-Shabaab in Somalia; these efforts have greatly enlarged the area of territory held by legitimate Somali authorities and given the country its best chance in 20 years to achieve stability and self-governance.

- The Global Counterterrorism Forum (GCTF), the Administration's signature multilateral counterterrorism initiative is on its way to becoming the "go-to" multilateral venue for pursuing innovative, civilian-focused, capacity-building initiatives. The GCTF continues to attract high-level political support and concrete contributions from a diversity of its members. It has been particularly successful in attracting support for initiatives in its two strategic priority areas: strengthening rule-of-law institutions and countering violent extremism (CVE). Its two ministerial-level meetings have produced concrete achievements, including mobilizing more than $175 million in programming for rule-of-law based, counterterrorism training of criminal justice officials, with a particular emphasis on countries in transition. Adopting GCTF framework documents on rule of law and prison rehabilitation/de-radicalization, as well as announcing of the intention to establish centers of excellence on CVE in Abu Dhabi and Rule of Law in Tunis, will have a lasting impact.

- Addressing transition in the Middle East, State has used its technical expertise to develop closer relationships with many key partners to mitigate regional and global threats. In the aftermath of the "Arab Awakening," State led the effort to secure loose weapons in Libya, including securing or accounting for nearly 5,000 Man Portable Air Defense Systems (MANPADS) and components.

- As a result of extensive diplomatic engagement, the international community increased pressure on Iran to cease its proliferation-sensitive nuclear activities and comply with its international nuclear obligations. The United States applied new measures targeting Iran's oil revenues and the Central Bank of Iran and imposed new sanctions against the Iranian energy and petrochemical sectors; the European Union imposed an embargo on Iranian oil; and several countries have de-flagged Iranian shipping vessels. This is impeding Iran's ability to conduct international trade and find partners willing to take the risk of conducting any business with Iran.

- The bilateral relationship between the United States and Iraq continues to deepen. Under the Strategic Framework Agreement, the Governments of Iraq and the United States continue to work together at the most senior levels on a wide range of issues through eight Joint Coordination Committees (JCC), including defense and security, education and cultural affairs, energy, law enforcement and judicial cooperation, politics and diplomacy, services, and trade and finance.

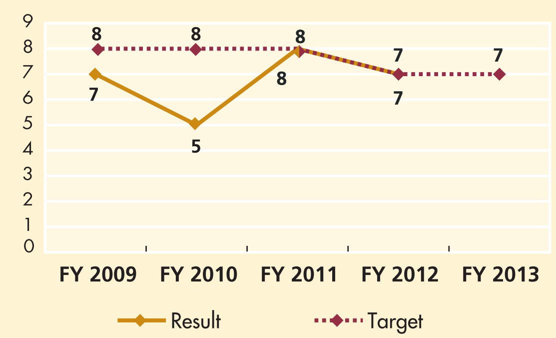
- The United States remained focused on advancing a two-state solution to the Israeli-Palestinian conflict through the promotion of direct negotiations between Israelis and the Palestinians based on the vision President Obama outlined in May 2011. The Administration's strategy in pursuit of Israeli-Palestinian peace consists of two mutually reinforcing lines of effort: a vigorous political negotiating track and equally vigorous institution-building track.
- In Afghanistan, U.S. support to Interagency Specialty Teams from the Departments of Homeland Security and Justice and the U.S. Marshal Service allowed them to provide rule of law expertise and mentorship to their military and Afghan counterparts in the areas of judicial security, correction facilities, anti-corruption, border operations, and reintegration programs for detainees.

Summary and Analysis of Performance Trends

This section details a key performance indicator to illustrate the Department's performance in an area that links to key budget and policy priorities under Strategic Goal 1. The indicator – the number of key milestones achieved annually that improve the capabilities of nuclear scientists and foreign governments to combat nuclear smuggling and prevent terrorist acquisition of a nuclear weapon – represents the Department's priority to improve the capabilities of foreign governments to prevent terrorist acquisition of nuclear materials or the expertise that could be used to develop and use a nuclear device. Overall, there have been some outstanding successes, including the maturation of the Global Initiative to Combat Nuclear Terrorism, development and expansion of the Preventing Nuclear Smuggling Program, and development of the nuclear component of the Global Threat Reduction program. Success has also been registered as the Department assists the International Atomic Energy Agency (IAEA) in developing and implementing norms, regulations, and guidelines regarding nuclear security. The diplomatic impetus provided by the 2010 Nuclear Security Summit in Washington and the 2012 Nuclear Security Summit in South Korea greatly assisted in this effort. Success often depends on foreign government actions and decision-making, so performance targets are not met all the time. This indicator tracks work in multiple initiatives and programs, including, but not limited to:

- The Global Initiative to Combat Nuclear Terrorism (GICNT) is a voluntary partnership of 85 states that collaborate through multilateral activities to strengthen the global capacity to combat the nuclear terrorism threat. Still in its infancy when President Obama, in his 2009 Prague speech, called for making the GICNT a "durable" international institution, GICNT performance metrics have matured as policy has solidified. The fact that some GICNT targets were not met in FY 2010, but fully met in FY 2011 and FY 2012, reflects this change in policy.
- The Preventing Nuclear Smuggling Program (PNSP) helps the most vulnerable states identify and address gaps in their capabilities to prevent, detect, and respond to nuclear and radiological smuggling. PNSP has recently exceeded its targets in large part due to the two Nuclear Security Summits focusing international attention to the issue, resulting in additional international funding and international political will.
- The Global Threat Reduction nuclear security program helps to build a self-sufficient nuclear security culture in priority countries, particularly in the Middle East,

Illustrative Indicator 1: The number of key milestones achieved annually that improve the capabilities of nuclear scientists and foreign governments to combat nuclear smuggling and prevent terrorist acquisition of a nuclear weapon[1]



Source: U.S. Department of State, Bureau of International Security and Nonproliferation.

[1] Performance data is developed from information from GICNT partners; consultations with foreign governments; IAEA documents and consultations; intelligence reporting; embassy reporting; and from ISN Non-proliferation, Anti-terrorism, Demining, and Related programs.

through training and integration into the international technical community. Due to the development of innovative engagement tools, such as capitalizing on alumni networks from international training programs and closer partnerships with the IAEA and other nuclear security organizations, the program exceeded its targets in FY 2011 and FY 2012.

- Assisting the IAEA in developing norms and technical guidance for nuclear and radiological safety and security. The effort to promote the IAEA Code of Conduct on radioactive sources exceeded its target, and definite progress was made in encouraging states to minimize the use of Highly-Enriched Uranium.

- The number of ratifications (97 are needed for entry into force) of the Amended Convention on the Physical Protection of Nuclear Material (CPPNM), which establishes legally binding international norms for physical protection of nuclear material in domestic use, storage, and transport, and adds to the original Convention two new offenses to the global penal regime, nuclear smuggling and sabotage. The high annual number of ratifications seen in FY 2010 and since has been the result of the impetus provided by the two Nuclear Security Summits in 2010 and 2012.

STRATEGIC GOAL 2: GOVERNING JUSTLY AND DEMOCRATICALLY

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

Public Benefit. U.S. leadership in promoting human rights is a national tradition, a moral imperative, and a national security priority. As the National Security Strategy makes clear, the United States "supports the expansion of democracy and human rights abroad because governments that respect these values are more just, peaceful, and legitimate… their success abroad fosters an environment that supports America's national interests." The Department's goals are simple: to ensure that people are protected by the law, are free from bodily harm, free to select their leaders, and free to assemble, associate, and express themselves. We advance these goals by investing in the essential institutions of democratic accountability, including independent media, democratic political parties, civil society organizations including election monitors, independent labor unions, and organizations defending fundamental freedoms; addressing human rights and democratization challenges in fragile democracies and post-conflict societies; and promoting effective and efficient stewardship of American taxpayer dollars.

To achieve these goals, the Department engages with governments and civil society, focusing on transitioning and post-conflict societies, as well as on those parts of the world not yet seeing democratic progress. We are institutionalizing successful programs to protect and integrate vulnerable communities – such as people with disabilities, lesbian, gay, bisexual, and transgender people, women, religious minorities, and ethnic minorities – in the political process, and are leading efforts to promote labor rights and business adherence to human rights standards. The Department also continues to fund programs in support of free expression and the free flow of information online and off. This investment helps to amplify the voices of civil society and human rights activists and support democratic partners.

Secretary of State Clinton presents Azezet Habtezghi Kidane, also known as Sister Aziza, an Eritrean nun with the Comboni Missionary Sisters, Israel, with a plaque as she is recognized at the release of the 2012 Trafficking in Persons Report at the State Department in Washington, June 19, 2012. ***@AP Image***

Key Achievements

- In September 2012, the Department garnered the support of 40 governments and organizations to condemn the grave human rights violations committed against the Syrian people and agree upon the urgent need to document violations of international human rights and humanitarian law in Syria. This group pledged to contribute more than $3 million, as well as in-kind contributions of transitional justice and human rights experts, to support these efforts through the Syria Justice and Accountability Center (SJAC). The SJAC is an independent multilateral organization that arose out of a Department initiative to coordinate the documentation, storage, and analyses of information on human rights violations in Syria. The U.S. contribution of $1 million leveraged contributions by other countries.

- The Department and USAID continue to provide technologies and knowledge that empower millions to safely exercise their human rights online, launching 24 new Internet Freedom initiatives in FY 2012. These programs range from a project to develop sophisticated new technologies for overcoming online censorship to a new effort providing emergency support to embattled digital activists launched in partnership with the Dutch and U.K. Governments.

- In December 2011, Secretary Clinton launched the Global Equality Fund to support programs advancing the human rights of lesbian, gay, bisexual and transgender (LGBT) persons around the world with more than $3 million from the Department and USAID. Following the launch, the Department now supports civil society organizations working to improve human rights protections for LGBT persons in all regions of the world, including emergency support to the most vulnerable LGBT advocates.

- The Secretary's Office of Global Women's Issues (S/GWI) played a key role in the development and coordination of the first U.S. National Action Plan (NAP) on Women, Peace, and Security (WPS) launched in December 2011. And, its supplemental implementation guidance was released in August 2012 to ensure that women participate equally in preventing conflict and building peace in countries threatened and affected by war, violence, and insecurity.

- S/GWI promoted gender equality in bilateral, regional, and multilateral diplomatic activity and has ensured that U.S. strategic/partnership dialogues with a number of countries – including Bangladesh, China, India, and Indonesia – integrate a gender component or include a working group to address women's issues. Under the U.S.-Brazilian Memorandum for the Advancement of Women, the office facilitated an exchange program for U.S. and Brazilian women scientists and advanced bilateral cooperation in the area of girls' education in science, technology, mathematics and engineering (STEM).

Summary and Analysis of Performance Trends

The first half of FY 2012 saw modest progress on the Democracy, Human Rights, and Good Governance (DHGG) Agency Priority Goal (APG). Department of State and USAID programs supported the landmark elections that were held in the Arab world during this time period, including the election of a constitutional assembly in Tunisia, parliamentary elections in Morocco, elections for both houses of the Egyptian Parliament, and the presidential election in Yemen. USAID and the Department provided technical assistance in support of these elections in the form of election monitoring and reporting, training of observers and elections officials, and voter outreach campaign support.

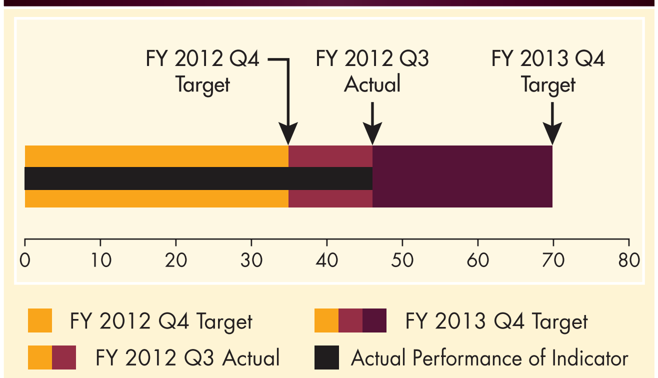
The Department of State and USAID political party assistance also saw gains during this period, in the number of parties and political groupings trained to develop more programmatic platforms and policy agendas, as 46 parties were trained in understanding results of public opinion polling and using this information to develop clear messages, collaboration, and political transition. In the next period and beyond, the Department hopes to strengthen its political party programming by performing a desk review of all programs and making new awards for political party strengthening and civil society capacity building.

The third quarter of FY 2012 saw continued progress. Department of State and USAID programs supported democratic electoral activities in the Arab world and are on track to meet annual targets set for training political parties and political groupings to help them develop more programmatic platforms and policy agendas, though in some countries, training is on hold due to unrest. Two large political party training projects ended during the third quarter reporting period, with follow-on projects to start in the next quarter.

Demands for people to have a stronger voice in their governance continued to grow and paved the way for democratic reform in many parts of the Middle East. Support for civil society to engage in advocacy interventions has remained strong and effective: one program took advantage of opportunities to engage with civil society and has doubled the amount of civil society organizations it is working with compared to last quarter. Though, unrest in some countries is affecting the ability to fully engage with civil society, the Department State and USAID are on track to meet the annual target. In Egypt, meanwhile, a restrictive draft law proposed by the government was put aside in favor of a new draft developed in parliamentary committee after consultation with Non-governmental Organizations (NGOs).

The following graph shows that by the third quarter of fiscal year 2012, the Department and USAID had already surpassed its FY 2012 target to provide assistance to 35 political parties and political groupings across the region in developing programmatic platforms and policy agendas. In the third quarter of fiscal year 2012, the actual number of assistance the Department provided to political parties and political

Illustrative Indicator 2: Number of political parties and political groupings across the region in which U.S. Government provided assistance in developing programmatic platforms and policy agendas[1]



Source: U.S. Department of State, Bureau of Democracy, Human Rights, and Labor.

[1] By September 30, 2013, help support continued progress toward or lay the foundations for transitions to accountable, electoral democracies in the Middle East and North Africa (MENA) that respect civil and political liberties and human rights.

groupings was 46. By the close of FY 2013, the Department and USAID aim to provide assistance to 70 political parties and political groupings.

STRATEGIC GOAL 3: INVESTING IN PEOPLE

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

Public Benefit. Bringing better health systems to people around the globe contributes to a more secure, stable, and prosperous world. As President Obama stated, "We will not be successful in our efforts to end deaths from AIDS, malaria, and tuberculosis unless we do more to improve health systems around the world, focus our efforts on child and maternal health, and ensure that best practices drive the funding for these programs." While progress has been made, urgent health challenges remain in the following priority areas of HIV/AIDS, child mortality, maternal mortality, tuberculosis, malaria, tropical diseases, unintended pregnancy, and undernourishment. In particular, U.S. Government investments focus on improving the health of women, newborns, and children through programs including topics such as infectious disease, nutrition, maternal and child health, and safe water. The Global Health Initiative (GHI) aims to maximize the impact the United States achieves for every dollar invested in global health.

To cite one example, as a result of the health delivery platform put in place by the President's Emergency Plan for AIDS Relief (PEPFAR), the U.S. Government now has increased capacity of partner countries to deliver health services and essential drugs and commodities, and to manage and oversee their health systems. This approach to improving world health is an essential aspect of 21st Century Statecraft that persuades partner countries to take action on development issues. PEPFAR takes a comprehensive approach to HIV/AIDS prevention, treatment, and care, working in close partnership with host country governments and civil society, as well as international partners. Antiretroviral (ARV) treatment provides direct therapeutic benefits for the individuals who receive treatment by increasing the length and quality of their lives – enabling

Secretary of State Clinton meets with wounded soldiers during a visit to a hospital in Tripoli, Libya, October 18, 2011.
Department of State

many individuals to resume normal daily activities and provide care for their families. ARVs also reduce viral load in patients on therapy, which contributes to dramatically decreased rates of HIV transmission. PEPFAR-supported treatment has helped to save and extend millions of lives as well as avoid the orphaning of hundreds of thousands of children whose parents are infected with HIV.

The Global Fund to Fight AIDS, Tuberculosis and Malaria is a unique global public/private partnership dedicated to attracting and disbursing additional resources to prevent and treat HIV/AIDS, tuberculosis, and malaria in more than 140 countries. It uses an innovative model that finances country-owned programs according to principles of performance-based funding. The Fund represents a key opportunity to support country ownership, promote sustainability, and leverage additional financing from other donors to augment U.S. Government bilateral programs. The Global Fund is critical to the achievement of our global health goals, and the United States is the largest donor to the Global Fund, contributing $7.1 billion since 2001.

Key Achievements

- PEPFAR country teams, under the leadership of Ambassadors and Deputy Chiefs of Mission, advanced the Country Ownership agenda for sustainability of the HIV/AIDS response, while continuing to increase results achieved with PEPFAR support. PEPFAR seeks to provide partner governments with the tools and training necessary for assuming more responsibility in financing, overseeing, and implementing development efforts. In the context of U.S. global health programs, this agenda promotes greater local political and institutional ownership of HIV/AIDS prevention, treatment, care and health system strengthening efforts supported by PEPFAR, while ensuring the capabilities and accountability mechanisms to sustain the programs. In 2012, PEPFAR countries that have advanced the Country Ownership agenda include the following:

  - In South Africa, the government signed a Partnership Implementation Framework with the United States, which lays out a plan to transition treatment and care programs from PEPFAR to the South African Government (SAG). Under this Framework, the SAG committed to increase its share of the national AIDS program from 71 percent to nearly 90 percent by 2017, while PEPFAR decreases its level of support from 29 percent to 12 percent.
  - In Namibia, the government, PEPFAR and the Global Fund established the Human Resources for Health Task Force, culminating in transitioning health worker positions from the Global Fund and PEPFAR payrolls to the public system. These investments have set the stage for transition to an increasingly country-led and country-financed HIV/AIDS effort supported by U.S. technical collaboration.
  - In Rwanda, the United States has transferred the oversight and management of the PEPFAR-supported treatment programs at 70 medical facilities, serving over 30,000 HIV-positive patients in 2011, directly to the Rwandan government, while PEPFAR has continued to provide financing.
  - In Botswana, where the government manages, operates, and pays for much of its HIV treatment programs, PEPFAR is supporting the government in working with American universities to build a national medical school that will train the nation's next generation of healthcare workers.

In FY 2013, PEPFAR will continue to advance this Country Ownership model in additional countries.

THE STATE DEPARTMENT AND THE U.S. GLOBAL HEALTH INITIATIVE: SAVING LIVES AND PROMOTING SECURITY

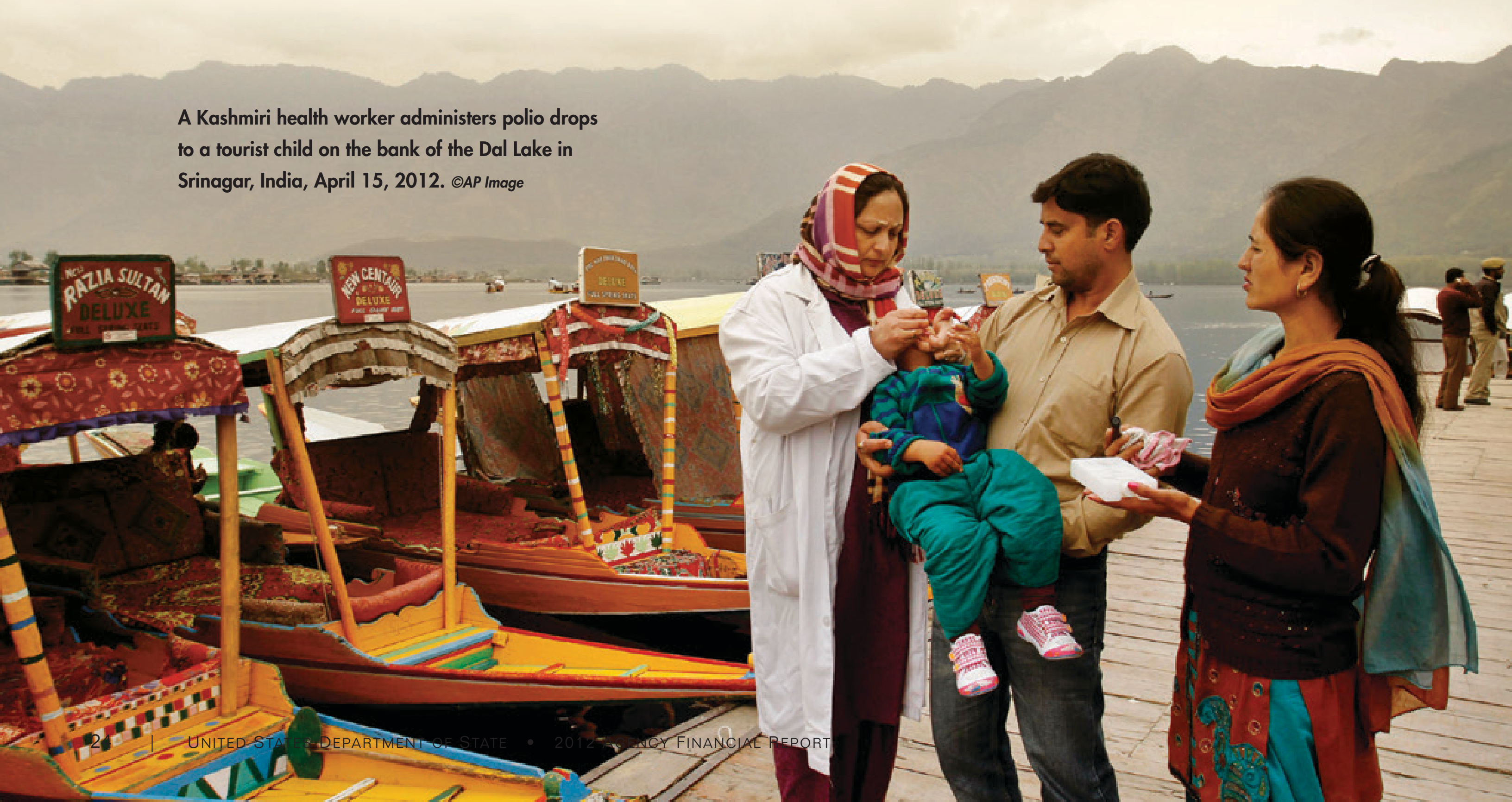
The Global Health Initiative (GHI), announced by President Barack Obama in 2009, is challenging the world to come together to build health services and capacity in developing countries. GHI is an integrated, coordinated and results-driven approach to global health; it brings together disease-specific programs to ensure more unified global health investments.

Despite the constrained fiscal environment, the Administration remains committed to the long-term goals of GHI. Health continues to be made a priority, accounting for 25 percent of the United State's foreign assistance budget, which makes the United States the largest donor in the world for the sector. The GHI was envisioned to include funding from fiscal years (FY) 2009-2014. To date, the GHI has been appropriated funding for FY 2009-2012 and is already making significant progress in each health area.

> "GHI…represents a new approach, informed by new thinking and aimed at a new goal: To save the greatest possible number of lives, both by increasing our existing health programs and by building upon them to help countries develop their own capacity to improve the health of their own people."
>
> *— Secretary of State, Hillary Rodham Clinton*

GHI in Action

The U.S. Global AIDS Coordinator is appointed by the President and confirmed by the Senate to coordinate and oversee the U.S. global response to HIV/AIDS. Reporting directly to the Secretary of State, the U.S. Global AIDS Coordinator, among other efforts, leads the U.S. Government's international HIV/AIDS efforts, including the coordination of interagency teams.



A Kashmiri health worker administers polio drops to a tourist child on the bank of the Dal Lake in Srinagar, India, April 15, 2012. *©AP Image*

Interagency teams – with representatives from all relevant U.S. Government agencies – implement coordinated GHI country strategies. Each strategy, developed in close collaboration with the host country and its national health plan, serves as a message that the U.S. embassy can take to local health ministries and other stakeholders. The interagency planning process has helped country teams reduce programming redundancies and allocate resources more strategically. To date, 42 countries have or soon will complete GHI country strategies. Details on the work being done are on the GHI website – *www.ghi.gov*.

GHI Principles

Based on global principles for effective development, GHI uses seven principles throughout U.S. global health programming. These principles ensure that GHI programs achieve positive change and also contribute to sustainable outcomes. They include:

- Focus on women, girls and gender equality
- Encourage country ownership and invest in country-led plans
- Build sustainability through the strengthening of health systems
- Strengthen and leverage key multilateral organizations, global health partnerships, and private sector engagement
- Increase impact through strategic coordination and integration
- Improve metrics, monitoring, and evaluation
- Promote research and innovation to identify what works

Health Targets

GHI launched eight global health targets that rallied the whole U.S. Government around a set of common goals. The combined efforts of all the U.S. global health agencies have resulted in strong progress in the following areas:

1. **HIV/AIDS**: Through the U.S. President's Emergency Plan for AIDS Relief (PEPFAR), support the prevention of more than 12 million new HIV infections; provide direct support for more than 6 million people in treatment; and support care for more than 12 million people, including 5 million orphans and vulnerable children.

2. **Malaria**: Through the President's Malaria Initiative, halve the prevalence of malaria for 450 million people, representing 70 percent of the at-risk population in Africa. Expand malaria efforts to Nigeria and the Democratic Republic of Congo.

3. **Tuberculosis (TB)**: Contribute to the treatment of at least 2.6 million new TB cases and 57,200 multi-drug resistant cases of TB.

4. **Maternal Health**: Reduce maternal mortality by 30 percent across assisted countries.

5. **Child Health**: Reduce younger than age-five mortality rates by 35 percent across assisted countries.

6. **Nutrition**: Reduce child under nutrition by 30 percent across assisted countries in conjunction with the President's Feed the Future Initiative.

7. **Family Planning and Reproductive Health**: Prevent 54 million unintended pregnancies. Reach a modern contraceptive use rate of 35 percent on average across assisted countries and reduce to 20 percent the proportion of women aged 18-24 who give birth for the first time before age 18.

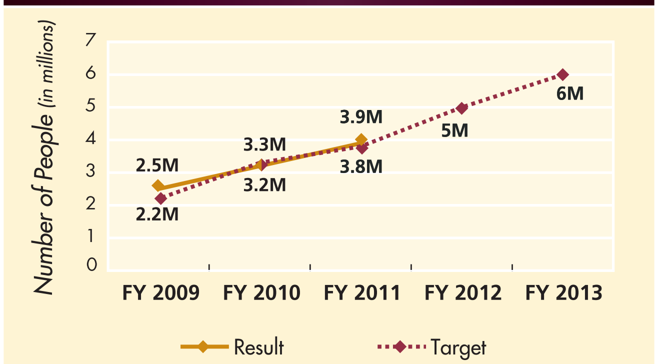
8. **Neglected Tropical Diseases** (NTDs): Reduce by 50 percent the prevalence of seven NTDs among 70 percent of the affected population, contributing to: the elimination of onchocerciasis in Latin America; lymphatic filariasis globally; blinding trachoma; and leprosy.

"Each strategy, developed in close collaboration with the host country and its national health plan, serves as a message that the U.S. embassy can take to local health ministries and other stakeholders."

Summary and Analysis of Performance Trends

The number of people receiving HIV/AIDS treatment annually is depicted in Illustrative Indicator 3 for this Strategic Goal. The indicator measures the reach of PEPFAR and can be analyzed country by country to identify which countries are facing challenges in scaling up their programs and which may have practices that should be replicated elsewhere. As of the midpoint of FY 2012, PEPFAR supported nearly 4.5 million people on treatment.

Illustrative Indicator 3: Number of people receiving HIV/AIDS treatment[1]



Source: Semi-Annual and Annual Progress Reports as captured in United States Country Operational Plan Report System.

[1] FY 2012 result not yet available, will be presented in the FY 2012 Joint Summary Report in early 2013.

STRATEGIC GOAL 4: PROMOTING ECONOMIC GROWTH AND PROSPERITY

Strengthen world economic growth and protect the environment, while expanding opportunities for U.S. businesses and ensuring economic security for the nation.

Public Benefit. Under the Economic Statecraft initiative launched by Secretary Clinton in 2011, the State Department has placed economics at the center of U.S. foreign policy by using economic tools to advance foreign policy goals, and using foreign policy tools to promote economic growth and prosperity in the United States. Through its more than 200 diplomatic missions overseas, the Department of State promotes U.S. exports and encourages new investment into the United States. This helps expand opportunities for American businesses and create jobs. The Department also works to establish global "rules of the road" that promote an open, free, transparent, and fair international economic system in which U.S. companies have the opportunity to compete.

The Department plays a leading role in the promotion of responsible and ethical business practices, advocates transparency in public budgeting and procurement, promotes a comprehensive approach to corporate social responsibility, provides guidance and support for American companies, and partners with the private sector to advance corporate policies that help companies "do well by doing good." Department initiatives support businesses' contributions to U.S. foreign policy goals of global peace, security, sustainable development, and prosperity.

The Department plays an active role in implementing President Obama's National Export Initiative. The Department assists American firms as they explore new export markets and advocate on their behalf with other governments for fair treatment, transparency, and maximum opportunity in competitive global markets. The Department's Agricultural Biotechnology program addresses barriers to trade and opens markets for American farm products. In the process, it also contributes to the development of effective food aid policies, promotes rural development and increases agricultural productivity around the world. Through its "Open Skies" policy, the Department leads negotiations to open international markets to U.S. airlines, thus expanding opportunities for U.S. firms, jobs for U.S. workers, and benefits for U.S. consumers. In joint efforts with the U.S. Trade Representative, the Department works to conclude bilateral investment treaties designed to create new investment opportunities and protect U.S. investors. The Department works closely with the Export-Import Bank to identify key emerging markets and buyers for cutting edge American products. Our diplomats are also salespeople for the United States, encouraging investment that creates jobs in the United States as part of the President's Select USA Initiative.

Through programs that encourage innovation and greater transparency, the United States seeks to empower developing countries with the means to fund their own development, be more accountable to the citizens they serve, and ensure the integrity of their markets for businesses and investment. For instance, the Department leads efforts to protect the intellectual property of U.S. firms and individuals.

Special Representative for Commercial and Business Affairs Lorraine Hariton shakes hands with Youghourta Benali, Maghreb Delegation in Algeria winner and founder of Walletix, in Algiers, Algeria, October 30, 2011. *Department of State*

By embracing business transparency efforts such as patent protection and intellectual property rights in accordance with international standards, foreign countries can attract the products of U.S. workers and companies. We also advocate domestic revenue mobilization, anti-corruption, and good governance to advance responsible practices in public financial management. By helping countries increase revenues at home through transparent and efficient administrative practices, we can enable other nations to fund their own development rather than rely on international assistance.

The Department supports U.S. policy to restore financial stability and growth in the wake of the global financial crisis, working closely with National Security Staff and the U.S. Department of Treasury. In leading the U.S. delegation on debt restructuring negotiations at the Paris Club of creditor nations, the Department has helped numerous poor countries restore sustainable levels of external debt. The Department has a voice in shaping the World Bank and other multilateral development banks' lending and policies. Secretary Clinton chairs the Board of the Millennium Challenge Corporation, which seeks to reduce poverty through sustainable economic growth. Under the U.S. Presidency of the G8, and in particular through our leadership of the Deauville Partnership with Arab Countries in Transition, the State Department is leading efforts to work with countries in the Middle East and North Africa region to promote stabilization, integration and job creation.

Key Achievements

- **Jobs Diplomacy:** Through trade agreements, investment treaties, and other bilateral mechanisms, the Department opened new markets and created level playing fields for U.S. firms. The Department played a key role in the negotiation and passage of the Colombia, Panama, and Korea Free Trade Agreements (FTAs); pressed Russia to join the World Trade Organization (WTO); helped complete a revised WTO Government Procurement Agreement; led the U.S. Government's launch of a new model Bilateral Investment Treaty and resumed investment treaty negotiations with India and China; and negotiated new Open Skies agreements with four partners, bringing total U.S. Open Skies partners to 107. The Department has also increased its outreach to business through a series of Global Business Conferences. In September 2012, the Department's Global Infrastructure Conference convened nearly 100 American private sector executives, official delegations from four major overseas infrastructure markets, and a broad range of senior officials from key U.S. Government agencies to explore how U.S. Government agencies can better help U.S. firms gain a larger share of this growing global market. The State Department's new "Direct Line to American Business" program connects U.S. companies with our Ambassadors and missions overseas. Revamped websites for every U.S. Embassy include "Business Tabs" that make it easier to find information about export and business opportunities overseas.

- **Economic Support for the Middle East and North Africa:** The Department continues to mobilize U.S. and multilateral cooperation and assistance programs to support the dramatic democratic transitions underway. The Department launched the successful effort to have the European Bank for Reconstruction and Development expand into North Africa and the Levant. The Department partnered with the Overseas Private Investment Corporation (OPIC) on projects worth over $1.5 billion, and originated the idea of an OPIC-led franchise lending facility for the region.

American Recovery and Reinvestment Act

State Department's Role in the American Recovery and Reinvestment Act

Of the total $787 billion appropriated for the American Recovery and Reinvestment Act (ARRA) of 2009, the Department received $562 million for projects and $2 million for the Office of Inspector General. The Department is using ARRA funds to create and save jobs, repair and modernize domestic infrastructure crucial to the safety of American citizens, and expand consular services offered to American taxpayers. Details about specific projects and a complete description of the Department's ARRA implementation plan are posted on the Web at *http://www.state.gov/recovery/*.

Construction Projects – Through funding ($15 million), the Department expanded its network of passport agencies to address public demand for travel documents in previously underserved areas of the country. All new passport facilities are open and operational. These include Atlanta, Georgia; Buffalo, New York; El Paso, Texas; San Diego, California; and St. Albans, Vermont. New counters are now in use at the Passport Centers in Hot Springs, Arkansas and the National Passport Center in Portsmouth, New Hampshire. At the National Foreign Affairs Training Center ($5 million), new classrooms are fully operational and new signage has been displayed.

Construction ($120 million) on a domestic Enterprise Server Operations Center (ESOC) has been completed. The data center opened June 2012. The new data center provides for high availability, redundancy, and disaster recovery for systems that ran previously only on the East Coast and provides much needed capacity for the Department to achieve its goals in support of the Federal Data Center Consolidation Initiative. The new facility operates on a Federal campus in a high security environment and is expected to provide for incremental growth over the next 30 years with only modest investments in construction costs. Environmental studies and master planning are ongoing for the site identified as the potential location of the Diplomatic Security Foreign Affairs Security Training Center (FASTC). FASTC ($70 million) will provide a centralized location that supports security-related training for Department of State and other U.S. Government staff posted at U.S. embassies overseas.

International Boundary and Water Commission (IBWC) – Funding ($220 million) accelerated the IBWC's modernization program by 20 years, remediating risks identified by geo-physical analysis suggesting that 60 percent of the levee system in high-priority areas was deficient. The IBWC projects are raising or making structural improvements to 237 miles of the levees to ensure they provide adequate protection and meet the standards established by the Federal Emergency Management Agency (FEMA). Construction work is reported at 91 percent complete. The majority of the planned construction is expected to be completed by the end of 2012, with one segment continuing until early 2013.

Information Technology and Cyber Security – Through funding ($132 million), cyber security, information technology, and advanced telecommunications equipment deployed during FY 2011 increased the integrity and resiliency of the Department's network and its ability to counter emerging threats. The Global Information Technology Program replaced 13,245 antiquated classified and unclassified desktop computers at U.S. missions worldwide. The Department replaced obsolete telephone systems at three of its largest diplomatic missions at embassies Bangkok (Thailand), Brussels (Belgium), and Vienna (Austria). The new units replaced systems that were 13-15 years old and had been expanded to maximum capacity. The Mobile Computing program significantly expanded the Department's unclassified Remote Access and Telework capabilities allowing simultaneous access to 35,000 mobile users worldwide. No new activities took place during FY 2012.

Office of Inspector General – Funding ($2 million) to provide oversight for using ARRA funds and ARRA projects by the Department expired on September 30, 2010. Throughout the Department's Recovery Act implementation, OIG initiated 26 projects between October 2009 and June 2012 to assess Department and IBWC activities funded by ARRA. As of July 2012, all OIG activities related to this funding have been concluded. OIG audits and reviews of the Department's use of ARRA funds resulted in 25 reports issued, and recommendations of questioned costs and potential funds identified be put to better use.

In September 2012, the Department hosted the second U.S.-United Arab Emirates Economic Policy Dialogue, which addressed issues of mutual interest and areas of disagreement to strengthen the bilateral economic partnership. The Department facilitated Partners for a New Beginning-North African Partnership for Economic Opportunity (PNB-NAPEO) projects that engaged the U.S. private sector, NGOs, Maghreb entrepreneurs and business people to create locally conceived and driven projects that foster entrepreneurship. The Department has been active on business delegations to the region and in fostering entrepreneurship to help create new enterprises and value-added jobs. Through our leadership of the G8 Deauville Partnership with Arab Countries in Transition, the State Department is leading efforts to promote development of small- and medium-sized enterprises in North Africa and the Middle East in cooperation with the Organization for Economic Cooperation and Development and multilateral development banks.

- **Development Diplomacy:** Department efforts focused on partnerships and innovation. The Domestic Finance for Development (DF4D) program championed a whole-of-government approach to empower developing countries to finance more of their own needs through mobilizing domestic public revenue, improving budget transparency, and fighting corruption. Working with the Department of Commerce, the Department launched a special program to focus on business opportunities for U.S. companies in large infrastructure projects.

  The Department will continue to work with the private sector at the intersection of business and development. Through the Department's Global Entrepreneurship Program, the Department teamed with over 100 private sector partners to empower local people and businesses to become full participants in their economies. In many countries, the Global Entrepreneurship Program worked with local businesses and communities to foster innovation, and provide tools for people looking to build a new life for themselves. In December 2012, the Department will collaborate with the United Arab Emirates (UAE) to organize the third Global Entrepreneurship Summit, which will attract more than a thousand entrepreneurs, investors, and government representatives from around the world to create a better environment in which entrepreneurship can flourish. The Department deepened its focus on addressing some of the institutional challenges to sustainable development, such as the lack of private finance to support economically productive, yet capital intensive investments such as infrastructure. The Department launched a partnership with USAID, OPIC and the Inter-American Development bank called, the "Building Remittance Investment for Development, Growth and Entrepreneurship (BRIDGE)" initiative which was piloted in El Salvador, and seeks to use structured finance mechanisms to leverage the estimated $50 billion of annual worker remittance flows from the United States to Latin America, thus enabling greater availability of multi-year, lower-cost financing to support capital investment.

- **Advancing a Free and Open Internet:** The Department will provide U.S. leadership for the International Telecommunication Union's (ITU) World Conference on International Telecommunication taking place in December 2012 in Dubai, UAE. ITU is addressing the question of reform for the International Telecommunication Regulations (ITRs), while seeking to preserve the decentralized and market-driven nature of the Internet and promoting the free flow of information. Similarly, using the OECD as a platform, the United States initiated a transparent, multi-stakeholder process to develop new Internet Policymaking Principles promoting a light-handed American approach to managing and governing the Internet. In December 2011, the OECD formally adopted these principles and has since worked with Member and non-Member states to implement them. Also during FY 2012, the Department led U.S. participation at the ITU's quadrennial, treaty-based, World Radiocommunication Conference (WRC). Our joint interagency and private sector delegation successfully advanced U.S. positions to protect and harmonize spectrum allocations for the U.S. economy. The WRC treaty document concluded in January 2012, has preserved U.S. access to spectrum and protected wireless broadband rollout for the U.S. economy, while promoting standards that keep markets open for U.S. exports.

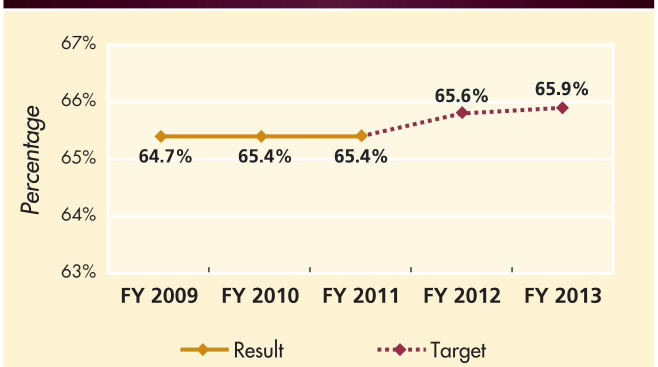
- **Using "Smart" Sanctions:** The Department played a central role in developing new sources of economic leverage to accomplish U.S. foreign policy goals in Iran, Syria, Libya, and Burma. In Libya, the Department used domestic and UN sanctions in concert with military pressure to isolate and eventually end Muammar Qaddafi's regime. The Department proactively designed and implemented new sanctions to sharpen the Iranian regime's choices and to isolate the Assad regime in Syria. The Department continues to help unwind sanctions against Burma to continue the ongoing reform process.

- **Preventing the Illicit Diamond Trade from Fueling Conflicts:** As the 2012 Chair of the Kimberley Process (KP), the international effort to eradicate conflict diamonds, the Department advanced international efforts to update the definition of "conflict diamond" to cover additional types of conflicts that move beyond those enshrined in the original KP regulations. The Department established a system for sharing false certificates both internally and with the World Customs Organization and, in November 2012, is hosting a conference of law enforcement officials to discuss improving KP implementation. Based on a successful conference the Department hosted in June 2012, the Department is working to get the Kimberley Process to adopt an updated declaration of development-related policy goals, including promotion of best practices with respect to revenue transparency, human rights and formalizing artisanal mining. The Department is finalizing a data anomaly questionnaire process that will improve efforts against possible smuggling or other KP non-compliance issues. For the first time, the Department has reached 100 percent statistical reporting from every country in the KP. The Department brought leaders from other natural resource governance initiatives to join a KP meeting to ensure the Kimberley Process is up to date on best practices, and more engaged with complementary organizations. The Department is establishing guidelines for national task forces on implementation and adopting updated technical definitions, both of which will greatly improve KP compliance. Finally, the Department added one new participant, Cameroon, and is progressing with efforts to soon admit Panama, Kazakhstan, and Cambodia.

Summary and Analysis of Performance Trends

The United States is the leading producer and exporter of crops developed through the use of agricultural biotechnology. These crops continue, however, to face well-organized opposition despite their potential to increase yields as well as their benefits for development, poverty alleviation, and food security. This indicator measures both the number of jurisdictions allowing the commercial use of agricultural biotechnology and the global acreage of biotech crops under cultivation thus serving as a yardstick for market access to biotechnology. An increase in this indicator points to new opportunities for U.S. exporters. Data for 2012 are expected to be released in February 2013. The data that is available, however, shows significant increases in the global acreage of biotech crops over the last 16 years. Biotech crops reached 160 million hectares in 2011, an 8 percent increase from 2010 (and above the U.S. target of 5 percent). The United States produced 69 million hectares of biotech crops (43 percent of the global total), many of which were exported to overseas markets. We expect increase in global acreage to grow at a similar rate in 2012. While there were some regulatory victories in 2011 – notably, Japan approved virus-resistant papaya from the United States for consumption as fresh fruit and Turkey reinstated imports of biotech crops – no additional countries allowed commercial production of agricultural biotechnology. Although the United States did not meet its target for total number of jurisdictions allowing commercial production of agricultural biotechnology in FY 2011 (of one additional country), up to ten countries are poised to do so over the next three years.

Illustrative Indicator 4: Percentage of World Energy Supplies from Non-Oil Sources[1]



Source: U.S. Department of Energy.

[1] Indicator new in FY 2010, targets established beginning in FY 2011.

STRATEGIC GOAL 5: PROVIDING HUMANITARIAN ASSISTANCE

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

Public Benefit. The Department of State and USAID are the lead U.S. Government agencies that respond to complex humanitarian emergencies and natural disasters overseas. The United States' commitment to humanitarian response demonstrates America's compassion for victims of armed conflict, natural disasters, persecution, human rights violations, widespread health and food insecurity, and other threats. It requires urgent responses to emergencies, concerted efforts to address hunger and protracted crises, and planning to build the necessary capacity to prevent and mitigate the effects of conflict and disasters.

The U.S. Government's emergency response to population displacement and distress caused by natural and human-made disasters is tightly linked to all other foreign assistance goals, including the protection of civilian populations, programs to strengthen support for human rights, provision of health and basic education services, and support for livelihoods of beneficiaries. The United States provides substantial resources and diplomatic leadership through international and non-governmental organizations to save lives and minimize suffering in the midst of crises, increase access to protection, promote shared responsibility, and coordinate funding and implementation strategies.

Populations of concern to the State Department's Bureau of Population, Refugees, and Migration (PRM) exceeded 42 million worldwide in 2011, including over 15 million refugees, as well as millions of conflict victims, stateless persons, and vulnerable migrants. A confluence of global phenomena suggests that future humanitarian needs will continue: natural disasters, climate change, the global economy, food insecurity, population growth, urbanization, and civil strife all contribute to increased numbers of people in need, exacerbating the severity and duration of suffering and hindering the advancement of stability and development.

Refugee resettlement is an important solution and protection tool for some of the most vulnerable refugees, and a form of responsibility-sharing that can help resolve protracted refugee situations. The United States provides protection and durable

Assistant Secretary for the Bureau of Population, Refugees, and Migration, Anne C. Richard, meets with Syrian refugees at a camp Hatay Province, Turkey, September 2012. *Department of State*

solutions through its long-standing tradition of welcoming refugees to communities across the country.

In the area of international migration, the United States advances policies and programs that protect and assist asylum-seekers, victims of human trafficking, women, children, and other vulnerable migrants; supports international efforts to protect the human rights of migrants; promotes humane and responsible migration policies; and supports capacity-building activities to help governments manage migration, especially in areas where migrants travel in mixed movements of people, such as those in the Gulf of Aden and the Caribbean. Through a combination of strong humanitarian diplomacy and assistance programming, the United States supported key achievements in voluntary return and reintegration for refugees and internally displaced persons, and in promoting international laws to prevent and reduce statelessness and protect stateless persons.

Key Achievements

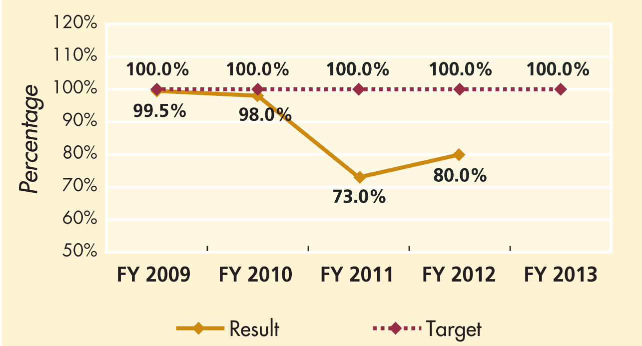
- In FY 2012, the U.S. Refugee Admissions Program reached a number of major milestones. On February 15, 2012, the United States admitted its three millionth refugee since 1975. The five largest nationalities resettled since 1975 are Vietnamese, Ukrainian, Iraqi, Cuban, and Somali refugees. On September 5, 2012, the 60 thousandth Bhutanese refugee, since the launch of resettlement from Nepal in 2007, departed for a new life in the United States. Also in September 2012, the United States welcomed the 100 thousandth refugee from East Asia since 2004. This milestone includes refugees of 34 nationalities/ethnicities resettled to the United States from the region, the vast majority being Burmese refugees from Thailand and Malaysia.

- Persistently high rates of global acute malnutrition (GAM) in Ethiopia's Dollo camps, where more than half the children were malnourished in October/November 2011, took a very positive turn for the better during FY 2012. A joint nutrition and health mission conducted in June documented significant improvement in malnutrition rates, the crude mortality rate, under five mortality rate, and anemia prevalence in the camps. The GAM rate in Kobe and Hilawyen camps dropped dramatically from 47.8 percent and 50.6 percent in November to 13.1 percent and 15.9 percent, respectively. Severe Acute Malnutrition rates in Kobe and Hilawyen decreased from 18.5 percent and 18.9 percent to 1.9 percent and 2.5 percent, respectively.
- In response to the Syrian conflict, the International Committee of the Red Cross (ICRC), with PRM support, has provided aid for over 800,000 people, most of them displaced, since the beginning of 2012. Since mid-July, nearly 180,000 people have received food and other essentials in and around Damascus and in Aleppo, Homs, and elsewhere in the country. Since the beginning of the year, ICRC has also provided clean drinking water for over one million people in Damascus, Rural Damascus, and Homs.
- In FY 2012, nine countries acceded to one or both of the statelessness conventions. They include Burkina Faso, Republic of Moldova (both), Bulgaria (both), Benin (both), Georgia, Turkmenistan (both), Ecuador, Paraguay, and Serbia. With these new accessions, the number of parties to the 1954 and 1961 Conventions are up to 74 and 47, respectively.

Summary and Analysis of Performance Trends

The number of refugees admitted to the United States is an illustrative indicator for this Strategic Goal. In FY 2012, the United States admitted 58,238 refugees, which represents 80 percent of the regional ceilings established by Presidential Determination. The primary reason for the reduced number of refugee arrivals in FY 2012, as in FY 2011, was the implementation in late 2010 of a new enhanced security check for all refugees at the final stages of processing for U.S. resettlement, which added to the processing time and delayed travel. Following policy changes approved by senior U.S. officials in February 2012, refugee arrivals began to increase in April and continued to increase throughout the remainder of the fiscal year. There were also issues outside the control of the U.S. Government, which contributed to the lower arrivals, including insecurity in a number of refugee processing locations and barriers imposed by refugee-hosting governments. While total arrivals in FY 2012 are only slightly higher than in FY 2011, the Department is on track to reach targets for FY 2013.

Illustrative Indicator 5: Percentage of refugees admitted to the United States against the regional ceilings established by Presidential Determination



Source: Department of State, Bureau of Population, Refugees, and Migration (PRM).

STRATEGIC GOAL 6: PROMOTING INTERNATIONAL UNDERSTANDING

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

Public Benefit. The Department recognizes the central role of public diplomacy (PD) as a tool of Smart Power and as an essential element for 21st Century Statecraft, and has committed to renewing America's engagement with the people of the world by enhancing mutual respect and understanding, creating partnerships aimed at solving common problems, and building support for U.S. policy priorities among foreign audiences.

To address the challenges of today, the Department has developed the first detailed global strategy for public diplomacy in over a decade – a strategic framework for 21st Century public diplomacy – ensuring its alignment with foreign policy objectives, and bringing a strategic focus to how public diplomacy programs and structures support those objectives. The principles of the framework were also included in the QDDR, thus establishing this as the PD "doctrine" for the foreseeable future.

Public Diplomacy programs explain American society, culture, values, government, and policy making to a broader international public, including youth and women, opinion leaders, as well as current and future policy makers. By improving their understanding of the United States – and demonstrating American appreciation and respect for their societies and values – we can establish a positive tone and framework for policy discussions, based on mutual respect and common interests.

The Department is meeting the challenges of today's 24/7 global media cycle with 21st Century Statecraft tools to reach audiences through broadcast, print and digital platforms. Regional Media Hubs, social media engagement, foreign language spokespeople and crisis communications teams work to ensure that our policy messages are portrayed accurately to international audiences.

The Department's wide range of educational, professional, cultural and youth programs are strategic elements of America's foreign policy and play central roles in President Obama's efforts to promote dialogue, reframe the narrative, improve the image of the United States around the world, and develop collaborative approaches to shared challenges. Expanding and strengthening people-to-people relationships around common interests demonstrates our commitment to democracy, civil society, innovation, entrepreneurship, economic growth and opportunity. "American Spaces" (places where foreign audiences can meet Americans and get information about the United States) helps us to reengage face-to-face with local audiences.

Our public diplomacy efforts also help combat violent extremism, counter violent extremist voices, discredit and delegitimize al-Qaeda, and empower local, credible voices. Violent extremists use a variety of platforms to spread their message. The Department is expanding its ability to counter these messages through the Interagency Center for Strategic Counterterrorism Communication.

By expanding the use of social media, we are reaching the ever-increasing number of people who are actively communicating via these new media and engaging effectively within the 24/7 reality of connective technologies. The Department's global social media presence today reaches 16.6 million Facebook, Twitter and YouTube followers.

By the end of 2012, the Department will make all embassy and consular websites mobile-ready, running on our global content management system (CMS). This centralized Web management system also supports the ability to administer embassy websites in times of crisis, as was the case in Japan, Egypt, Libya and Syria, while building critical new outreach tools such as Virtual Embassy Tehran.

Key Achievements

- The Department's *Fund for Innovation in Public Diplomacy* enables embassies to quickly capitalize on public diplomacy opportunities that advance Department policy priorities. In 2012, the Under Secretary for Public Diplomacy conducted a special Innovation Fund competition to advance Economic Statecraft; 33 projects

Secretary of State Clinton, accompanied by U.S. Ambassador to Timor-Leste Judith R. Fergin, is greeted by traditional dancers at the Cooperativa Café Timor in Dili, Timor-Leste, September 6, 2012. Established in 1994 with the support of USAID, the self-supporting cooperative has now expanded to vanilla, clove, cacao, and cassava production for export. UNMIT photo by Bernardino Soares. *Department of State* were funded, for a total of $1.5 million, on topics including entrepreneurship, skills training for women and youth, and travel and tourism.

- ***International Media Engagement:*** The Department continued to expand its capacity to reach international audiences by engaging foreign broadcast, print and digital media through Regional Media Hubs, foreign language spokespeople and innovative uses of technology. The Department's six Regional Media Hubs are positioned strategically around the globe in major media markets to reach the most influential global and regional outlets. As virtual extensions of the Department of State's Spokesperson's podium, the Hubs respond to the rapidly moving international media environment to amplify the U.S. Government's highest priority policy messages. Hub video teams traveled to support major policy events, capturing footage of U.S. officials in action for distribution to broadcast and digital media via satellite and the State Department's newly launched online video distribution platform – StateOnDemand. Spokespeople amplified the President and Secretary's messages in Arabic, Farsi, Spanish, Urdu, Dari, and other languages to ensure accurate coverage of U.S. policy in foreign media. In addition, media all over the world accessed senior policymakers in Washington via LiveAtState virtual press conferences, which use state-of-the-art technology to link foreign journalists and bloggers with U.S officials for meaningful discussions.

- ***Crisis Communications Surge Capacity:*** To ensure that the Department can disseminate accurate and timely information to both domestic and foreign audiences during a crisis, the Department's Bureau of Public Affairs established the *Public Affairs Fly Away Communications Team (PA FACT)*. These rapid response teams deploy on a short-term basis to provide expertise and equipment for posts in time of crisis. PA FACT members also train and deploy with larger inter-agency teams to provide strategic messaging support for complicated operations during international crises.

- ***Social Media:*** The Department continued to expand its social media outreach by routinely scheduling global online engagements in up to nine languages on a variety of social media platforms, from Facebook to Twitter to Google+. The Spokesperson responded to questions received from Twitter at the podium for the first time, and the Department conducted its first-ever Google+ Hangout in Farsi for Persian-language journalists. The State Department's flagship social media sites saw exponential growth across platforms, and online audiences interacted with content tailored to their interests with the launch of "My State Department" on state.gov.

- ***Delivering a Global Network Capacity:*** The Bureau of International Information Programs (IIP) has built the Department's first-ever capacity to conduct global information campaigns that marry online and real-world assets. The Department can now communicate virtually to an international public of almost 10 million through our English and foreign language Facebook properties, reaching a young audience in strategic countries, while simultaneously disseminating the same message through 450 embassy and consulate websites as well as 280 post social media properties around the globe, reaching tens of millions more. In-person engagement completes the picture at U.S. embassies and 850 American Spaces, which received over 12 million visitors last year. Two campaigns this summer, "50 States in 50 Days" in support of the President's National Travel and Tourism Strategy, and the Global Economic Statecraft Day, confirmed the reach and success of this global capability.

- ***Revitalized American Spaces:*** IIP created a central support and management team for the 850 American Spaces around the world that provide access to U.S. information and the opportunity for meaningful engagement in a welcoming, accessible environment outside of embassy walls. IIP established universal standards, expanded content and administered funds to enhance the effectiveness of spaces as outreach facilities to critical local populations. The Department pioneered and deployed "moveable spaces" to all posts, supported Science Corners in South America and Africa, enlisted the expertise of the Smithsonian to conduct a pilot program to design model American Spaces, and supported innovative projects, from bookmobiles to pop-up reading centers.

- ***Curating and Creating Content to Build America's Reputation Overseas:*** IIP has re-imagined content and programs to connect with foreign audiences like

Free Trade Agreements – Benefits to the United States: Creating Jobs And Overseas Market Access

Free Trade Agreements (FTAs) support American jobs, expand markets, and enhance U.S. competitiveness. By removing barriers to U.S. goods, FTAs create new opportunities for U.S. companies, workers, and investors. During a worldwide economic downturn, FTAs help promote faster economic recovery in the United States and in other countries.

Results of Free Trade Agreements

- **Commitments to Protect Labor Rights:** FTAs set high standards for protection of workers' rights – including obligations for the other country to respect fundamental labor rights and to effectively enforce labor laws designed to ensure that U.S. workers can compete in the worldwide labor market.
- **A More Open and Level Playing Field for U.S. Investors:** FTAs create greater access to foreign markets, strong investor protections, and a way for U.S. investors to enforce their rights and settle disputes with other countries.
- **Greater Access to Services Markets Overseas:** FTAs help open international markets to the U.S. services sector, ranging from energy and environmental services to financial services and distribution.
- **Tariff Elimination on Agricultural Products:** FTAs create new opportunities for U.S. farmers, ranchers, and food processors by eliminating tariffs on a range of agricultural commodities, such as wheat, barley, soybeans, flour, beef, bacon, almost all fruit and vegetable products, peanuts, cotton, and most processed food products.

A field full of wheat in London, Ohio. FTAs create opportunities for U.S. agricultural farms like this one by eliminating tariffs on wheat commodities. *©AP Image*

"...FREE TRADE AND OPEN MARKETS ARE POWERFUL TOOLS TO IMPROVE LIVING STANDARDS FAR AND WIDE. THEY DO CREATE NEW JOBS. THEY DO OPEN UP NEW ECONOMIC OPPORTUNITIES, RAISE STANDARDS OF LIVING, AND LEAD TO THE KIND OF WIN-WIN SOLUTIONS THAT BRING PEOPLE AND COUNTRIES CLOSER TOGETHER."

— Secretary of State, Hillary Rodham Clinton

- **Fair and Open Government Procurement:** FTAs expand American firms' access to foreign government procurement markets, creating new opportunities for exporters in a range of fields and ensuring that U.S. firms can bid on contracts on a level playing field with local firms.
- **Protection of the Environment:** High environmental standards are incorporated into America's trade agreements. Both parties to a trade agreement commit to effectively enforce their own domestic environmental laws and adopt, maintain and implement laws, regulations, and other measures to fulfill obligations under multilateral environmental agreements. Environmental obligations are subject to the same dispute settlement and enforcement mechanisms as commercial obligations.

Trade Adjustment Assistance (TAA) for American Workers

Trade adjustment programs offer a variety of assistance to U.S. workers whose jobs have been lost as a result of foreign trade. The Trade Adjustment Assistance (TAA) for Workers program would restore and reauthorize a Federal program offering a range of support to displaced workers.

The streamlined TAA program includes the following assistance to displaced workers:

- Training services for workers to learn 21st Century job skills,
- Assistance for job search and relocation,
- A tax credit to maintain health coverage, and
- Trade Readjustment Allowances that provide critical support during training.

never before. The content reflects the Department's priorities, from science and technology, to innovation and entrepreneurship, civil society, religion and press freedom. The Department dramatically increased the use of video, photos and graphics as demanded by today's digitally connected citizens. The popular "Meet the Ambassador" video series and mash-ups of the Secretary's speeches deliver policy messages to hundreds of millions of people. To better reach overseas audiences, the Department created a multi-media interactive video conferencing team, CO.NX, that links American thought leaders with audiences overseas to punctuate and amplify our foreign policy agenda. This year, CO.NX and its U.S. embassy partners will deliver over 1,000 interactive panels with Department principals and third-party experts on important policy issues to audiences across the globe. The Department actively developed partnerships with public and private entities like the Smithsonian, Metropolitan Museum of Art, National Academies of Science and the Library of Congress to leverage their deep assets. IIP has modernized and digitized agency publications, which continue to be critical resources for posts, and is transforming the Department's speaker programs through an integrated approach that includes social media and virtual programs.

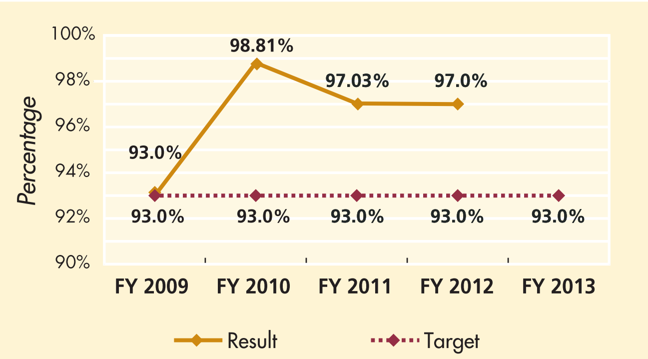
- ***Study Abroad Increases:*** The number of American students studying abroad is growing slowly but steadily, up four percent since 2008 for a current total of 270,604. The number of U.S. applicants for Bureau of Educational and Cultural Affairs (ECA) high school exchange programs rose by 65 percent in 2012. The number of international students studying in the United States is at a record high, and ECA's "EducationUSA" student advising network is reaching more potential students than ever before in 170 countries.

- ***Exchanges Promote U.S. Policy:*** Educational, professional and cultural exchanges have become indispensable pillars of strategic dialogues with Brazil, China, India, Indonesia, Iraq, Russia, and other countries. It is almost impossible to conceive of a major bilateral initiative that does not include an exchanges component. The strategic dialogue with India helped triple the size of the U.S.-India Fulbright program and dialogues with Brazil, China, and Indonesia have resulted in record numbers of participants in educational exchanges with those countries. The ECA community college exchanges have led India and Indonesia to adopt this U.S. model for their own educational systems.

Summary and Analysis of Performance Trends

The Department assesses educational and cultural exchange program performance by collecting data directly from program participants. Illustrative Indicator 6 measures the percentage of exchange participants who reported an increase or positive change in their understanding of the United States (political and economic institutions, norms, and values) immediately following the conclusion of their programs. In FY 2012, the Department again exceeded its target, with more than 97 percent of foreign publics reporting an increased or positive change in understanding. Statistics are compiled from surveys of actual participants ("alumni") of exchange programs. While there are many factors that could account for variations from year to year, what is most important is the trend: each year, overwhelmingly, the participants' perceptions of the United States are positively impacted by their experiences. Other indicators measured changes in exchange participant favorability toward the U.S. Government (71 percent reported a more favorable view in FY 2012), and toward the American people (85 percent reported a more favorable view in FY 2012), as a result of their participation in an exchange program. These results show the effectiveness of educational and cultural exchange programs in positively and substantively reshaping understanding of, and attitudes toward, the United States.

Illustrative Indicator 6: Percentage of participants who increased or changed their understanding of the United States immediately following their program



Source: U.S. Department of State, Bureau of Educational and Cultural Affairs.

STRATEGIC GOAL 7: STRENGTHENING CONSULAR AND MANAGEMENT CAPABILITIES

Assist American citizens to travel, conduct business and live abroad securely, and ensure a high quality workforce supported by modern, secure infrastructure and operational capabilities.

Public Benefit. Approximately 6.3 million U.S. citizens reside abroad, and Americans make about 65 million trips overseas every year. The Department helps them prepare for crises and avoid problems abroad through our *Consular Information Program, and online Smart Traveler Enrollment Program*, which more than 1.25 million U.S. citizens used in FY 2012. The Department provides services throughout the cycle of life, from certifying the birth of U.S. citizens born abroad, to assisting families when a U.S. citizen dies overseas. The Department also assists U.S. citizens whose children have been wrongfully taken to or kept in foreign countries – a growing problem. The Department expanded and continues the World Virtual School (WVS) program that permits continuity of instruction for the dependent children of U.S. Government employees assigned to diplomatic and consular missions when the schools they attended are closed during emergencies. In FY 2012, the American Cooperative School of Tunis (ACST) used WVS to provide continuing education programs to the 650 students – including 47 U.S. Government dependents – who were enrolled for the current school year and were evacuated when the school had to be closed during the turmoil in September 2012. ACST will continue to use WVS until it is determined that the school can reopen and U.S. Government dependent students can return to Tunis. The Damascus Community School (DCS) used the WVS program for 45 students for the entire second semester of the 2011-2012 school year. Eight students graduated from DCS, using the WVS program. Schools in other locations, such as Islamabad, also use the WVS program as needed. Currently, 74 of 197 overseas schools participate in the WVS program.

During times of crisis, the Department adapts quickly to fluctuations in demand for our services. For example, the multiple crises in 2011 and 2012 – from ongoing unrest and violence in the Middle East and Africa to natural disasters throughout the world – showcase the Department's ability to respond promptly and effectively to major crises. Applying lessons learned as a result of these and previous crises, the Department used a range of communication tools to reach out to U.S. citizens affected by the events, disseminate information, and identify immediate needs. The Department coordinated closely with other U.S. Government agencies and with foreign governments to plan for and respond to crises. The Department is working to standardize data and software across the enterprise in an effort to give decision-makers higher-quality data to make better business decisions. The Department uses a Geographical Information System that provides emergency managers access to a wide variety of geo-coded data on the Department's personnel and facilities and on foreign missions across the United States. It also receives automatic weather updates that support spatial queries and demographics information critical for responding to bomb threats and chemical plumes. The Department continues, in collaboration with the Department of Homeland Security and other agencies, to protect America's homeland with improved technology and efficiency at ports of entry and in visa processing, smarter screening technology for Government officials, and more secure U.S. travel documents (both visas and passports).

In support of this strategic goal, the Department is pursuing a multi-year hiring program to build the talented, diverse workforce we need to handle our foreign policy priorities and strengthen diplomacy. The Department is providing rigorous training programs to further professional development, including foreign language training in priority languages such as Arabic and Chinese Mandarin. Training and targeted recruiting for language skills have led to a steady increase in the number of language-designated positions filled with incumbents who meet or exceed the language requirements. Between FY 2008 and FY 2011, the Department's Foreign Service Institute (FSI) has supported the comprehensive training needs (orientation, consular, tradecraft, and leadership) of Diplomacy 3.0 by providing training for 5,556 new hires and by providing increased language training. FSI has also increased distance learning enrollments by 173 percent from 22,724 in FY 2008 to 61,788 in FY 2011. The Department's Office of Language Services assisted dozens of posts worldwide by translating the country profiles in the annual Human Rights Reports (HRRs), International Religious Freedom Reports (IRFs), and Trafficking in Persons Reports (TIPs) – nearly one million words into fourteen

From left to right, Embassy Cairo Public Diplomacy Officer Adam Lenert, Embassy Riga Chief Consul Tim Buckley, Embassy Dhaka Chief Consul Bill Hammaker, and Embassy Cairo Consular Affairs Officer Jessica Adams, pose for a photo with an American couple at the Cairo International Airport in Egypt, February 7, 2011.
Department of State

languages. For support to Diplomatic Security's Anti-Terrorism Assistance Program, the Office translated materials for 161 courses into 16 languages, totaling over 10 million words. Moreover, the Interpreting Division has worked to expand its global network with universities, international agencies, and governments around the world. It has done so to find qualified, professional talent in almost 100 languages at a moment's notice and to meet the constantly expanding and accelerating demands of the Department of State and the White House. The Office of Language Services is pursuing a multi-year hiring program to build the talented, diverse interpreting workforce needed to handle the Department's foreign policy priorities and strengthen diplomacy. The Department is increasingly leveraging technology to provide translations at greater speed to allow U.S. diplomatic missions to post them on their websites to increase transparency, efficiency, and effectiveness.

Our missions overseas provide the diplomatic platform for all civilian agencies of the U.S. Government. We manage the global chain, providing goods and services domestically and to all agencies at diplomatic and consular missions overseas. The Department of Defense (DoD) concurred with the recommendation to expand the Department's household goods pilot program to manage the shipment of DoD employees' household effects to and from posts when DoD personnel are assigned under a Chief of Mission. To date, the Department has executed over 1,700 shipments to and from the 15 pilot posts, and the feedback from DoD employees and post shipping offices indicates the program is an overwhelming success. Through an inter-agency Memorandum of Agreement (MOA) between the Department, DoD, and the U.S. Coast Guard, effective October 1, 2012, locations will expand from the original 15 posts to 24. The Department successfully transitioned mail service for Chief of Mission personnel in Iraq from Army Post Office (APO) to Diplomatic Post Office (DPO) mail service managed by the Department of State, while simultaneously reducing costs from the previous mail system. The Department's Collaborative Management Initiative (CMI) is the flagship framework for continuous process improvement of management operations at overseas posts. A key part of CMI is eServices, which has processed 4 million service requests since its inception, giving customers around the world a common look and feel for requesting services, and giving performance feedback and metrics to service providers.

To provide a viable platform for the diplomatic component of Smart Power, we provide and maintain energy efficient, sustainable, secure, safe, and functional facilities in the United States and overseas for both State employees and those of other agencies. In FY 2012, we made great strides in support of the Department's sustainability goals. The Department implemented a Fleet Management Information System (FMIS) that is currently being deployed to DOS facilities worldwide. The program includes dispatch services with a robust system for electronic reservations and utilization tracking, among other metrics. State also coordinated with the Department of Defense to refuel with alternative fuels available at military installations in the Washington, D.C. region.

Our diplomatic security programs protect both people and national security information. During the past 12 months, the Department's cyber security team detected and responded to an ever-increasing volume of network security incidents. For example, in 2011, the Department received over 19,000 spear phishing e-mails. In 2012, the Department received over 27,000 which represents a 42 percent increase in spear-phishing and/or malicious e-mail traffic compared to the previous 12-month period. This steady increase in malicious software (malware) is significant because spear-phishing e-mails containing malware can place "code" on Department machines, which may compromise the integrity of U.S. Government networks and possibly enable the exfiltration of sensitive data.

The Department continues its commitment to enhance energy independence and reduce global warming by greening our facilities. At of the end of FY 2012, 44 percent of the entire domestic real estate portfolio has been certified by independent parties (e.g., LEED, Green Globes, Energy Star) as sustainable and/or energy efficient, more than twice the goal established for the Department by the Office of Management and Budget and the Council of Environmental Quality. The Department is also exploring the feasibility of regional renewable energy farms to support our facilities around the world. The Department's Commercial Services Management (A/CSM) Office re-engineered the business processes of the Authentications Office, which provides signed certificates of authenticity for a variety of documents to individuals, institutions, and government agencies. Documents that might require authentication for use abroad, include company bylaws, powers of attorney, trademarks, diplomas, treaties, warrants, extraditions, agreements, certificates of good standing, and courier letters. The improved processes resulted in a reduction of this backlog to a stable range of 5 to 10 days from a backlog of 45 days in August 2011, significantly improving service to customers. The Department of State's Bureau of Consular Affairs is expanding consular services offered to American taxpayers and looking forward to opening a satellite passport office in San Juan, Puerto Rico in 2013 to better serve U.S. citizens living in Puerto Rico, the U.S. Virgin Islands, and throughout the Caribbean. When fully operational, the satellite office will employ 28 workers, 13 direct-hire government workers, and 15 contractors, most of whom will be hired locally. The Department has reached the final stages of site selection for the Diplomatic Security Hard Skills Training Center; and the Information Resources Management data center consolidation in Lakewood, Colorado is nearing completion.

Key Achievements

- The Integrated Logistics Management System (ILMS), the Department's global platform for integrating post logistics operations with Washington headquarters and Regional Centers, became fully deployed domestically and overseas at 260+ posts. Critical to ensuring diplomatic personnel around the world can provide the goods and services that are essential to support the Department's mission, ILMS was recognized by the American Council for Technology-Industry Advisory Council (ACT-IAC) through two prestigious awards. ILMS was selected from thirty finalists and six categories across all of Government by ACT-IAC's Overall Winner for Excellence.gov Top Government Programs and the winner for Excellence in Enterprise Efficiencies.
- The Department won the 2012 Archivist's Achievement Award for innovative and cost-effective use of technology for a records management tool that will be adopted as a best practice in the U.S. Government. The Department leveraged the technology with a dynamic website that received over 3,000 online Freedom of Information Act (FOIA) requests, posted nearly 3,500 declassified documents, and hosted over 1,000 visitors daily (over 350,000 annually). State declassified nearly 3 million pages of permanent historical records covering U.S. foreign policy, and declassified and released over 100,000 pages in response to FOIA requests.
- The Denver Resident Office and Miami Field Office received Leadership in Energy and Environmental Design (LEED) Silver certification.
- As part of the Department's effort to build a 21st Century workforce and strengthen diplomacy, the Foreign Service and Civil Service position baselines increased by 21 and about 9 percent, respectively, since 2008. In FY 2012, the Department also worked with Consular Affairs to fill a consular staffing gap in China and Brazil with 44 Limited Non-Career Appointments.
- Staffing top priority posts, including Afghanistan, Iraq, and Pakistan, continues to be a main concern for the Department. In FY 2012, the Department filled over 95 percent of these positions for the 2013 assignments cycle. The Department met or exceeded OPM's goals for hiring of veterans and individuals with disabilities since the President signed the November 2009 and July 2010 Executive Orders mandating increased recruitment of qualified individuals among these groups, and the Department is on track to meet OPM's goals this year.

- In FY 2012, the Bureau of Overseas Buildings Operations (OBO) completed eight major capital construction projects relocating more than 2,278 personnel into more secure, safer, and functional facilities. Currently, 38 projects are under design and construction. In addition, OBO completed nine major compound security upgrade projects. This year, the Department instituted a new program of Maintenance Cost Sharing whereby all agencies contribute to the maintenance of shared buildings overseas. This will help address the backlog of deferred maintenance. The Department also started a new program of Design Excellence. Implementing this new program will enhance our ability to provide outstanding facilities representing American values and the best of American talent, innovation, and technology. Additionally, one of the guiding principles of Design Excellence is to advance sustainability features and energy conservation.
- Roughly 97 percent of the agreed-upon administrative services under the International Cooperative Administrative Support Services (ICASS) have been consolidated. ICASS is the principal means by which the U.S. Government provides and shares the cost of common administrative support at its more than 250 diplomatic and consular posts overseas.
- In FY 2012, the Bureau of Diplomatic Security (DS) led the International Security Events Group and successfully supported the President's mandate under National Security Presidential Directive 46 to provide the greatest possible security for U.S. citizens, athletes, and other interests participating and attending the London 2012 Summer Olympic Games and Paralympics. DS Olympic Security Coordinators liaised with host-country law enforcement, security, intelligence services, and organizing officials to ensure the safety and security of Team USA. A U.S. Government interagency Joint Operations Center provided expertise, resources, and support from across the U.S. Government to respond to potential crises impacting American interests.
- The Department has pre-positioned medical materials at more than 250 U.S. embassies, consulates, and missions. These materials include medical equipment and supplies to provide alternate medical functionality in case of a terrorist attack. Nearly 100 percent of these newly updated Reserve Medical Unit Kits have been deployed to designated areas overseas as of May 2012.
- The White House issued an Executive Order establishing visa and foreign visitor processing goals, which stated that more than 80 percent of all applicants worldwide should have their visa interview within three weeks of receiving their application. Currently, the Department is exceeding this goal.
- Passport Services issued over 13.1 million passports in FY 2012, a 4 percent increase from FY 2011; further demand increases are projected for FY 2013. Processing times for issuing a passport averaged 8.3 days for routine service and 3.3 days for expedited request. During the busy season (February through June), Passport Service's processing times remained responsive at 8.9 days for routine and 3.4 days for expedited requests.
- The Department marked the first time that all Department costs, related to consular activity, would be funded from fees, significantly reducing the Department's reliance on appropriated funds. This completed a 4-year consular realignment initiative that shifted $441.4 million in consular-related costs from appropriated dollars to funds generated from visas, passports, and other consular activities. This allowed the Department to fund consular staff and facilities from fees.
- Green Computing: The Bureau of Information Resource Management (IRM) made advances in implementing green information technology, lowering the agency carbon footprint and costs, and improving efficiency and sustainability. We implemented a new printing policy to transition the Department from desktop printers to network printing. We also deployed an Enterprise Desktop Power Management solution that automatically "powers down" workstations after hours. Finally, the Department has been providing access to its servers via virtual environments to optimize resources to reduce the physical footprint of hardware, while minimizing power and cooling requirements.
- Global OpenNet: IRM successfully deployed its modernized remote access solution, Global OpenNet

(GO). GO provides more user-desktop functionality to remote end users, making staff more productive when teleworking. IRM also increased the capability to support more simultaneous connections to GO. The Department is on track to provide up to 35,000 users GO access.

- Data Center Consolidation: The Department continues to successfully execute our Data Center Consolidation efforts as detailed in the Department's Federal Data Center Consolidation Initiative Plan. Consolidating data centers into the Enterprise Server Operations Centers (ESOC) has resulted in improved security, continuity of operations, efficiencies through access to virtual environments, and significant cost avoidance that can be redirected to other priority projects across the Department. The domestic ESOC is now fully operational and Leadership in Energy and Environmental Design (LEED) Gold Certified. The Department is on track to complete consolidating the major data centers down to four facilities by the end of FY 2015, pending available future resources.

Summary and Analysis of Performance Trends

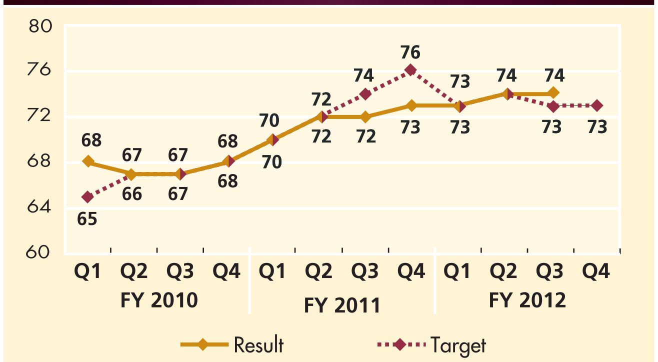
During FY 2012, the Department and USAID began reporting its results quarterly for the goal to strengthen diplomacy and development by leading through civilian power. The following two Illustrative Indicators for Strategic Goal 7 show quarterly data for staffing priority for language designated positions and positions in Afghanistan, Iraq, and Pakistan (AIP).

The language-designated position (LDP) fill rate is the percent of all language-designated positions filled by incumbents meeting or exceeding the language requirement for the position. A vacant LDP does not have an incumbent, but we include vacant LDPs in our calculation because vacant LDPs could be an indication of a shortage of qualified officers and/or a need for more language-trained employees.

Since FY 2010, the Department has experienced a steady increase in the LDP fill rate because of Diplomacy 3.0, the Department's multi-year hiring program that began in 2009. The goals of Diplomacy 3.0 have been to mitigate extended vacancies caused by increased commitments at priority posts such as Afghanistan, Iraq and Pakistan (AIP); eliminate the mid-level staffing deficit; build in a training component; and strengthen the service with the right mix of entry-level, mid-level and senior employees. Under the Diplomacy 3.0 umbrella are various recruitment and training initiatives. For example, the Department has recruited individuals with language skills (Chinese Mandarin and Portuguese) for limited non-career consular positions at posts with high volumes of visa adjudication, such as posts in Brazil and China. Additionally, with an increase in training, the Department has been able to provide more opportunities for short- and long-term foreign language training in priority languages such as Arabic and Chinese Mandarin, which take two years of training to become proficient.

With guidance from the Office of Management and Budget, the Department revised its FY 2012 and FY 2013 LDP fill rate targets based on FY 2012 funding, and the assumption that future funding levels might be less than funding requests. If resources remain at lower than requested levels, our improvement trend in the LDP fill rate may begin to plateau. The Department will continue to allocate staff to the highest global priorities and to maximize the number of LDPs that are filled to requirements, using available resources.

Illustrative Indicator 7: High performance/Agency Priority Goals increase the LDP fill rate with qualified incumbents



Source: Department of State, HR/RMA Position Data.

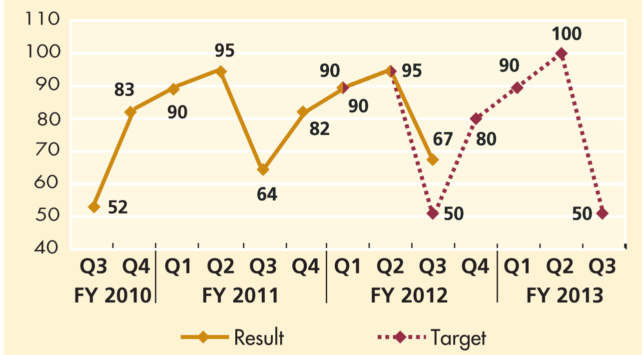
The Staffing High Priority Posts metric is a measure of the percentage of AIP positions filled for the current assignment cycle, which begins one full year in advance of the rotation dates. This is not a real time metric of AIP staffing rates.

The targets for this metric illustrate the nature of the AIP assignment cycle in Illustrative Indicator 8. The AIP assignment cycle begins in the second/third quarter, about three months before the regular summer assignment cycle, and ends in the second quarter of the following fiscal year. Accordingly, the target is at its maximum value in the second quarter when the assignment cycle ends, and the target is at lowest value in the third quarter when the new assignment cycle begins.

Current AIP fill rates for the 2013 summer (third quarter) assignment cycle, which we began tracking in the third quarter of 2012, are on par with previous assignment cycles. Staffing AIP posts continues to be a priority for the Department. Using a variety of recruitment strategies, which includes robust incentives packages, the Department has consistently met staffing requirements in those posts with volunteers, bypassing the need for direct assignments.

The Department will continue to review long-term and short-term staffing requirements at the three embassies and constituent posts, which will inform future recruitment strategies and policies.

Illustrative Indicator 8: Agency Priority Goals Priority post (AIP) staffing



Source: Department of State, HR/RMA Position Data.

Where to apply for a U.S. Passport?

Visit *http://travel.state.gov/passport/get/get_4855.html* to get up-to-date information regarding the process to apply for a passport. Passport Services, a division of the Bureau of Consular Affairs, is responsible for issuing passports to U.S. citizens. In addition to a network of more than 9,000 public government offices across the U.S. designated by Passport Services to accept passport applications, the Department serves American citizens at these passport service locations:

Hot Springs, AR; Atlanta, GA; Boston, MA; Buffalo, NY; Chicago, IL; Aurora, CO; Stamford, CT; Dallas, TX; Detroit, MI; El Paso, TX; Honolulu, HI; Houston, TX; Los Angeles, CA; Miami, FL; Minneapolis, MN; Portsmouth, NH; New Orleans, LA; New York, NY; Philadelphia, PA; San Diego, CA; San Francisco, CA; Seattle, WA; St. Albans, VT; Tucson, AZ; Washington, D.C.

The State Department and Global Women's Issues

The Secretary's Office of Global Women's Issues (S/GWI), led by Ambassador-at-Large for Global Women's Issues, Melanne Verveer, works with Department bureaus and interagency partners to ensure that the advancement of the status of women and girls is fully integrated into the development and execution of U.S. foreign policy. To this end, in March 2012 under the direction of S/GWI, the Department issued the first-ever gender policy directive, a roadmap for employing the full range of diplomatic tools to bolster women's leadership and participation opportunities in local and national government processes, civil society, and international and multi-lateral forums; and address barriers to unlock the potential of women to contribute to economies, and integrate women into peacekeeping and peace building.

Since the launch of the Secretary's International Fund for Women and Girls in April 2010, S/GWI has awarded $8.7 million in small targeted grants to local organizations for 72 projects in 41 countries through a combination of public and private funding mechanisms, including $5 million in U.S. Government funds and $3.7 million in private funds. The Office has also convened more than 400 women to engage in discussions at conferences and to participate in trainings to advance the status of women globally. Below are a few of S/GWI's key achievements for fiscal year 2012.

FY 2012 Key Achievements Timeline

1. **April.** To strengthen women's economic participation and invest in women-run small and medium enterprises, S/GWI advanced regional initiatives, such as the Women Entrepreneurs in the Americas (WEAmericas) initiative, which leverages public-private partnerships to increase women's economic opportunities, business skills, and access to markets, finance, training, and networks.

2. **June.** In support of the Women in Public Service Project (WPSP), a partnership with top U.S. women's colleges to identify, mentor and train emerging women public service leaders around the world, S/GWI facilitated the participation of 40 emerging women leaders from the Middle East and North Africa in the inaugural WPSP Summer Institute at Wellesley College.

3. **July.** S/GWI convened about 200 women from throughout Southeast Asia for the first-ever Lower Mekong Initiative Women's Empowerment and Gender Equality Policy Dialogue in Siem Reap, Cambodia. S/GWI played a key role in facilitating the U.S. launch of the Pacific Women's Empowerment Initiative with the governments of Australia, New Zealand and Papua New Guinea, which promotes multilateral cooperation on women's advancement in the Asia-Pacific and led to the Rarotonga Partnership for the Advancement of Pacific Island Women – a collaborative initiative to build capacity, support emerging women leaders, and establish networks for sustainable leadership development in the region.

Melanne Verveer, U.S. Ambassador-at-Large for Global Women's Issues, and Carolina Cardona, Director of U.S. Peace Corps Program in Togo, with a group of women entrepreneurs, small enterprise business women, and local leaders, attending a women's event in Lome, Togo, January 17, 2012. *Department of State*

4. **August.** S/GWI played a key role in the development and coordination of the first U.S. National Action Plan (NAP) on Women, Peace, and Security (WPS) launched in December, 2011, as well as the supplemental implementation guidance released in August 2012, to ensure that women participate equally in preventing conflict and building peace in countries threatened and affected by war, violence, and insecurity.

5. **September.** S/GWI stepped up efforts to engage with and provide opportunities to some of the most disadvantaged and rural women around the world. In this regard, the Ambassador launched the Grassroots Women's Political Leadership Forum, a South and Central Asian regional training program for 60 local- and village-level women leaders from 6 countries on the campus of the Asian University for Women (AUW) in Chittagong, Bangladesh. The program boosted attendees' leadership, political, and policymaking skills that are essential for emerging women leaders to become more effective agents of change and progress in their communities.

Summary Analysis of Financial Condition

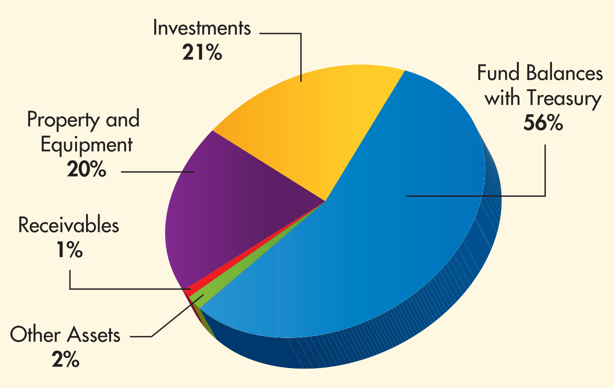
Overview of Financial Position

Assets. The Department's total assets were $79.6 billion at September 30, 2012, an increase of $5.9 billion or 8 percent over the 2011 total. Fund Balances with Treasury were up $3.8 billion due to an increase in unpaid obligations and recoveries over the prior year. Investments were up $495 million because contributions and appropriations received to support the Foreign Service Retirement and Disability Fund (FSRDF) were greater than benefit payments; the excess is required to be invested for future benefit payments. Other Assets increased $166 million due to additional advances and prepayments made in FY 2012. Receivables decreased by $20 million primarily as a result of a decrease in billed reimbursable agreements with other Federal agencies and interest receivables.

Top 11 Real Property Projects – 2012 *(dollars in millions)*

Project Name	Total
Seoul	$ 123
Islamabad	111
Kabul Nox and Housing	89
Sather Baghdad Project	89
Dakar	77
Guangzhou	70
Belgrade	69
Basrah Interim Facility	64
Santo Domingo	57
Monterrey	57
Rio Grande Flood Control System – IBWC	37
TOTAL	$ 843

Assets by Type



Assets as of September 30, 2012 and 2011

(dollars in millions)	2012	2011
Fund Balances with Treasury	$ 44,223	$ 40,415
Investments, Net	16,928	16,433
Property and Equipment, Net	16,087	14,606
Receivables, Net	632	652
Advances, Prepayments, Other Assets	1,702	1,536
Total Assets	$ 79,572	$ 73,642

Property and equipment increased by $1.5 billion due to construction of new embassies, necessary security upgrades at existing embassies and personal property acquisitions. The table above shows the top 11 real property projects that account for $843 million of this increase. In addition, personal property increased by about $264 million because of purchases of aircraft and vehicles.

Fund Balances with Treasury, Investments and Property and Equipment comprise 97 percent of total assets for 2012 and 2011. Investments consist almost entirely of U.S. Government securities held in the FSRDF; government agencies are, for the most part, precluded from making any other type of investment.

Many Heritage Assets, including art, historic American furnishings, rare books and cultural objects, are not reflected in assets on the Department's Balance Sheet. Federal accounting standards attempt to match costs to accomplishments in operating performance, and have deemed that the allocation of historical cost through depreciation of a national treasure or other priceless item intended to be preserved forever as part of our American heritage would not contribute to performance cost measurement. The standards require only the maintenance cost of these heritage assets be expensed, since it is part of the government's role to maintain them forever in good condition. All of the embassies and other properties on the Secretary of State's Register of Culturally Significant Property, however, do appear as assets on the Balance Sheet, since they are used in the day-to-day operations of the Department.

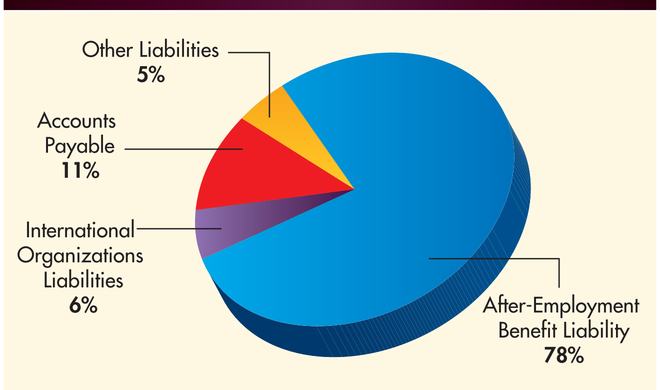
Liabilities. The Department's total liabilities were up $1.3 billion, 5 percent, between 2011 and 2012. The liability for future benefits payments to retired foreign service officers included in the After-Employment Benefit Liability comprises 78 percent of total liabilities. Total After-Employment Benefits Liability was up $1.2 billion, 7 percent, due to increasing participation in the Foreign Service Disability and Retirement Fund due to increasing participation in the benefit plan and changes in assumptions. Also included in this total are other after-employment benefits for Foreign Service Nationals. Accounts Payable increased by $643 million, 30 percent. This change is due to the increase in delivered, but not paid for goods and services received to support International Narcotics and Law Enforcement, Global Health Programs, Diplomatic and Consular Programs, and the Working Capital Fund. The International Organizations Liability decreased by $233 million or 14 percent, based on assessments the Department received.

Ending Net Position. The Department's net position, comprised of unexpended appropriations and the cumulative results of operations, increased 9 percent between 2011 and 2012. Unexpended appropriations were up by 11 percent or $3.4 billion, primarily due to increases in appropriations still available in the Diplomatic and Consular Programs fund, up $1.9 billion, the Pakistan Counterinsurgency Capability fund, up by $724 million, and the Overseas Buildings Operations fund, up $591million. Cumulative Results of Operations were up $1.2 billion, primarily due to resources used to purchase property and equipment, which are capitalized on the Balance Sheet rather than present in Net Cost as expenses.

RESULTS OF OPERATIONS

The following two charts illustrate the sources of funds the Department received in 2012 and the results of operations by net program costs reported on the Statement of Net Cost.

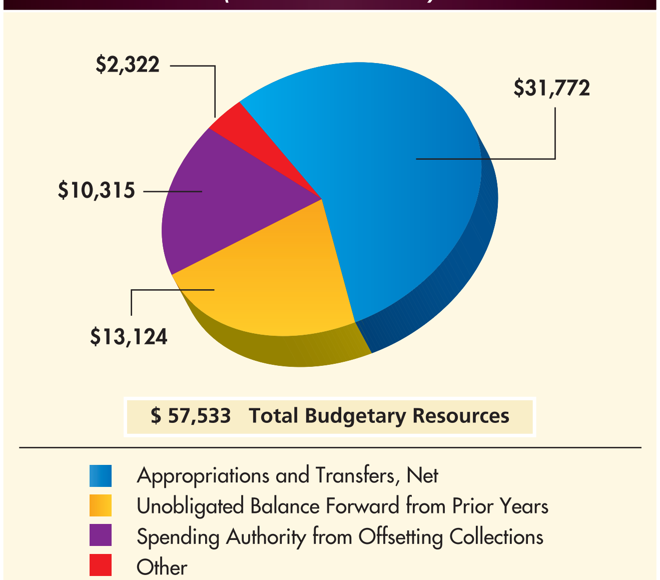
Liabilities by Type



Liabilities as of September 30, 2012 and 2011

(dollars in millions)	2012	2011
After-Employment Benefit Liability	$ 19,893	$ 18,674
International Organizations Liabilities	1,425	1,658
Accounts Payable	2,793	2,150
Other Liabilities	1,316	1,642
Total Liabilities	$ 25,427	$ 24,124

Sources of Funds
(dollars in millions)

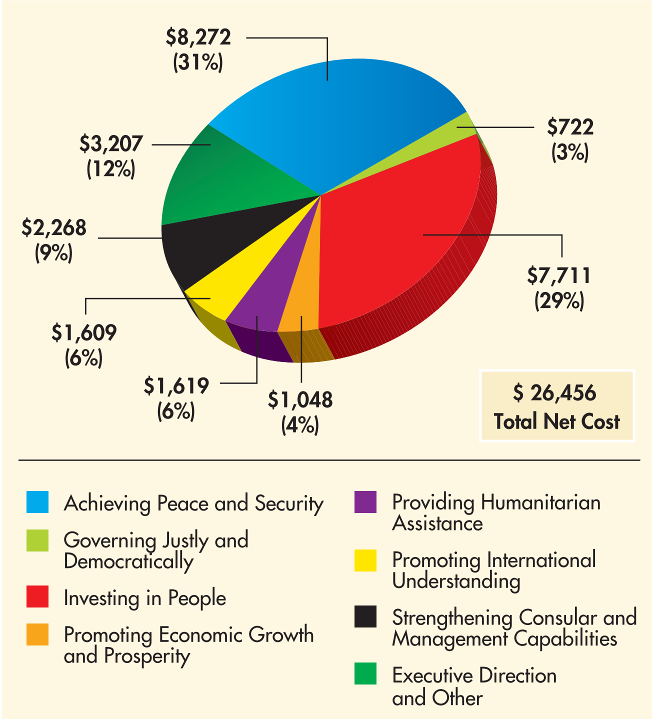


The Combined Statement of Budgetary Resources details what budgetary resources were available to the Department for the year and the status of those resources at year-end. Total Budgetary Resources were up $4.2 billion, 8 percent, in 2012 over 2011. Increases in authority from offsetting collections of $706 million, other changes in unobligated balance of $250 million, recoveries of prior-year unpaid obligations of $255 million, and an increase in budget authority from appropriations granted by Congress of $3.5 billion offset by decreases in unobligated balances brought forward of $213 million, account for the increase. Appropriations and offsetting collections comprised 73 percent of year-end resources. The remainder was transfers, recoveries of prior-year unpaid obligations, and unobligated balances brought forward. The Department obligated $40.1 billion of the $57.5 billion total resources in 2012, an increase of $220 million, 1 percent, over 2011. Total resources obligated was 70 percent for 2012 as compared to 75 percent for 2011.

The Consolidated Statement of Net Cost presents the Department's costs by strategic goal. These strategic goals were determined by the Department's current State-USAID Joint Strategic Plan for 2007 – 2012 established pursuant to the Government Performance and Results Act of 1993. Cost by goal is net of earned revenue by goal. Revenue to the Department from other Federal agencies must be established and billed based on actual costs only, without profit, per statute. Revenue from the public, in the form of fees for service, such as visa issuance, is also without profit, at the Department. Therefore, the net cost per goal measures actual cost to the American taxpayer after fees and agreements with other Federal agencies that should net to zero. Note 15 to the financial statements presents further details of costs by responsibility segments, per Under Secretary.

Total net cost of $26.5 billion is an increase of 14 percent or $3.3 billion over 2011. The goals of Achieving Peace and Security, Investing in People, and Strengthening Consular and Management Capabilities account for most of this change. As seen in the Net Cost by Strategic Goal chart, the Achieving Peace and Security goal is the largest representing 31 percent of the FY 2012 total net cost. Our International Narcotics and Law Enforcement (INL) cost increased by $376 million and is included in the strategic goal Achieving

Net Cost by Strategic Goal
(dollars in millions)



Peace and Security. This increase includes contractual expenses, educational grants and personnel costs. Our second largest goal, Investing in People, accounted for $1.2 billion of the total net cost increase. This was primarily the result of an increase in initiatives for Global Health Programs, formerly known as Global Health and Child Survival. Additionally, support costs for Diplomatic & Consular Programs and Diplomatic Security functions accounted for $1.5 billion of the increase in total costs. The majority of these costs were distributed to the goal, Strengthening Consular and Management Capabilities.

THE DEPARTMENT'S BUDGETARY POSITION

The Department of State supports diplomats and development experts who protect our national security, promote our economic growth, and protect our values in virtually every country in the world. The State Department and USAID budgets amount to only one percent of total Federal budget outlays, an investment on the part of the American people that pays excellent returns and constitutes an integrated strategy for renewing America's global leadership. Both State and

USAID disclose their financial status and provide transparency and accountability to the American people, Congress, and the President – including both successes and challenges. State's FY 2012 budget was $17.1 billion for State Operations and $18 billion for Foreign Assistance. For USAID's AFRs, see: *http://www.usaid.gov/results-and-data/progress-data/agency-financial-report.*

Budgetary Position for State Operations

The FY 2012 budget for the Department of State operations totals $17.1 billion, including appropriations for Administration of Foreign Affairs ($13.4 billion), contributions to international organizations and international peacekeeping activities ($3.4 billion), international commissions ($124 million), and related programs ($153 million). These totals included $4.6 billion Overseas Contingency Operations (OCO) funding for State Operations, the first time Congress appropriated funding under this title. These funds were primarily for temporary and extraordinary requirements in Iraq, Afghanistan, and Pakistan, but included a small amount for activities outside the Frontline States. The Department received OCO funding for Diplomatic & Consular Programs; Worldwide Security Protection; Embassy Security, Construction, and Maintenance; Educational and Cultural Exchanges; Contributions to International Organizations; and Conflict and Stabilization Operations. The Department's FY 2012 budget was funded by the Consolidated Appropriations Act, 2012 (Division I, Public Law No. 112-74).

In addition to appropriated funds, the Department continues to use revenue from user fees – Machine Readable Visa fees, Enhanced Border Security Program fees, the Western Hemisphere Travel Surcharge, and other fees – for the Border Security Program. The revenue from these fees supports program requirements to protect American citizens and safeguard the nation's borders.

Appropriations for Administration of Foreign Affairs constitute the Department's core operational funding. They support the people and programs that carry out U.S. foreign policy and advance U.S. national security, political, and economic interests at more than 270 posts in over 180 countries around the world. These funds also build, maintain, and secure the infrastructure of the American diplomatic platform, from which most U.S. Government agencies operate overseas.

For FY 2012, the Department's principal operating appropriation – Diplomatic and Consular Programs (D&CP) – was funded at $10.9 billion. Total D&CP funding included $3.5 billion to support operations of the U.S. Mission in Iraq; $1.1 billion for Department activities in Afghanistan; $160 million for Department activities in Pakistan; $1.6 billion for the Worldwide Security Protection (WSP) program to strengthen security for diplomatic personnel and facilities under threat from terrorism; and $546.8 million for public diplomacy programs to counter extremist misinformation and secure support for U.S. policies abroad. The funding also included resources to further agency-specific initiatives on rightsizing the U.S. Government's overseas presence and Federal real property asset management.

The Department's Information Technology (IT) Central Fund for FY 2012 investments in IT was $217.5 million. The IT Central Fund included $59 million from the Capital Investment Fund (CIF) appropriation and $158 million in revenue from Expedited Passport fees. Investment priorities included modernization of the Department's global IT infrastructure to assure reliable access to foreign affairs applications and information and projects to facilitate collaboration and data sharing internally and with other agencies.

The Embassy Security, Construction, and Maintenance (ESCM) appropriation was funded at $1.6 billion. This funding helped provide U.S. missions overseas with secure, safe and functional facilities. The funding also supported maintenance and repairs of the Department's real estate portfolio, which exceeds $53 billion in replacement value and includes over 18,600 properties. ESCM funding included $775 million to support compound security projects, and the Capital Security Construction program, which was expanded in FY 2012 to include the maintenance cost sharing program. Other agencies with overseas staff under Chief of Mission authority also contributed $509 million to capital security cost-sharing reimbursements for the construction of new diplomatic facilities.

The Educational and Cultural Exchange Programs (ECE) appropriation was funded at $599 million. Aligned with public diplomacy efforts, these strategic activities engaged foreign audiences to develop mutual understanding and build foundations for international cooperation. The funding included $333 million for academic programs of proven value, such as the J. William Fulbright Scholarship Program and English language teaching. It also included $201 million for professional and cultural exchanges, notably the International Visitor Leadership Program and Citizen Exchange Program.

The Department's FY 2013 budget request supports comprehensive American engagement and implements the vision of U.S. global leadership articulated in the National Security Strategy released in May 2010. The resources requested strengthen core elements of America's civilian power and provide the women and men of the Department of State with the tools they need to advance America's interests and values worldwide.

For FY 2013, the President's Budget Request for the Department is $17.9 billion. As in FY 2012, the Department's request is separated into two components: base, or "enduring," and OCO, which addresses the extraordinary and temporary costs associated with Department operations in Iraq, Afghanistan, and Pakistan. The enduring portion of the request, $13.5 billion, includes resources to support worldwide core national security and foreign policy priorities. The request for D&CP is $11.4 billion, including $2.1 billion for WSP to meet new demands in all regions. The request provides $83 million for CIF investments in IT infrastructure and collaborative tools. The request for ESCM is $1.6 billion, including resources for design and/or construction of secure facilities, additional site acquisitions, and compound security projects. Further, the request provides $587 million for ECE to sustain the exchanges component of public diplomacy. The core budget represents the Department's ongoing investment necessary to advance America's security and economic interests around the world.

The Department's request includes $4.4 billion for OCO. Of this amount, $4.3 billion supports diplomatic and security operations while $50 million is required to sustain activities of the Special Inspectors General in Iraq, Afghanistan, and Pakistan. These are expenses the Department is incurring as civilian employees take on more responsibility in the Frontline States and are expected to be phased out over time as these countries rebuild and take responsibility for their own security. Separating extraordinary shorter-term outlays from core ongoing expenses makes the Department's budget more transparent and reduces overlap and duplication by aligning spending in the Frontline States with the Department of Defense, which also receives OCO funding.

To maximize our efficiency, the Department will continue to focus on improving the way it does business. It will concentrate particularly on reforms recommended in the Quadrennial Diplomacy and Development Review (QDDR) released in December 2010. Following this blueprint for change, the Department will seek innovative solutions and build cross-agency partnerships to achieve measurable results.

In sum, the FY 2013 request provides funding for diplomatic operations, programs, and initiatives that constitute an integrated strategy for renewing America's global leadership and advancing vital U.S. national interests. With these resources, America can, must, and will continue to lead in the 21st Century.

Budgetary Position for Foreign Assistance

The FY 2012 Department of State Foreign Assistance budget totaled $18 billion. Foreign Assistance programs enable the U.S. Government to promote stability in key countries and regions, advance economic transformations, confront security challenges, respond to humanitarian crises, and encourage better governance, policies, and institutions. The Department's FY 2012 Foreign Assistance budget was funded by the Consolidated Appropriations Act, 2012 (Division I, Public Law No. 112-74).

Foreign Assistance programs under the purview of the Department of State are the Democracy Fund; Foreign Military Financing; Global Health Programs; the Global Security Contingency Fund; International Military Education and Training; International Narcotics Control and Law Enforcement; International Organizations and Programs; Migration and Refugee Assistance; U.S. Emergency Refugee and Migration Assistance; Nonproliferation, Antiterrorism, Demining, and Related Programs; the Pakistan Counterinsurgency Capability Fund; and Peacekeeping Operations. The Department also implements funds from the Economic Support Fund (ESF) and Assistance for Europe, Eurasia, and Central Asia (AEECA) accounts.

An important aspect of the Department's FY 2012 budget is the new Overseas Contingency Operations (OCO) component. OCO funds the extraordinary, but temporary, costs of the Department of State and the U.S. Agency for International Development (USAID) operations in Iraq, Afghanistan, and Pakistan, as well as other extraordinary contingency costs in places like Yemen and Somalia. The Department's Foreign Assistance portion of the FY 2012 budget for OCO totals $3 billion in Foreign Military Financing, the Global Security Contingency Fund, International Narcotics Control and Law Enforcement, Migration and Refugee Assistance, Nonproliferation, Antiterrorism, Demining, and Related Programs, the Pakistan Counterinsurgency Capability Fund, and Peacekeeping Operations.

The Democracy Fund appropriation totaled $115 million in FY 2012; the funds were split, however, between the Department of State and the U.S. Agency for International Development (USAID). The Department was allocated $68 million to promote democracy in priority countries where egregious human rights violations occur, democracy and human rights advocates are under pressure, governments are not democratic or are in transition, and where there is growing demand for human rights and democracy. Additionally, the fund was also used for programs promoting Internet Freedom.

The FY 2012 Foreign Military Financing (FMF) appropriation totaled $6.3 billion, of which $1.1 billion is designated as OCO-related and $5.2 billion supports core programs. FMF furthers U.S. interests around the world by training and equipping coalition partners and friendly foreign governments that are working to achieve common security goals and shared burdens in joint missions. FMF promotes U.S. national security by contributing to regional and global stability, strengthening military support for democratically-elected governments, containing transnational threats including terrorism and trafficking in narcotics, weapons, and persons. While the greatest proportion of FMF in FY 2012 was allocated to Israel, Egypt, Iraq, Jordan, and Pakistan, the remaining funds were allocated strategically within regions to support ongoing efforts to incorporate the most recent North Atlantic Treaty Organization (NATO) members into the organization, support prospective NATO members and Coalition partners, and assist critical Coalition partners in Afghanistan.

In FY 2012, the portion of the Global Health Programs (GHP) appropriation managed by the Department of State totaled $5.5 billion. This is the primary source of funding for the President's Plan for AIDS Relief (PEPFAR), the largest effort made by any nation to combat a single disease. These funds are used to achieve prevention, care, and treatment goals while also strengthening health systems, including new health care worker goals, and emphasizing country ownership to build a long-term sustainable response to the epidemic. Similar to prior years, the majority of the funds ($3.4 billion) continued to be allocated to the Africa region where the HIV/AIDS epidemic is the most widespread. There was also a $1.3 billion contribution to the Global Fund to Fight AIDS, Tuberculosis and Malaria.

The FY 2012 Global Security Contingency Fund (GSCF) appropriation included $50 million in OCO funding, which was transferred from the Pakistan Counterinsurgency Capability Fund (PCCF). The account is used to support the Department's new three year pilot initiative which streamlines the way the U.S. Government provides assistance to military forces and other security forces responsible for conducting border and maritime security, internal security, and counterterrorism operations, as well as the government agencies responsible for such forces in response to emergent challenges or opportunities.

The FY 2012 International Military Education and Training (IMET) appropriation totaled $106 million. IMET is a key component of U.S. security assistance that promotes regional stability and defense capabilities through professional military training and education. IMET students from allied and friendly nations receive valuable training and education on U.S. military practices and standards. This training includes professional military leadership, technical and specialized military instructions, exposure to democratic values, and respect for internationally recognized standards of human rights. IMET is an effective mechanism for strengthening military alliances and international coalitions critical to the global fight against terrorism.

The International Narcotics Control and Law Enforcement (INCLE) appropriation for FY 2012 totaled $2.1 billion, from which $315 million was transferred to other accounts, leaving a balance of $1.7 billion ($669 million in OCO funding and $1.1 billion in core funding). INCLE supports bilateral and global programs critical to combating transnational crime and illicit threats, including efforts against terrorist networks in the illegal drug trade and illicit enterprises. INCLE programs strengthen law enforcement jurisdictions and institutions. In FY 2012, many INCLE resources were focused where security situations are most dire and where U.S. resources are used in tandem with host-country government strategies to maximize impact. INCLE resources were also targeted to countries having specific challenges to overcome in establishing a secure and stable environment, including Afghanistan, Pakistan, Mexico, Lebanon, Haiti, South Sudan, and Iraq. Finally, INCLE-funded programs helped to reduce the flow of drugs to the United States and address instability in the Andean region by strengthening the ability of both source and transit countries to investigate and prosecute major drug-trafficking organizations and their leaders by blocking and seizing their assets.

The FY 2012 International Organizations and Programs (IO&P) appropriation totaled $348 million. IO&P provides international organizations voluntary contributions that advanced U.S. strategic goals by supporting and enhancing international consultation and coordination. This approach is required in transnational areas where solutions to problems are best addressed globally, such as protecting the ozone layer or safeguarding international air traffic. In other areas, such as in development programs, the United States can multiply the influence and effectiveness of its contributions through support for international programs. The largest contributions in FY 2012 were made to the United Nations Children's Fund (UNICEF), the United Nations Development Program (UNDP), and the United Nations Population Fund (UNFPA).

In FY 2012, the Migration and Refugee Assistance (MRA) appropriation totaled $1.9 billion, of which $229 million was OCO and $1.6 billion was for core programs. Through the MRA account, the U.S. Government provides humanitarian assistance and resettlement opportunities for refugees and conflict victims around the globe. MRA is an essential component of U.S. foreign policy, reflecting America's dedication to assisting those in need. In FY 2012, MRA contributed to key international humanitarian organizations and non-governmental organizations to address international humanitarian needs and refugee resettlement in the United States. MRA funds supported programs that met basic life-sustaining needs; protected refugees and conflict victims; assisted refugees with voluntary repatriation, local integration, or permanent third-country resettlement; and fostered the effective management of human international migration.

The FY 2012 U.S. Emergency Refugee and Migration Assistance (ERMA) appropriation totaled $27 million. ERMA serves as a contingency fund from which the President can draw in order to respond effectively to humanitarian crises in an ever-changing international environment. Funds provided in FY 2012 ensured the United States was able to respond quickly to urgent and unexpected refugee and migration needs. ERMA addresses various humanitarian emergencies such as serious food shortages, including assisting refugees, internationally displaced persons, vulnerable migrants, and other victims of conflict in countries throughout Africa and other regions.

The Nonproliferation, Antiterrorism, Demining, and Related Programs (NADR) appropriation in FY 2012 totaled $711 million, of which $121 million was OCO and $590 million supported core programs. NADR funding is used to support U.S. strategic and humanitarian priority efforts, especially in the areas of nonproliferation and disarmament, export control, and other border security assistance; global threat-reduction programs, antiterrorism programs; and conventional weapons destruction.

The FY 2012 Pakistan Counterinsurgency Capability Fund (PCCF) was appropriated $850 million in OCO funding. From that level, there were two transfers of $50 million to ESF OCO and GSCF, respectively, leaving $750 million remaining in the account. PCCF is designed to build counterinsurgency capabilities of Pakistan's security forces engaged in operations against militant extremists in the Federally Administered Tribal Areas (FATA) and Khyber-Pakhtunkhwa. Funding for PCCF is used to enhance the capabilities of the Pakistan Army, the Pakistan Air Force, and the Frontier Corps in the following key areas: air mobility; night operations;

counter-improvised explosive devises; command and control; intelligence, surveillance and reconnaissance; close air support; joint fires; intelligence-driven operations; and combat logistics and sustainment with a priority on communications, survivability, precision targeting, and night operations support. Furthermore, PCCF is used for a combination of infrastructure enhancements, counterinsurgency-related training, and equipment. PCCF will provide modest support to assist the development of local law enforcement and the FATA Levy Forces, in coordination with other Department efforts.

The Peacekeeping Operations (PKO) appropriation totaled $429 million, of which $126 million was OCO and $303 million supported core programs. This level includes a $45 million transfer from INCLE's OCO appropriation. PKO is used to enhance international support for voluntary multinational stabilization efforts, including international missions not supported by the United Nations, and U.S. conflict-resolution activities. PKO funding is used to provide security assistance to help diminish and resolve conflicts, enhance participation in peacekeeping and stability operations, address counterterrorism threats, and reform military establishments into professional military forces with respect for the rule of law. In FY 2012, the PKO program supported ongoing requirements for the Global Peace Operations Initiative, security sector reform in the newly independent Republic of South Sudan, as well as multinational peacekeeping and regional stability operations, particularly in Somalia.

The Department of State's FY 2013 budget request for Foreign Assistance is currently under congressional consideration. The request is for $18.1 billion, of which $15.3 billion supports core programs and another $2.8 billion is for OCO funding. The request includes $10.6 billion for the international security assistance programs of FMF ($6.4 billion), GSCF ($25 million), IMET ($103 million), INCLE ($2.5 billion), NADR ($636 million), the Pakistan Counterinsurgency Capability Fund ($800 million), and PKO ($249 million). The requests for MRA ($1.6 billion) and ERMA ($50 million) will continue to support overseas humanitarian assistance and programs to admit refugees into the United States. The request also includes $327 million for voluntary contributions to international organizations and $5.4 billion for the GHP account for the Department-managed PEPFAR programs. The Department's OCO request is made up of $911 million in FMF, $1.1 billion in INCLE, and the $800 million in PCCF.

Limitation of Financial Statements

Management prepares the accompanying financial statements to report the financial position and results of operations for the Department of State pursuant to the requirements of Chapter 31 of the U.S. Code Section 3515(b). While these statements have been prepared from the books and records of the Department in accordance with FASAB standards using OMB Circular A-136, *Financial Reporting Requirements*, revised, and other applicable authority, these statements are in addition to the financial reports, prepared from the same books and records, used to monitor and control the budgetary resources. These statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity.

Managing for Results: Evidence-Based Decision-Making

The State Department carries out its mission in a challenging global environment, facing complex concerns about national security, global health, economic growth and other facets that touch on the lives of Americans at home and abroad. Like other U.S. Government agencies that operate in an increasingly constrained budget environment under pressure to "do more with less," the Department of State and USAID have taken steps to confront the challenge of how to address these problems effectively, of how to determine what works and what does not.

The implementation in February 2012 of the Department's Program Evaluation Policy represented a significant milestone toward creating a learning organization with a commitment to accountability and the sharing of lessons learned, and using performance information to improve the effectiveness of Department of State funded efforts by basing programming decisions on evidence about what works. Consistent with the findings and recommendations of the Quadrennial Diplomacy and Development Review (QDDR), the new ***Managing for Results*** framework (see p.12) lays the groundwork for integrated planning, budgeting and performance management processes that will promote both the production of good evidence *and* the actual use of that evidence. A component of the new Department of State-USAID ***Managing for Results*** framework, the Department's evaluation policy provides a strategy for gathering feedback in the management and study of Department of State-funded programs and projects. The policy aims to optimize the impact of the Department of State resources by increasing the level of evaluation and strengthening evaluation rigor, and by developing and utilizing a more rigorous base of information to guide decisions about program design, funding, implementation, and management.

In addition to program evaluations, the Department promoted other initiatives to strengthen the ways in which information is generated, used, and shared within diplomatic and assistance programs:

- As part of an interagency effort with USAID and other partners, the Department undertook a foreign assistance indicator reengineering process to review and establish indicators that are the basis for standardized foreign assistance performance data collection. Further, the Department and USAID promoted the use of third-party country performance data and analytic best practices to facilitate more informed decision-making and alignment of foreign assistance resources against key policy priorities.
- The Department implemented quarterly data-driven progress reviews that engaged Department of State program managers in regular discussions with the highest levels of Agency leadership. These discussions emphasize the use of performance data as a management tool.
- As mentioned, Department of State and USAID developed a new planning, budgeting, program management and performance management annual cycle which incorporates evidence and evaluation. The new process enhances the feedback loop among all four components of the ***Managing for Results*** framework for decision-makers worldwide by:
  - Putting planning first, so that subsequent budget requests align with goals and objectives;
  - Instructing domestic bureaus and posts overseas to identify what success looks like and to measure progress;
  - Providing agency-wide tools to allow Department of State and USAID managers to drill down into each aspect of the framework, access guidance documents, tools and templates;
  - Incorporating the planning for and implementation of evaluations into strategic planning, program and project design, performance monitoring, learning and budget planning; and
  - Partnering with the Foreign Service Institute to augment training for employees.

In the next fiscal year, the Department will pursue these and other avenues to continue developing a more coherent and effective system in which we learn what works, address problems and more effectively, use reliable performance information to achieve policy and program goals.

Internal Controls, Financial Management Systems and Compliance with Laws and Regulations

Management Assurances

The Department's Management Control policy is comprehensive and requires all Department managers to establish cost-effective systems of management controls to ensure U.S. Government activities are managed effectively, efficiently, economically, and with integrity. All levels of management are responsible for ensuring adequate controls over all Department operations.

Federal Managers' Financial Integrity Act

The Department of State's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). The Department conducted its assessment of the effectiveness of internal control over the efficiency and effectiveness of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, the Department identified a material weakness in internal control related to the Educational and Cultural Affairs (ECA) Summer Work Travel Program as of September 30, 2012. Except for this ECA weakness (described in the Departmental Governance section of this report), the Department can provide reasonable assurance that its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations and financial management systems met the objectives of FMFIA as of September 30.

In addition, management is responsible for establishing and maintaining effective internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. The Department conducted its assessment of the effectiveness of internal control over financial reporting in accordance with Appendix A of OMB Circular A-123. Based on the results of this assessment, the Department identified a material weakness in internal control related to financial reporting of Foreign Service Nationals' After-Employment Benefits as of June 30, 2012. However, the Department diligently worked to take corrective actions and the material weakness has been resolved as of September 30. Therefore, the Department can provide reasonable assurance that its internal control over financial reporting as of September 30 was operating effectively and the Department found no material weaknesses in the design or operation of the internal control over financial reporting.

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

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

Hillary Rodham Clinton
Secretary of State
November 15, 2012

DEPARTMENTAL GOVERNANCE

MANAGEMENT CONTROL PROGRAM

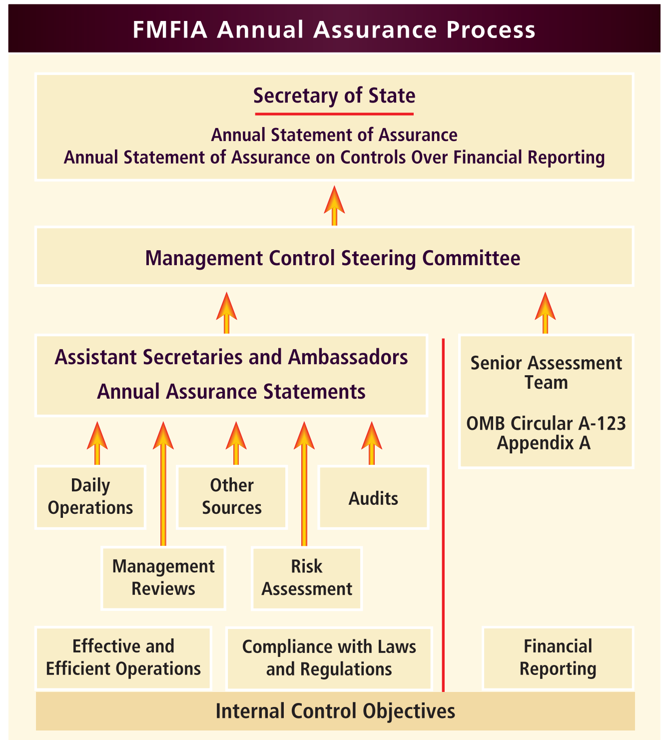
The Federal Managers' Financial Integrity Act (FMFIA) requires agencies to establish internal control and financial systems that provide reasonable assurance that the following objectives are achieved:

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

It also requires that the head of the agency, based on an evaluation, provide an annual Statement of Assurance on whether the agency has met this requirement. OMB Circular A-123, *Management's Responsibility for Internal Control*, implements the FMFIA and defines management's responsibility for internal control in Federal agencies.

Appendix A of Circular A-123 was added to improve governance and accountability for internal control over financial reporting in Federal entities similar to the internal control requirements for publicly-traded companies contained in the Sarbanes-Oxley Act of 2002. The Circular A-123 requires that the agency head provide a separate assurance statement on the effectiveness of internal control over financial reporting (ICOFR), which is an addition to and also a component of the overall FMFIA assurance statement.

The Secretary of State's 2012 Annual Assurance Statement for FMFIA and ICOFR is provided on the preceding page. We have also provided a Summary of Financial Statement Audits and Management Assurances as required by OMB Circular A-136, *Financial Reporting Requirements*, revised, later in this report's section called Other Accompanying Information.



The Department's Management Control Steering Committee (MCSC) oversees the Department's management control program. The MCSC is chaired by the Comptroller, and is comprised of ten Assistant Secretaries [including the Inspector General (non-voting)], the Chief Information Officer, the Deputy Chief Financial Officer, the Deputy Legal Adviser, the Director for the Office of Budget and Planning, and the Director for the Office of Overseas Buildings Operations. Individual assurance statements from Ambassadors assigned overseas and Assistant Secretaries in Washington, D.C. serve as the primary basis for the Department's FMFIA assurance issued by the Secretary. The assurance statements are based on information gathered from various sources including the managers' personal knowledge of day-to-day operations and existing controls, management program reviews, and other management-initiated evaluations. In addition, the Office of Inspector General, the Special Inspector General for Iraq Reconstruction, the Special Inspector General for Afghanistan Reconstruction, and the Government Accountability Office conduct reviews, audits, inspections, and investigations that are considered by management.
At the close of FY 2011, the Department reported a material weakness in internal controls related to the Educational and Cultural Affairs (ECA) Summer Work Travel (SWT) program. The Department had insufficient oversight to ensure the health, safety, and welfare of the SWT program. Throughout FY 2012, the Department took unprecedented action to address the weaknesses in the program.

Through the issuance of two Interim Final Rules in 2011 and 2012, the Department institutionalized new policies, safeguards, and procedures which prohibited certain categories of work, refocused the core cultural purpose of the program and mandated stricter employer vetting. In concert with the new rules, the Department conducted extensive and unprecedented on-site workplace and housing monitoring to ensure compliance. The Department has also removed several problematic sponsors from the program and experienced reductions in program participant numbers. While great strides have been made to strengthen the oversight of the program, there is more to do, including a spring 2013 Notice of Proposed Rule Making and a spring 2013 OIG compliance follow-on review. Completion of these additional steps will demonstrate that the significant improvements already made to the program have been successfully institutionalized. For this reason, the Department elected to continue to report the matter as a material weakness instead of a significant deficiency. The Department will continue taking swift action to remediate issues with the program.

The Senior Assessment Team (SAT) provided oversight during 2012 for the internal control program in place to meet Appendix A requirements. The SAT reports to the MCSC and is comprised of 15 senior executives from bureaus that have significant responsibilities relative to the Department's financial resources, processes, and reporting. Due to the broad knowledge of management involved with the Appendix A assessment, the Department evaluated issues on a detailed level. The findings that resulted from the FY 2012 Appendix A assessment included several significant deficiencies in internal control over financial reporting. By statute, the Department establishes compensation plans for FSNs we employ in foreign countries based upon prevailing laws and practices in the host country. The Department worked diligently to address the issues identified in the Foreign Service Nationals' After-Employment Benefits (FSNAEB) that were reported as a material weakness in the prior year. Remediation efforts were undertaken throughout the fiscal year, although the issues were still considered a material weakness as of June 30. However, as a result of the progress made in the fourth quarter, the MCSC voted to downgrade this item to a significant deficiency as of September 30. Below is a table illustrating actions taken to resolve the FSNAEB material weakness.

Appendix A Material Weakness Resolved as of September 30, 2012

Material Weakness Resolved	Corrective Actions Taken
As of June 30, 2012, deficiencies existed in the controls over accounting for FSNAEB. Specifically, the Department did not have a complete inventory of plans with reported balances for the future liability for defined benefits, lump-sum retirement, and severance benefits for each plan.	The Department implemented procedures to verify the completeness of our inventory of benefit plans, and accounting for the financial aspects of these complex compensation plans for FSNs we employ in foreign countries based upon prevailing laws and practices in the host country.

It is the Department's policy that any organization with a material weakness or significant deficiency must prepare and implement a corrective action plan to fix the weakness. The plan, combined with the individual assurance statements and Appendix A assessments, provide the framework for monitoring and improving the Department's management controls on a continuous basis.

The Office of Management Controls employs an integrated process to perform the work necessary to meet the requirements of Appendix A, and Appendix C regarding the Improper Payments Information Act, and the FMFIA. The Department employs a risk-based approach in evaluating internal controls over financial reporting on a multi-year rotating basis, which has proven to be efficient. The Department is working to expand the use of risk-based assessments in an integrated approach to the entire FMFIA program.

The Department's management controls program is designed to ensure full compliance with the goals, objectives, and requirements of the FMFIA and various Federal regulations. To that end, the Department has dedicated considerable resources to administer a successful management control program. Management will continue to channel focused efforts to resolve issues for all significant deficiencies in internal control over financial reporting that were identified by management and auditors.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires that agencies' financial management systems provide reliable financial data that complies with Federal system requirements, Federal accounting standards, and the U.S. Government Standard General Ledger (SGL).

To assess conformance with FFMIA, the Department uses FFMIA implementation guidance issued by OMB (January 2001 Memorandum to Executive Department Heads, Chief Financial Officers, and Inspectors General), results of OIG and GAO audit reports, annual financial statement audits, the Department's annual Federal Information Security Management Act (FISMA) Report, and other relevant information. The Department's assessment also relies upon evaluations and assurances under the Federal Managers' Financial Integrity Act (FMFIA), including assessments performed to meet the requirements of OMB Circular A-123 Appendix A. Particular importance is given to any reported material weakness and material non-conformance identified during these internal control assessments. The Department has made it a priority to meet the objectives of the FFMIA.

In its Report on Compliance and Other Matters, the Independent Auditor reported that the Department's financial management systems did not substantially comply with certain Federal system requirements, Federal accounting standards, and the USSGL at the transaction level. The Department appreciates that the Independent Auditor has noted certain weaknesses in our financial management systems. In our assessments and evaluations, the Department identified similar weaknesses but consider them as deficiencies versus substantial non-conformances relative to substantial compliance with the requirements of the FFMIA. The Department will work with the Independent Auditor in FY 2013 and beyond to resolve these issues.

Federal Information Security Management Act

The Department of State's 2012 Federal Information Security Management Act (FISMA) and Privacy Management Report will highlight how the Department continues to apply a layered approach of security risk management through the application of multiple levels of protection in a manner that is commensurate with the risk and impact facing the Department's information and information systems. It should also note the improvements based on earlier recommendations.

During FY 2012, the Department continued to enhance its comprehensive risk-based and cost effective information security program through extensive engagement with stakeholders throughout the Department and the implementation of specific and tangible efforts that have enhanced the maturity level of a number of programs and procedures including:

- The maturity of the continuous monitoring program through:
  - Certain Active Directory account attributes now require accounts to have compliant descriptions, including the manager field to ensure accountability.
  - New scanning allows for the discovery of routers and switches and these discovery results are provided in iPost.
  - Passwords with longer ages than 60 days are negatively scored.
  - Piloting scoring is underway for important Active Directory account qualities such as "no password required" and "no account expiration date".
- The mandatory nature of the yearly cyber-security awareness briefing for all employees is now tracked with automatic mechanisms that disable the accounts of personnel who have not taken the course within a year of their last course.

- Diplomatic Security is performing an engineering analysis of available database scanning tools to determine which tool is most appropriate, useful and cost effective with respect to a likelihood of threat against the Department's databases. An early examination of appropriate scanning tools concludes that the initial cost to the Department will exceed $1.5 million. The tool is anticipated to be purchased in calendar year 2013.
- Plans of Action and Milestones now include the estimated funding resources required to resolve the weakness, as well as the being linked to source of funding.
- The Department is currently expending extraordinary resources to address two issues the OIG earlier noted: Certification and Accreditation (C&A) and Contingency Planning. $1.8 million has been allocated for C&A efforts currently underway and additional staff has been hired to address the OIG's concerns regarding Contingency Planning and Continuity of Operations.

In the FISMA report, the Office of Inspector General will cite weaknesses to enterprise-wide security they consider to be a significant deficiency in accordance with OMB M-11-33. The Department acknowledges the weaknesses identified by the OIG, but does not agree that any of the findings, either individually or collectively, rise to the level of a significant deficiency that would require treating the matter as an additional material weakness in accordance with OMB M-11-33 which states "a significant deficiency is defined as a weakness in an agency's overall information systems security program…that significantly restricts the capability of the agency to carry out its mission or compromises the security of its information, information systems, personnel, or other resources, operations, or assets. In this context, the risk is great enough that the agency head and other agencies must be notified and immediate or near-immediate action must be taken." Management has defined corrective actions for the applicable weaknesses cited by the OIG, and will address each in a prioritized manner based upon the risk and impact posed to the Department's security posture.

MODERNIZING U.S. DIPLOMACY TO BETTER SUPPORT DEVELOPMENT

The Quadrennial Diplomacy and Development Review, in support of the Presidential Policy Directive on Global Development, lays out initial steps the Department and USAID will take to transform U.S. development programs to deliver results. The Department of State is uniquely positioned to use diplomacy to amplify development outcomes. Secretary Clinton's Fifth Policy Guidance Cable: Modernizing U.S. Diplomacy to Better Support Development (July 2012) provided policy guidance for Department of State officials in the field and in Washington on modernizing U.S. diplomacy and leadership to better support development priorities and outcomes.

This guidance requires using high-level government-to-government access to more systematically engage in policy dialogue and advocacy, and using broad relationships with local communities, civil society, and the private sector to mobilize demand for change. It requires using global leadership to promote international norms and performance standards and U.S. convening power to create powerful incentive regimes that encourage developing countries to pursue reforms. It requires using U.S. aid as a catalyst to promote the conditions for self-sustaining progress and employing all aspects of our foreign policy apparatus to promote systemic reform. Fundamentally, it requires a broadening from service delivery and traditional development aid to a strategy of influence, engagement, partnership, and reform mobilization.

Integrated Country Strategies (ICSs) are being prepared and will each provide a Mission's single, multi-year strategy encapsulating U.S. Government policy priorities and objectives, and the means by which diplomatic engagement, foreign assistance, and other tools will be used to achieve them. The ICS builds on the Joint Department of State-USAID Strategic Plan and serves as the basis for the annual budget request and project design.

The Economic Statecraft Taskforce set specific targets, announced in August 2012 by Deputy Secretary Nides to update U.S. foreign policy priorities, tap market-minded solutions to strategic challenges, build "jobs diplomacy," and improve organization and communication. Several programs are underway through the Bureau of Economic and Business Affairs to further Economic Statecraft toward those goals, including the Global Infrastructure Conference, Bilateral Investment Treaty negotiations, and the Fiscal Transparency Fund. With such strengthened applications of diplomacy tools, U.S. assistance will better reflect U.S. priorities and raise the level of accomplishment in development assistance.

ADVANCING GLOBAL COLLABORATION AT THE LOCAL LEVEL

Pioneering Subnational Opportunities

As the United States builds 21st Century partnerships, countries the world over are recognizing that subnational engagement – building ties between states and territories, cities and counties, and tribal communities – broadens and deepens their bilateral relationships. The U.S. Department of State's (Department) Office of the Special Representative for Global Intergovernmental Affairs (S/SRGIA) is engaging the world's current and next generation of leaders at the subnational level. To expand and strengthen these efforts, S/SRGIA, in conjunction with our embassies and bureau/office teams, has led the negotiations and engagement to finalize the following collaboration frameworks:

- U.S.-Brazil MOU to Support State and Local Cooperation (April 2012)
- U.S.-India "Conversation among Cities" announced at the Strategic Dialogue (June 2012)
- U.S.-Russia Joint Statement on Interregional Cooperation (September 2012)

In addition, the U.S.-China MOU to Promote Subnational Cooperation (January 2011) was reaffirmed at the U.S.-China Strategic and Economic Dialogue in Beijing, China in May 2012.

Results for the American People

The establishment of these cooperative frameworks for subnational engagement provides opportunities for state and local leaders to increase exports, foreign direct investment, tourism and other economic activity to support job creation and global competitiveness. Additionally, these cooperative frameworks allow subnational leaders to form innovative partnerships for education and sustainability. Advancing global collaboration at the local level, the Department is a catalyst for positive economic impact in communities across the nation.

Partnerships Promote Global Opportunities for Job Creation

Local economies are the building blocks of our nation's economy. The Department's engagement with elected officials at the state and local levels, and public and private stakeholders, supports the formation of critical partnerships that promote economic development and job creation. The Department has been a value-added partner to U.S. governors in the design and execution of their international trade and investment missions that expand export and investment opportunities and educational ties.

Special Representative Lewis (S/R Lewis) collaborates and participates in the U.S. China Governor's Forum in Beijing, October 11, 2011.
Department of State/NGA

For example, SRGIA's advance visits to over six Indian cities meeting with mayors and Chief Ministers laid the groundwork for subnational cooperation in India, contributing to the success of Maryland Governor Martin O'Malley's historic India trade mission, with over 100 delegates in November 2011. S/SRGIA, in collaboration with the Bureau of South and Central Asian Affairs, led an interagency team that provided pre-travel briefings for the delegation, facilitated discussions with U.S. Charge d'Affaires Peter Burleigh and key members of the Mission India team, and convened meetings in Mumbai, Delhi and Hyderabad with key Indian stakeholders, including Chief Ministers and private sector leaders. After Maryland's successful mission, the Governor announced over $60 million in business deals for Maryland companies, which are expected to generate hundreds of jobs for the state's citizens.

Subnational Engagement: Permanent Foreign Policy Tool

U.S. state and local leaders are trusted partners in the Department's 21st Century diplomacy as we strive to make America more competitive in the global marketplace. Today's subnational leaders are the global leaders of tomorrow. S/SRGIA will continue to leverage its resources and relationships to support economic development at home and abroad and to build stable, secure and prosperous societies.

FINANCIAL SECTION

MESSAGE FROM THE COMPTROLLER


James L. Millette

The Department of State is firmly committed to delivering the highest standard of financial accountability and reporting in support of our critical foreign affairs mission. This Agency Financial Report (AFR) is a key element and essential discipline in disclosing the Department's financial status and providing transparency and accountability to the American people. The AFR provides a comprehensive view of the Department's financial activities set against the backdrop of the global issues and engagements we face as an institution working to advance U.S. interests abroad. It is important to recognize that behind this high-level snapshot is the immense financial work and dedication that occurs every day by our financial professionals in more than 270 locations and 180 countries, often in the most challenging environments.

The scale and complexity of the Department's activities and corresponding financial management requirements continue to grow in the face of a wide range of global and regional issues. As highlighted in the Message from the Secretary, the United States is faced with a broad range of foreign policy challenges, whether it's transition in Afghanistan; a new relationship with post-war Iraq; revolutions and transitions in the Middle East and North Africa; combating nuclear proliferation and pandemic disease; or promoting food security and the President's Emergency Plan for AIDS Relief. Through the Quadrennial Diplomacy and Development Review (QDDR), Secretary Clinton has challenged us to improve our efficiency and effectiveness in tackling these and other challenges, including the now realigned Bureau of the Comptroller and Global Financial Services. I'm extremely proud of the Department's financial personnel and our contributions to these efforts, our focus on continuous financial management improvements, and our stewardship over the Department's financial resources.

There is a wealth of financial, performance and management information in this AFR. The key component of course is the presentation of the annual financial statements and Independent Auditor's Report. This presentation is the culmination of a rigorous year-round process with our partners, the Independent Auditor and the Office of the Inspector General, as we work to deliver meaningful financial statements by November 15 and demonstrate the Department's commitment to strong financial management practices. In our complex and ever changing global financial management environment, there are always surprises. We strive to meet these challenges and our compliance requirements, managing and prioritizing improvements in our financial processes and systems, supporting the President's Accountable Government Initiative, and meeting our day-to-day financial management support obligations. We realize that in today's fiscal climate how we balance these efforts has added significance as we work to squeeze the most value from our limited resources and execute investment decisions that support our most critical needs. Our ultimate goal is to support an accountable and efficient financial platform that furthers the Department's global operations and mission as well as provide accurate and high-value financial information for decision-makers and transparency and confidence for the American public.

To that end, I am extremely pleased to report that the Department has received an unqualified or "clean" opinion from the Independent Auditor for FY 2012. I want to thank Kearney & Company for their efforts and professionalism in working through the many complex issues associated with the Department's financial processes. Late in last year's process, a number of issues were raised regarding the Department's financial reporting of after-employment benefits for the Foreign Service Nationals (FSN) we employ around the world. This resulted in a qualified opinion on the Consolidated Balance Sheet and Statement of Changes in Net Position and a material weakness around FSN after-employment reporting for FY 2011. We took significant steps this year to solidify the inventory of these country-by-country plans and improve the actuarial work for the future liability for defined benefit, lump-sum retirement, and severance benefits related to these plans. As a result of this comprehensive work, the Independent Auditor lifted the qualification for FY 2011 and reduced the related material weakness for FY 2012. While we are pleased with this improvement, we will need to ensure this progress is fully institutionalized as we move forward.

The Department maintains a robust system of internal controls that are validated by senior leadership and administered by the Bureau of the Comptroller and Global Financial Services. For FY 2011, a material weakness was identified by the Department regarding the effective oversight of the Summer Work Travel Program for students traveling to the United States for temporary and seasonal employment during their academic breaks. While improvements and plans were put in place this year to address this issue, the Department elected to maintain it as a material weakness to complete the validation of the corrective actions. In addition, the Independent Auditor's Report on Internal Control cites a material weakness that relates to financial reporting, which represents an aggregation of several different reporting issues. While identifying and reporting significant deficiencies of our own, management recognizes the issues identified as a material weakness by the auditors, but disagrees with the severity at which they are aggregated and categorized. The Department will work with the OIG and the Independent Auditors in FY 2013 to ensure we include their recommendations for improvements for these areas in our corrective action plans.

We recognize that there are a number of items identified by the external audit that will require our continued attention, diligence, and improvement. We are committed to addressing these items and meeting these challenges. Given the global and complex nature of our operations, there will always be areas of concern and opportunities for improvement. We understand that fact, and I am confident in our resolve as we continue to manage the Department's finite resources on behalf of America's taxpayers in support of our nation's diplomatic affairs.

James L. Millette

James L. Millette
Comptroller
November 15, 2012

United States Department of State and the Broadcasting Board of Governors

Office of Inspector General

November 16, 2012

INFORMATION MEMO FOR THE SECRETARY

FROM: OIG – Harold W. Geisel

SUBJECT: Independent Auditor's Report on the U.S. Department of State 2012 and 2011 Financial Statements (AUD-FM-13-08)

An independent certified public accounting firm, Kearney & Company, P.C., was engaged to audit the financial statements of the U.S. Department of State (Department) as of September 30, 2012 and 2011, and for the years then ended, and to provide a report on internal control over financial reporting and compliance with laws and regulations, to report on whether the Department's financial management systems substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA), and to report any reportable noncompliance with laws and regulations it tested. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards; Office of Management and Budget audit guidance; and the *Financial Audit Manual*, issued by the Government Accountability Office and the President's Council on Integrity and Efficiency.

In its audit report on the Department's 2011 and 2010 financial statements, dated November 14, 2011, Kearney & Company qualified its opinion on the FY 2011 consolidated balance sheet and consolidated statement of changes in net position based on a scope limitation related to after-employment benefits provided to locally employed overseas staff. The Department addressed these issues and restated its FY 2011 financial statements. Accordingly, Kearney & Company's present opinion on the FY 2011 consolidated balance sheet and consolidated statement of changes in net position is different from that expressed in its previous report.

UNCLASSIFIED

UNCLASSIFIED

In its audit of the Department's FY 2012 and FY 2011 financial statements, Kearney & Company found

- the consolidated balance sheets and the related consolidated statements of net cost and changes in net position and combined statements of budgetary resources present fairly, in all material respects, the financial position of the Department as of September 30, 2012 and 2011, and its net cost of operations, changes in net position, and budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America;

- a material weakness[1] in internal control; and

- instances of reportable noncompliance with laws and regulations tested, including instances in which the Department's financial management systems did not substantially comply with FFMIA.

Kearney & Company is responsible for the attached auditor's report, which includes the Report of Independent Auditors, the Report on Internal Control, and the Report on Compliance, dated November 15, 2012, and the conclusions expressed in the report. The Office of Inspector General (OIG) does not express an opinion on the Department's financial statements or conclusions on internal control and compliance with laws and regulations, including whether the Department's financial management systems substantially complied with FFMIA.

Comments on the auditor's report from the Bureau of the Comptroller and Global Financial Services are attached to the report.

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

Attachments: As stated.

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

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REPORT OF INDEPENDENT AUDITORS
AUD-FM-13-08

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

We have audited the accompanying consolidated balance sheets of the U.S. Department of State (Department) as of September 30, 2012 and 2011, and the related consolidated statements of net cost and changes in net position and combined statements of budgetary resources for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our report dated November 14, 2011, we qualified our opinion on the FY 2011 consolidated balance sheet and consolidated statement of changes in net position based on a scope limitation related to potentially material amounts for after-employment benefits provided to locally employed overseas staff that had not been previously reported in the Department's financial statements. As described in Note 20, the Department addressed these issues and restated its FY 2011 financial statements. Accordingly, our present opinion on the FY 2011 consolidated balance sheet and consolidated statement of changes in net position, as presented herein, is different from that expressed in our previous report.

In our opinion, the financial statements referred to above, present fairly, in all material respects, the financial position of the Department, as of September 30, 2012 and 2011, and its net cost of operations, changes in net position, and budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 and Note 20 to the financial statements, the Department changed its method of reporting actuarial liabilities and benefit plan assets relating to after-employment benefits provided to locally employed overseas staff in FY 2012.

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis, the Combining Schedule of Budgetary Resources, and

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Deferred Maintenance be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by OMB Circular A-136, *Financial Reporting Requirements*, and the Federal Accounting Standards Advisory Board who consider it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the Department's financial statements taken as a whole. Other Accompanying Information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have also issued reports, dated November 15, 2012, on our consideration of the Department's internal control over financial reporting and compliance and on our tests of its compliance with certain provisions of laws and regulations for the year ended September 30, 2012. Our report on internal control includes a discussion of significant internal control deficiencies related to after-employment benefits for locally employed overseas staff that led to the restatement of the FY 2011 financial statements. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance, as well as the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, and should be considered in assessing the results of our audits.

Kearney & Company

November 15, 2012

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REPORT ON INTERNAL CONTROL

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

We have audited the financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2012, and have issued our report dated November 15, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Management of the Department is responsible for establishing, maintaining, and assessing internal control related to financial reporting and compliance.

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

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

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

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A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the following deficiency in the Department's internal control to be a material weakness.

Material Weaknesses

I. Financial Reporting

The Department compiled its financial statements through a multistep process using a combination of manual and automated procedures. Neither the Department's Global Financial Management System (GFMS) nor Hyperion, which is the system used to produce the proprietary trial balance, is used to fully compile the statements. The inability of the financial management system to track the necessary attributes related to financial reporting forces the Department to use a manual, labor-intensive process to develop its balance sheet, statement of net cost (SNC), and statement of changes in net position. The necessary data was extracted from multiple systems and source files and was sometimes manually keyed into crosswalk files or statement preparation templates (Microsoft Excel workbooks), which ultimately created the Department's financial statements. In addition, the Department lacked a budgetary financial reporting system that was integrated with the financial management system general ledger, which forced the Department to use a manual, labor-intensive process to develop its statement of budgetary resources (SBR). Manual adjustments require an increased measure of internal control and review, reduce the Department's ability to produce statements timely, and increase the likelihood of errors in the statements.

In our report on the Department's FY 2009 financial statements, we identified financial reporting as a material weakness. During FY 2010, the Department developed a corrective action plan to address selected control deficiencies and financial reporting risks surrounding the financial statement preparation process to reduce the material weakness. However, during FY 2011, the audit process identified additional control deficiencies that continued in FY 2012, which, when combined, resulted in a material weakness.

- Preparation of the SBR – The SBR is predominantly derived from an entity's budgetary general ledger in accordance with budgetary accounting rules. Information on the SBR should reconcile to budget execution information reported to the Department of the Treasury on Standard Form (SF) 133, Report on Budget Execution and Budgetary Resources, and with information reported in the Budget of the United States Government to ensure the integrity of the numbers presented. We found that the Department made numerous adjustments related to budgetary resources outside the financial system, most of which originated from automated calculations as well as manual journal entries. We identified a number of significant errors in the adjustments made during the manual preparation of the Department's SF 133 workbooks.

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The Department did not use the full functionality of its financial systems to capture all budgetary accounting events and to automate SBR reporting procedures. The manual nature of the process the Department used to compile its SBR was high risk and resource intensive. The process required significant intervention on the part of management, and it increased the risk of error and the risk that an auditable SBR might not be prepared timely to meet OMB financial reporting deadlines. In addition, the lack of a fully integrated budgetary accounting system jeopardized compliance with the Federal Financial Management Improvement Act. Significant audit adjustments were required as a result of errors identified during the audit.

- Preparation of the SNC – In FY 2012, the Department developed and executed a process to validate its methodology for allocating costs and revenues to produce its SNC. Based on the validation performed, the Department determined it needed to modify its SNC allocation methodology. The Department's SNC reports net costs by strategic goals based on the mapping of fund groups to individual strategic goals using data maintained in its accounting system. The mapping process originated in FY 2004, when the Department modified its Hyperion application to allocate costs and revenue among the Department's major programs based on its FY 2000 strategic goals. The Hyperion programming had not been updated to reflect the Department's current strategic goals. Therefore, in order to produce the SNC, the Department developed a multistep process using a combination of manual and automated procedures. The necessary data was extracted from multiple applications and source files.

  The Department did not take advantage of the full functionality of its accounting systems to capture cost accounting events and automate SNC reporting procedures. To automate the process, the Department would need to significantly reprogram the Hyperion application each time the Department's strategic goals were changed in order to align costs and revenues to the goals, which would require a commitment of time and resources. The Department did not document its manual process to allocate costs in a manner that was easy to understand without requiring a reviewer to substantially reperform calculations, which is especially important given the complexity of the process.

  The manual and fragmented nature of the current allocation process for the compilation of the Department's SNC created a high risk of errors. The process used by the Department was resource intensive and required significant intervention on the part of Department officials, which increased the risk that an auditable SNC might not be prepared in time to meet OMB financial reporting deadlines. Additionally, the amount of manual effort that was required in the limited financial reporting timeframe increased the likelihood that errors in the SNC could have gone undetected and made it difficult for management to oversee and monitor the effectiveness of the process without substantial effort, including reperforming calculations.

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- Abnormal Balances – The U.S. Standard General Ledger is a series of account numbers that Federal agencies use to maintain their transaction-level accounting information. Each general ledger account has a normal debit or credit balance. The Department entered accounting information into GFMS at the transaction level. To report consolidated information in its annual financial statements, the Department combined and reported transaction-level information at the fund (appropriation) and Department levels. Abnormal balances at both the fund and Department levels were present and unexplained or uncorrected throughout the year. The Department initiated a process to review and correct abnormal balances in FY 2012, but as of year-end, the process was not fully implemented or standardized. The presence of abnormal balances compromised the integrity of financial data and increased the risk of errors on the financial statements.

- Budgetary to Proprietary Accounts Reconciliation – Federal financial accounting standards require an entity to reconcile its proprietary information to budgetary information. The audit process identified a significant variance between proprietary and budgetary accounts payable. The Department did not routinely complete a timely and comprehensive reconciliation of budgetary and proprietary account relationships as part of the financial reporting process. Numerous adjustments to budgetary resources were made outside of the financial system, most of which originated from calculations for financial statement preparation purposes, as well as manual journal entries. These adjustments were sometimes made only to budgetary accounts, meaning the proprietary impact of the adjustments was not recorded. Completing a comprehensive budgetary to proprietary account reconciliation was not part of the Department's financial reporting control structure, and the absence of this reconciliation increased the risk that material errors might go undetected and uncorrected.

- Periodic Analysis of Financial Data – Periodic reviews and comparative analyses of financial data are effective tools used by many organizations to identify abnormalities and potential misstatements in accounting records. Properly designed and executed analytical comparisons help management identify significant variances in account balances. The Department did not perform sufficient, standardized, comparative analyses over accounts included in the SNC and the SBR. In addition, the Department did not have well-established procedures for periodic comparative reviews of financial data, including standard thresholds to trigger investigations of variances and requirements for supporting documentation. Without effective routine financial reviews, material errors and anomalies in the financial statements may not be identified and corrected.

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

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Significant Deficiencies

II. Foreign Service National After-Employment Benefits

The Department provides some Foreign Service National (FSN) employees with after-employment benefits through a variety of arrangements, including annuity-based defined benefit retirement plans, defined contribution retirement plans, lump-sum retirement payments, and separation benefits to FSNs who voluntarily resign or otherwise leave the workplace. Based on the pervasiveness of the deficiencies in internal control identified and the related risk of a material misstatement in the financial statements, we assessed the Department's FSN after-employment benefit accounting challenges as a material weakness in our report on the Department's FY 2011 financial statements. During FY 2012, the Department successfully executed several corrective actions, including:

- Determining the most appropriate accounting framework to be used for FSN after-employment benefits after consulting with the Federal Accounting Standards Advisory Board.
- Performing a series of reviews to confirm the nature of FSN after-employment benefits existing at overseas posts, including requiring a questionnaire to be completed by all posts, reviewing recent benefit payments made at posts, and conducting meetings with posts considered to potentially have significant benefit plans.
- Requesting and reviewing updated actuarial reports and asset balances for significant overseas defined benefit plans.
- Significantly refining the process used to estimate liabilities for lump-sum retirement and voluntary severance benefits, including the use of actuarial methods.

These corrective actions resulted in the restatement of FY 2011 FSN after-employment balances. The corrective actions reduced the risk of significant misstatements in the financial statements. However, the Department's internal control structure continued to exhibit several deficiencies that might negatively affect the Department's ability to account for FSN after-employment benefits in a complete, accurate, and timely manner. For FY 2012, we considered this combination of control deficiencies to be a significant deficiency. The individual deficiencies we identified are discussed below.

- Lack of Formalized Processes and Controls – The corrective actions taken were executed real time as we worked with the Department to ensure that the most significant risks and issues noted during the FY 2011 audit were addressed. However, additional steps are needed to fully implement routine and repeatable processes and controls relating to FSN after-employment benefits. In addition, centralized controls are needed to ensure that any newly established or updated benefit plans are approved and inventoried. The lack of formalized, routine processes to monitor and account for FSN benefit plans may lead to future funding and financial reporting challenges.

- Inaccurate Personnel Data for FSN Employees – We tested the accuracy of FSN personnel data maintained in the Department's payroll and human resources applications and found

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numerous inaccuracies. Specifically, we found that posts and financial service centers were not processing personnel actions consistently, accurately, and timely. The Department did not have a control in place to ensure the accuracy of FSN personnel data, such as a process to regularly reconcile the data between the payroll and human resources applications. The reasonableness of the liability estimates related to after-employment benefits relied on accurate underlying employee demographic data, such as salaries, birth dates, and employment start dates. Although the Department adjusted its liability estimation methodology in FY 2012 to address discrepancies, the calculation was prone to inaccuracies and required additional time and effort to calculate. In addition, the risk of improper payments exists if personnel actions are not processed properly or timely, or when payroll and benefit payments are calculated based on inaccurate data. The lack of reconciliation and review controls may result in errors and inconsistencies remaining undetected and uncorrected for long periods of time.

- Incomplete Inventory of FSN After-Employment Benefits – Although the Department performed procedures to compile an accurate inventory of after-employment benefits offered to FSN employees, the Department was unable to completely confirm the inventory during FY 2012. A validated inventory of benefits is necessary to calculate an accurate after-employment liability estimate and develop related financial statement disclosures. The lack of oversight related to FSN after-employment benefits may result in funding shortfalls, noncompliance with local employment regulations, or the disbursement of improper benefit payments.

- Limitation of Actuarial Reports for Specific Defined Benefit Plans – The Department relied on reports from each post's defined benefit plan actuary in order to obtain data needed for financial reporting purposes. These actuarial reports were typically based on host country pension regulations and other local factors. While the Department took steps to improve the relevance and consistency of the actuarial reports for its most significant defined benefit plans, the reports were not always current or based on actuarial assumptions promulgated by relevant standards. In addition, the Department did not have a process in place to assess the competence and objectivity of all local actuaries. Inconsistent and incomplete actuarial techniques and assumptions limited the Department's ability to fully report and disclose the financial position of its defined benefit plans. Without sufficient oversight, the solvency of defined benefit plans can be negatively impacted because the plans are sensitive to management decisions, such as the establishment of contribution rates and investment strategies.

- Incomplete Disclosure of Defined Contribution Plans – A note disclosure in the Department's financial statements is required for FSN defined contribution retirement plans. The Department used payroll and other financial data to estimate information for the required disclosure rather than using actual data related to each plan's contributions. Reliable data is needed to ensure that the Department's note disclosure for FSN defined contribution plans is complete and accurate.

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III. Property and Equipment

The Department reported over $16 billion in net property and equipment on its FY 2012 balance sheet. Real and leased property consisted primarily of facilities used for U.S. diplomatic missions abroad and capital improvements to these facilities. Personal property consisted of several asset categories, including aircraft, vehicles, security equipment, communication equipment, and software. Weaknesses in property were initially reported in the audit of the Department's FY 2005 financial statements and subsequent audits. In FY 2012, the Department's internal control structure continued to exhibit several deficiencies that negatively affected the Department's ability to account for real and personal property in a complete, accurate, and timely manner. We concluded that the combination of property-related control deficiencies was a significant deficiency. The individual deficiencies we identified are summarized as follows:

- <u>Timeliness and Accuracy of Property Capitalizations and Disposals</u> – The Department's control structure did not ensure that real and personal property acquisitions and disposals were recorded timely and accurately. In addition, for a specific subset of personal property, the control that was in place to automatically notify property management staff about equipment transactions was ineffective, resulting in several years of transactions that were not recorded in the Department's accounting records. In addition, we noted that the acquisition value recorded for numerous items of personal property could not be supported. The Department's monitoring activities were not always effective to ensure proper activity cutoff. The errors resulted in misstatements to the Department's financial statements. In addition, the errors and lack of effective controls may result in the loss of accountability for asset custodianship, which could lead to undetected theft or waste.

- <u>Inaccurate and Incomplete Department of Defense-Transferred Personal Property Records</u> – In 2011, the U.S. government presence in Iraq began transitioning from military-led to civilian-led operations. As part of the transition, the Department of Defense (DoD) transferred a significant amount of property to the Department upon DoD's withdrawal from Iraq. We tested the existence and completeness of assets transferred to the Department in Iraq from DoD and identified many assets that could not be physically confirmed by the Department. In addition, the Department was unable to provide documentation that numerous potentially reportable assets physically observed in Iraq were included in its asset records. Department officials indicated that the expedited timeline for the DoD withdrawal from Iraq compromised the Department's ability to effectively inventory the property transferred from DoD. The lack of appropriate inventory management procedures and controls results in the loss of accountability over assets, which could lead to undetected waste or theft. In addition, incomplete or inaccurate property records could result in misstatements to the Department's financial statements.

- <u>Incomplete Contractor-Held Property and Government-Furnished Equipment Records –</u> The Department uses contractors to provide support in overseas locations, including Iraq and Afghanistan. This support includes purchasing and operating personal property on

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behalf of the Department, generally referred to as contractor-held property. In other situations, the Department procures and provides personal property assets directly to contractors for use in supporting overseas missions, referred to as Government-furnished equipment (GFE). We identified several items in the hands of contractors that were not included in the Department's property records. In addition, during the audit, the Department identified hundreds of GFE items that had not been recorded in the Department's accounting or property management systems. The Department indicated that complete and accurate information pertaining to contractor-held property inventories and transactions was not always submitted by contractors on a timely basis. Additionally, the Department did not have a sufficient process in place to ensure that all GFE assets were properly included in the Department's inventory records prior to being issued to contractors. The incomplete and inaccurate inventory submissions resulted in misstatements to the Department's financial statements. In addition, the lack of appropriate inventory management procedures and controls results in the loss of accountability over assets, which could lead to undetected waste or theft.

- Inaccurate Operating Lease Disclosure – The Department manages over 15,000 real property leases throughout the world, including over 6,000 leases on behalf of other agencies conducting business overseas. For leases occupied by the Department, the Department must disclose the future minimum lease payments (FMLP) relating to the Department's operating lease obligations in the footnotes to the annual financial statements. We found recorded lease terms that did not agree with supporting documentation and leases that were not included in the lease inventory. We also analyzed the Department's methodology for calculating the FMLP and found that the formulas did not sufficiently take into account the frequency of required payments or advance payments.

  Operating lease information is entered into the Department's property management system by staff at posts. The employees have varying levels of knowledge, skills, and abilities with regard to entering the lease data. In addition, the Department's process to monitor the lease information entered by posts was not always effective. In addition, the Department calculated its FMLP using a Microsoft Excel spreadsheet that was manually created and updated, leaving the calculation susceptible to human error. The errors identified in the accuracy of the lease inventory and the Department's FMLP calculation methodology led to a significant error in the Department's footnote disclosure.

IV. Budgetary Accounting

The Department lacked sufficient reliable funds control over its accounting and business processes to ensure budgetary transactions were properly recorded, monitored, and reported. Beginning in our report on the Department's FY 2010 financial statements, we identified budgetary accounting as a significant deficiency. During FY 2012, the Department did not implement sufficient corrective actions to remediate existing deficiencies, and we concluded that the combination of control deficiencies was a significant deficiency. The individual deficiencies we identified are summarized as follows:

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- Unsupported Obligations – Obligations are definite commitments that create a legal liability of the Government for payment. The Department should only record legitimate obligations, which would include a reasonable estimate of potential future outlays. We identified a large number of low-value obligations for which the Department could not provide evidence of a binding agreement. The Department's financial system was designed to reject payments for invoices without established obligations. Because allotment holders were not always recording valid and accurate obligations prior to the receipt of goods or services, the Department established low-value obligations, which allow invoices to be paid in compliance with the Prompt Payment Act but effectively bypass system controls. The continued use of this practice could lead to a violation of the Antideficiency Act, and it increases the risk of fraud, misuse, and waste.

- Timeliness of Obligations – The Department should record an obligation in its financial management system when it enters into an agreement, such as a contract or a purchase order, to purchase goods and services. During our testing, we identified obligations that were not recorded within 15 days of execution of the obligating document and obligations that were posted subsequent to the receipt of goods and services. The Department did not have processes to ensure the accurate and timely creation, approval, and recording of obligations. Without an effective obligation process, controls to monitor funds and make timely payments may be compromised, which may lead to violations of the Antideficiency Act and the Prompt Payment Act.

- Capital Lease Obligations – The Department was required to obligate funds to cover the net present value of the Government's total estimated legal obligation over the life of a capital lease contract. However, the Department annually obligates funds equal to 1 year of the capital lease cost rather than the entire amount of the lease agreement. The Department obligated leases on an annual basis rather than the entire lease agreement period because that is the manner in which funds are budgeted and appropriated. Because of the unrecorded obligation, the Department's financial statements were misstated.

- New Obligations to Expired Funds – The Department may obligate funds for execution of Department programs and operations only during the period of fund availability. Once the appropriated funds are no longer available, the Department cannot record new obligations; however, increases and decreases to existing obligations are permitted for 5 years. We identified obligations made to expired funds during FY 2012. The Department did not have a process in place to review obligations to ensure that they were not made against expired funds. We did not find any system controls that prevented a user from recording a new obligation against expired funds. Weak control over expired funds increases the risk of waste and abuse. In addition, the Department may not be complying with appropriations law and the Antideficiency Act.

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V. Validity and Accuracy of Unliquidated Obligations

Unliquidated obligations (ULO) represent the cumulative amount of orders, contracts, and other binding agreements not yet outlayed. The Department's policies and procedures provide guidance related to the periodic review, analysis, and validation of the ULO balances posted to the general ledger. We identified invalid ULOs amounting to approximately $277 million that had not been identified by the Department's review process. The current internal control structure was not operating effectively to comply with existing policy or facilitate the accurate reporting of ULO balances in the financial statements. The Department's internal controls were not sufficient to ensure that ULOs were consistently and systematically evaluated for validity and deobligation. Weaknesses in controls over ULOs were initially reported in the audit of the Department's FY 1997 financial statements and subsequent audits.

VI. Information Technology

The Department's information technology (IT) internal control structure, both for the general support systems and critical financial reporting applications, exhibited limitations in several areas, including risk management strategies and user account management. The National Institute of Standards and Technology and the Government Accountability Office's *Federal Information System Controls Audit Manual* provide control objectives and evaluation techniques used during the course of our audit. Weaknesses in IT controls have been reported as a significant deficiency since FY 2009.

In accordance with the Federal Information Security Management Act of 2002 (FISMA), the Office of Inspector General (OIG) performed a review of the Department's information security program for FY 2012. Overall, OIG found that the Department had implemented an information security program, but OIG identified weaknesses in the areas of risk management strategy and security authorizations, security configuration management, plans of action and milestones, and the continuous monitoring program, which were collectively reported as a FISMA significant deficiency. A significant deficiency is the highest level of severity under FISMA.

Our scope was focused primarily on deficiencies that could lead to significant misstatements of or corruption to the Department's financial data. Based on IT deficiencies noted with the general support systems, we developed additional audit procedures to substantively test financial management system inputs and outputs. Our procedures did not identify any material misstatements that were caused by general support system deficiencies. In addition, we tested and confirmed certain compensating controls that would mitigate some of the risks that were attributable to the general support system weaknesses. Although the Department had addressed certain deficiencies in its financial reporting applications, we noted other IT deficiencies reported in prior years that had not been addressed and identified some additional deficiencies. Collectively, the deficiencies noted by OIG during the FISMA evaluation and by us during the financial statement audit are considered to be a significant deficiency within the scope of our financial statement audit. The deficiencies noted during the financial statement audit are summarized as follows:

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- Segregation of Duties – A fundamental element of internal control is the segregation of certain key duties. The basic idea underlying segregation of duties (SoD) is that no employee or group of employees should be in a position both to perpetrate and conceal errors or fraud in the normal course of their duties; no one individual should control all key aspects of a transaction or event. SoD would include separating the responsibilities for authorizing, processing and recording, and reviewing transactions, and handling related assets. We identified four Information System Security Officers that had the responsibility and logical capability to approve access requests and create, modify, and delete user accounts for significant financial applications. The same Information System Security Officers were responsible for monitoring changes within these applications. We also found many instances of SoD violations associated with the assignment of user roles in the Regional Financial Management System/Momentum (RFMS/M), the Consolidated American Payroll Processing System, and the Global Foreign Affairs Compensation System (GFACS). Additionally, the Department had not designed and implemented sufficient SoD controls for the Global Employment Management System or the Employee Benefits Information System. Inadequate SoD contributes to an overall weakening of the internal control environment and increases the risk that errors and irregularities could occur and remain undetected.

- Monitoring Audit Logs for Financial Applications – Monitoring activities or events within an application is a key control that is performed to detect suspicious behavior or malfunctions. An audit log is an automated record that contains specific events or activities within an application in an electronic form. The audit log enables administrators to have regular visibility into user access or other activities in a manageable way. The Department did not regularly review audit logs and investigate significant events for certain financial systems including GFMS, RFMS, GFACS, and the FSN Payroll System. We found that the Department did not have procedures in place that detailed the requirements for performing regular reviews of audit logs for the key financial management applications, including clearly assigning responsibility for the reviews. By not reviewing the audit logs on a regular basis, the Department does not have reasonable assurance that inappropriate access or changes to user accounts would be identified in a timely manner.

- Authorization of Service and Application Accounts – For the Department's significant financial applications, access to financial data was possible at the application level, the database level, and the operating system or network level. For each level, there were three possible types of accounts: user accounts, service accounts, and application accounts. User accounts are accounts that are assigned to human users while service accounts are computer accounts used to run background tasks, such as anti-virus software and software patching tools. Application accounts are similar to service accounts but are used to run temporary computer processes, such as interfaces and reports. The audit process identified 20 service or application accounts for which the Department was unable to provide documented management approval or business justification. In addition, the Department was unable to document that the service or application accounts had been regularly reviewed by management in order to recertify access permissions.

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Service and application accounts are not linked to an individual and are not regularly reviewed and approved by management, increasing the potential that unauthorized activities could occur without timely detection.

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We identified one material weakness, Financial Reporting, during our audit. However, the Department did not identify Financial Reporting as a material weakness in its FY 2012 Federal Managers' Financial Integrity Act assurance statement. We did not audit the Department's assurance statement, and accordingly, we express no opinion on it.

During the audit, we noted certain other matters that we will report to Department management in a separate letter.

STATUS OF PRIOR YEAR FINDINGS

In the Report on Internal Control included in the audit report on the Department's FY 2011 financial statements,[1] we noted several issues that were related to internal control over financial reporting. Our internal control findings are summarized in Table 1.

Table 1. Prior Year Significant Internal Control Deficiencies

Control Deficiency	FY 2011 Status	FY 2012 Status
Financial Reporting	Material Weakness	Material Weakness
Foreign Service National After-Employment Benefits	Material Weakness	Significant Deficiency
Property and Equipment	Significant Deficiency	Significant Deficiency
Budgetary Accounting	Significant Deficiency	Significant Deficiency
Validity and Accuracy of Unliquidated Obligations	Significant Deficiency	Significant Deficiency
Accrual Process	Significant Deficiency	Management Letter
Information Technology	Significant Deficiency	Significant Deficiency

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Department management has provided its response to our findings in a separate memorandum attached to this report. We did not audit management's response and, accordingly, we express no opinion on it.

[1] *Independent Auditor's Report on the U.S. Department of State 2011 and 2010 Financial Statements* (AUD/FM-12-05, Nov. 2011).

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This report is intended solely for the information and use of Department management; those charged with governance; and others within the Department and OIG, OMB, the Government Accountability Office, the Department of the Treasury, and Congress. It is not intended to be and should not be used by anyone other than these specified parties.

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November 15, 2012

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REPORT ON COMPLIANCE

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

We have audited the financial statements of the U.S. Department of State (Department) as of and for the year ended September 30, 2012, and have issued our report dated November 15, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04*, Audit Requirements for Federal Financial Statements*, as amended. Management of the Department is responsible for compliance with laws and regulations.

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 07-04, as amended, that we determined were applicable. As part of our audit, we also performed tests of compliance with Federal Financial Management Improvement Act (FFMIA), Section 803(a), requirements. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Department. Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our testing disclosed instances of noncompliance exclusive of FFMIA that are required to be reported under *Government Auditing Standards* and the requirements of OMB Bulletin No. 07-04, as amended, and which are summarized as follows:

- *Antideficiency Act*. This act prohibits the Department from (1) making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law; (2) involving the Government in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law; and (3) making obligations or expenditures in excess of an apportionment or reapportionment, or in excess of the amount permitted by agency regulations. Our audit procedures identified Department of the Treasury fund symbols with negative balances that were potentially in violation of the Antideficiency Act.

- *Prompt Payment Act.* This act requires Federal agencies to make payments in a timely manner, pay interest penalties when payments are late, and take discounts only when payments are made within the discount period. The Department did not always make payments within 30 days, as required. Additionally, we found that the Department did

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not consistently pay interest penalties for domestic and overseas payments in accordance with the Prompt Payment Act.

- *Appropriations Law and Regulations.* Every Federal department or agency has the initial and fundamental responsibility to ensure that its application of public funds adheres to the terms of the pertinent authorization and appropriation acts, as well as any other relevant statutory provisions. Each appropriation has three elements to the concept of availability: purpose, time, and amount. All three elements must be observed for obligations or expenditures to be considered legal. If an agency fails to obligate its annual funds by the end of the fiscal year for which they were appropriated, they cease to be available for incurring and recording new obligations and are said to have "expired." During the audit process, we determined that the Department established new obligations to expired funds.

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger (USSGL) at the transaction level. During FY 2012, the Department made progress addressing OMB's indicators of noncompliance with FFMIA. For instance, improvements were noted related to the ability to reconcile budgetary resource information in the Department's financial system to data reported by the Department of the Treasury. The Department had also enhanced automated funds controls in the financial system and validated the assumptions used to allocate revenue and costs to major programs during the preparation of the statement of net cost. In addition, the Department had taken sufficient action to reduce a material weakness related to after-employment benefits to a significant deficiency. However, we noted certain instances, as described, in which the Department's financial management systems and related controls did not substantially comply with certain Federal system requirements, Federal accounting standards, and the USSGL at the transaction level.

Federal Financial Management Systems Requirements

- The Department did not have a routine process to reconcile budgetary and proprietary accounts. Specific audit requests for reconciliations required significant manual analysis.
- Certain subsidiary systems, including property systems, were not integrated with the core accounting system. An audit trail from data in the core financial system to detailed source transactions in feeder systems was not always readily available.
- There were deficiencies with the Department's account management processes for key financial applications including inadequate monitoring of user access and changes to user accounts. In addition, adequate segregation of duties was not fully maintained in certain financial systems.
- Interest was not always paid on overdue domestic and overseas payments.
- During its annual evaluation of the Department's information security program, as required by the Federal Information Security Management Act, the Department's Office of Inspector General identified weaknesses with computer security that it reported collectively as representing a significant deficiency.

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Applicable Federal Accounting Standards

- The Department's core accounting system did not produce complete, auditable financial statements without significant manual adjustments. This resulted in a material weakness on financial reporting in our Report on Internal Control.

Standard General Ledger at the Transaction Level

- The Department's statements of budgetary resources and net cost were subject to numerous adjustments that were made outside the core accounting system and that could not be traced directly to USSGL account balances.
- The Department did not fully implement or standardize a process to review and validate abnormal balances in its accounting system.

The Department has not implemented and enforced systematic financial management controls to ensure substantial compliance with FFMIA. The Department has not developed and executed remediation plans to address instances of noncompliance. The Department's ability to meet Federal financial management system requirements and fully process transaction-level data in accordance with the USSGL is hindered by systemic limitations in systems and processes.

Except as noted above, our tests of compliance with the provisions of selected laws and regulations disclosed no other instances of noncompliance that would be reportable under the standards applicable to financial audits contained in *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended.

During the audit, we noted certain other matters that we will report to Department management in a separate letter.

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Department management has provided its response to our findings in a separate memorandum attached to this report. We did not audit management's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of Department management; those charged with governance; and others within the Department and the Office of Inspector General, OMB, the Government Accountability Office, the Department of the Treasury, and Congress, and it is not intended to be and should not be used by anyone other than these specified parties.

Kearney & Company

November 15, 2012

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United States Department of State

Washington, D.C. 20520

UNCLASSIFIED

November 15, 2012

MEMORANDUM

TO: OIG – Harry W. Geisel

FROM: CGFS – James L. Mille

SUBJECT: Draft Audit Report on the Department of State's Fiscal Year 2012 and 2011 Financial Statements

This memo is in response to your request for comments on the Draft Report of the Independent Auditor, Report on Internal Control, and Report on Compliance and Other Matters (Report) of the U.S. Department of State's Fiscal Year 2012 and 2011 Financial Statements.

The Department operates in over 270 locations and 180 countries, often in the most challenging environments. It is an immense operational endeavor, impacted on a daily basis by the ever changing nature of international affairs issues and the steady resolve of our foreign policy and leadership in the world. Few agencies or global corporations face these challenges in supporting their operations. We fully understand this and embrace our financial responsibilities to the Department and the American people as we pursue an efficient, accountable, and transparent financial management platform that enhances the Department's foreign affairs mission.

The external audit is now a year-round process and focus for the Department as we work to deliver meaningful financial statements by November 15 and demonstrate the Department's strong financial management practices. We strive to meet the challenges of addressing growing audit and compliance requirements, managing and prioritizing improvements in our financial processes and systems, supporting the President's Accountable Government Initiative, while meeting our day-to-day financial management support obligations. In today's fiscal climate, how we balance these important efforts as financial managers will have added significance as we work to squeeze the most value from our limited resources and execute investment decisions that support our most critical needs. This will be an ongoing challenge for all of us.
I am extremely proud that the Department has received an unqualified or "clean" opinion from the Independent Auditor for FY 2012. This year's audit process has been a concerted and dedicated effort

by all stakeholders involved. While we may not agree on every aspect of the process, we appreciate the commitment by all parties to work together throughout the audit process to produce our annual financial statements. Last year, late in the process, a number of issues were raised regarding the Department's financial reporting of after-employment benefits for the Foreign Service Nationals (FSN) we employ around the world. This resulted in a qualified opinion on the Consolidated Balance Sheet and Consolidated Statement of Changes in Net Position, and a material weakness around FSN after-employment reporting for FY 2011. We took significant steps this year to solidify the inventory of these country-by-country plans and improve the actuarial work for the future liability for defined benefit, lump-sum retirement, and severance benefits related to these plans. As a result of this comprehensive work, the Independent Auditor lifted the qualification for FY 2011 and downgraded the related material weakness to a significant deficiency for FY 2012. While we are pleased with this improvement, we will need to ensure this progress is fully institutionalized as we move forward.

As a Department, we remain committed to strong corporate governance and internal controls. We maintain a robust system of internal controls overseen and validated by senior leadership and administered by the Bureau of the Comptroller and Global Financial Services. For FY 2011, a material weakness was identified by the Department regarding the effective oversight of the Summer Work Travel Program for students traveling to the United States for temporary and seasonal employment during their academic breaks. While improvements and plans were put in place this year to address this issue, the Department elected to maintain it as a material weakness to complete the validation of the corrective actions. In addition, the Independent Auditor's Report on Internal Control cites a material weakness that relates to financial reporting, which represents an aggregation of several different reporting issues. While identifying and reporting significant deficiencies of our own, management recognizes the issues identified as a material weakness by the auditors, but disagrees with the severity at which they are aggregated and categorized. The Department will work with the OIG and the Independent Auditor in FY 2013 to ensure we include their recommendations for improvements for these areas in our corrective action plans.

We fully recognize that these and other items identified in the Draft Audit Report will require our continued attention, action, and improvement. We look forward to working with you, Kearney & Company, and other stakeholders on addressing these issues in the coming year. We are committed to build on the progress made over the last few years to continue to execute a robust and meaningful external audit program in the most efficient and effective way possible. We appreciate everyone's effort toward this goal.

Thank you for the opportunity to comment on the Draft Report. I would also like to extend our thanks to your staff and Kearney & Company for the professional and collaborative manner in which they conducted the audit. Few outside the financial community likely realize the time and effort that go into producing the audit and the AFR, as we work to demonstrate our commitment to strong financial management and transparency.

Introduction to Principal Financial Statements

The Principal Financial Statements (Statements) have been prepared to report the financial position and results of operations of the U.S. Department of State (Department). The Statements have been prepared from the books and records of the Department in accordance with formats prescribed by the Office of Management and Budget (OMB) in OMB Circular A-136, *Financial Reporting Requirements,* revised. The Statements are in addition to financial reports prepared by the Department in accordance with OMB and U.S. Department of the Treasury (Treasury) directives to monitor and control the status and use of budgetary resources, which are prepared from the same books and records. The Statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity. The Department has no authority to pay liabilities not covered by budgetary resources. Liquidation of such liabilities requires enactment of an appropriation. Comparative data for 2011 are included.

The **Consolidated Balance Sheet** provides information on assets, liabilities, and net position similar to balance sheets reported in the private sector. Intra-departmental balances have been eliminated from the amounts presented.

The **Consolidated Statement of Net Cost** reports the components of the net costs of the Department's operations for the period. The net cost of operations consists of the gross cost incurred by the Department less any exchange (i.e., earned) revenue from our activities. Intra-departmental balances have been eliminated from the amounts presented.

The **Consolidated Statement of Changes in Net Position** reports the beginning net position, the transactions that affect net position for the period, and the ending net position. Intra-departmental transactions have been eliminated from the amounts presented.

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

Required Supplementary Information contains a Combining Schedule of Budgetary Resources that provides additional information on amounts presented in the **Combined Statement of Budgetary Resources**, and information on Deferred Maintenance.

CONSOLIDATED BALANCE SHEET

(dollars in millions)

As of September 30,	Notes	2012	2011 Restated (Note 20)
ASSETS	2		
Intragovernmental Assets:			
Fund Balances With Treasury	3	$ 44,223	$ 40,415
Investments, Net	4	16,928	16,433
Interest Receivable		170	181
Accounts Receivable, Net	5	321	336
Advances and Prepayments	8	918	1,065
Total Intragovernmental Assets		62,560	58,430
Accounts and Loans Receivable, Net	5	141	135
Cash and Other Monetary Assets	6	143	122
Property and Equipment, Net	7	16,087	14,606
Other Assets	8	641	349
Total Assets		$ 79,572	$ 73,642
Stewardship Property and Equipment; Heritage Assets	7		
LIABILITIES	9		
Intragovernmental Liabilities:			
Accounts Payable		$ 364	$ 294
Other Liabilities		348	612
Total Intragovernmental Liabilities		712	906
Accounts Payable		2,429	1,856
After-Employment Benefit Liability	10	19,893	18,674
International Organizations Liabilities	11	1,425	1,658
Other Liabilities	9,12	968	1,030
Total Liabilities		25,427	24,124
Contingencies and Commitments	13		
NET POSITION			
Unexpended Appropriations—Earmarked Funds		—	—
Unexpended Appropriations—Other Funds		35,312	31,915
Cumulative Results of Operations—Earmarked Funds	14	(2,072)	(1,359)
Cumulative Results of Operations—Other Funds		20,905	18,962
Total Net Position		54,145	49,518
Total Liabilities and Net Position		$ 79,572	$ 73,642

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

CONSOLIDATED STATEMENT OF NET COST (NOTE 15)

(dollars in millions)

For the Year Ended September 30,	2012	2011 Restated (Note 20)
Achieving Peace and Security		
Total Cost	$ 9,174	$ 8,737
Earned Revenue	(902)	(1,152)
Net Program Costs	8,272	7,585
Governing Justly and Democratically		
Total Cost	832	925
Earned Revenue	(110)	(119)
Net Program Costs	722	806
Investing in People		
Total Cost	7,767	6,607
Earned Revenue	(56)	(50)
Net Program Costs	7,711	6,557
Promoting Economic Growth and Prosperity		
Total Cost	1,229	1,341
Earned Revenue	(181)	(194)
Net Program Costs	1,048	1,147
Providing Humanitarian Assistance		
Total Cost	1,619	1,972
Earned Revenue	—	—
Net Program Costs	1,619	1,972
Promoting International Understanding		
Total Cost	1,943	1,942
Earned Revenue	(334)	(337)
Net Program Costs	1,609	1,605
Strengthening Consular and Management Capabilities		
Total Cost	5,886	4,139
Earned Revenue	(3,618)	(3,250)
Net Program Costs	2,268	889
Executive Direction and Other Costs Not Assigned		
Total Cost	3,980	3,988
Earned Revenue	(1,543)	(1,733)
Net Program Costs Before Assumption Changes	2,437	2,255
Actuarial Loss on Pension Assumption Changes (Note 1, Note 10)	770	421
Net Program Costs	3,207	2,676
Total Cost and Loss on Assumption Changes	**33,200**	**30,072**
Total Revenue	**(6,744)**	**(6,835)**
Total Net Cost	**$ 26,456**	**$ 23,237**

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

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

(dollars in millions)

For the Year Ended September 30,	**2012**			**2011 Restated (Note 20)**
	Earmarked Funds	**All Other Funds**	**Consolidated Total**	**Consolidated Total**
Cumulative Results of Operations				
Beginning Balances	$ (1,359)	$ 18,962	$ 17,603	$ 15,463
After-Employment Benefit Adjustments (Note 20)	—	—	—	559
Beginning Balances, as adjusted	(1,359)	18,962	17,603	16,022
Budgetary Financing Sources:				
Appropriations Used	—	28,124	28,124	25,259
Non-exchange Revenue	—	70	70	42
Donations	19	—	19	19
Transfers in(out) without Reimbursement	45	(25)	20	124
Other Financing Sources:				
Donations	—	12	12	221
Imputed Financing from Costs Absorbed by Others	—	160	160	166
Non-entity Collections	—	(719)	(719)	(1,013)
Total Financing Sources	**64**	**27,622**	**27,686**	**24,818**
Net Cost of Operations	(777)	(25,679)	(26,456)	(23,237)
Net Change	(713)	1,943	1,230	1,581
Total Cumulative Results of Operations	**(2,072)**	**20,905**	**18,833**	**17,603**
Unexpended Appropriations				
Beginning Balances	$ —	$ 31,915	$ 31,915	$ 29,288
Budgetary Financing Sources:				
Appropriations Received	—	31,840	31,840	28,014
Appropriations Transferred in(out)	—	(94)	(94)	193
Rescissions and Canceling Funds	—	(225)	(225)	(321)
Appropriations Used	—	(28,124)	(28,124)	(25,259)
Total Budgetary Financing Sources	—	3,397	3,397	2,627
Total Unexpended Appropriations	**—**	**35,312**	**35,312**	**31,915**
Net Position	**$ (2,072)**	**$ 56,217**	**$ 54,145**	**$ 49,518**

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

COMBINED STATEMENT OF BUDGETARY RESOURCES (NOTE 16)

(dollars in millions)

For the Year Ended September 30,	2012	2011
Budgetary Resources:		
Unobligated Balance, brought forward, October 1	$ 13,460	$ 13,337
Adjustment to unobligated balance brought forward, October 1	(336)	—
Unobligated balance brought forward, October 1, as adjusted	13,124	13,337
Recoveries of Prior Year Unpaid Obligations	1,630	1,602
Other changes in unobligated balance	691	441
Unobligated balance from prior year budget authority, net	15,445	15,380
Appropriations (discretionary and mandatory)	31,772	28,302
Borrowing authority (discretionary and mandatory)	1	1
Spending authority from offsetting collections (discretionary and mandatory)	10,315	9,609
Total Budgetary Resources	**$ 57,533**	**$ 53,292**
Status of Budgetary Resources:		
Obligations Incurred	$ 40,052	$ 39,832
Apportioned	16,450	12,564
Exempt from apportionment	290	7
Unapportioned	741	889
Unobligated balance, end of year	17,481	13,460
Total Status of Budgetary Resources	**$ 57,533**	**$ 53,292**
Change in Obligated Balance:		
Unpaid obligations, brought forward, Oct 1 (gross)	$ 27,235	$ 24,734
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(416)	(237)
Obligated balance, start of year (net), before adjustments (+ or -)	26,819	24,497
Adjustments to obligated balance, start of year (+ or -)	336	—
Obligated balance, start of year (net), as adjusted	27,155	24,497
Obligations incurred	40,052	39,832
Outlays (gross) (-)	(38,450)	(35,729)
Change in uncollected customer payments from Federal sources (+ or -)	(368)	(179)
Recoveries of prior year unpaid obligations (-)	(1,630)	(1,602)
Unpaid obligations, end of year (gross)	27,543	27,235
Uncollected customer payments from Federal sources, end of year (-)	(784)	(416)
Obligated balance, end of year (net)	**$ 26,759**	**$ 26,819**
Budget Authority and Outlays, Net:		
Budget authority, gross (discretionary and mandatory)	$ 42,088	$ 37,912
Actual Offsetting collections (discretionary and mandatory) (-)	(9,947)	(9,430)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(368)	(179)
Budget authority, net (discretionary and mandatory)	31,773	28,303
Outlays, gross (discretionary and mandatory)	38,450	35,729
Actual Offsetting collections (discretionary and mandatory) (-)	(9,947)	(9,430)
Outlays, net (discretionary and mandatory)	28,503	26,299
Distributed offsetting receipts (-)	(394)	(299)
Agency outlays, net (discretionary and mandatory)	**$ 28,109**	**$ 26,000**

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

NOTES TO PRINCIPAL FINANCIAL STATEMENTS

ORGANIZATION

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

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity and Basis of Consolidation

The accompanying principal financial statements present the financial activities and position of the Department of State. The statements include all General, Special, Revolving, Trust and Deposit funds established at the Department of the Treasury to account for the resources entrusted to Department management, or for which the Department acts as a fiscal agent or custodian, (except fiduciary funds, see Note 19).

Included in the Department's reporting entity is the U.S. Section of the International Boundary and Water Commission (IBWC). Treaties in 1848, 1853, and 1970 established the boundary between the U.S. and Mexico that extends 1,954 miles, beginning at the Gulf of Mexico, following the Rio Grande a distance of 1,255 miles and eventually ending at the Pacific Ocean below California. Established in 1889, the IBWC has responsibility for applying the boundary and water treaties between the U.S. and Mexico and settling differences that may arise in their application.

Basis of Presentation and Accounting

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

The statements have been prepared from the Department's books and records, and are in accordance with the Department's Accounting Policies (the significant policies are summarized below in this Note). The Department's Accounting Policies follow accounting principles generally accepted in the United States of America (GAAP) for Federal entities as prescribed by the Federal Accounting Standards Advisory Board (FASAB). FASAB's Statement of Federal Financial Accounting Standards (SFFAS) No. 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, incorporates the GAAP hierarchy into FASAB's authoritative literature.

Transactions are recorded on both an accrual and budgetary basis. Budgetary accounting facilitates compliance with legal constraints.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, and exercise judgment that affects the reported amounts of assets, liabilities and net position and disclosure of contingent liabilities as of the date of the financial statements, and the reported amounts of revenues, financing sources, expenses and obligations incurred during the reporting period. These estimates are based on management's best knowledge of current events, historical experience, actions the Department may take in the future, and on various other assumptions that are believed to be reasonable under the circumstances. Due to the size and complexity of many of the Department's programs, the estimates are subject to a wide range of variables, including assumptions on future economic and financial events. Accordingly, actual results could differ from those estimates.

Revenues and Other Financing Sources

Department operations are financed through appropriations, reimbursement for the provision of goods or services to other Federal agencies, proceeds from the sale of property, certain consular-related and other fees, and donations. In addition, the Department collects passport, visa, and other consular fees that are not retained by the Department but are deposited directly to a Treasury account. The passport and visa fees are reported as earned revenues on the Statement of Net Cost and as a transfer-out of financing sources on the Statement of Changes in Net Position.

Congress annually enacts one-year and multi-year appropriations that provide the Department with the authority to obligate funds within the respective fiscal years for necessary expenses to carry out mandated program activities. In addition, Congress enacts appropriations that are available until expended. All appropriations are subject to OMB apportionment as well as congressional restrictions. For financial statement purposes, appropriations are recorded as a financing source (i.e., Appropriations Used) and reported on the Statement of Changes in Net Position at the time they are recognized as expenditures. Appropriations expended for capitalized property and equipment are recognized when the asset is purchased.

Work performed for other Federal agencies under reimbursable agreements is financed through the account providing the service and reimbursements are recognized as revenue when earned. Administrative support services at overseas posts are provided to other Federal agencies through the International Cooperative Administrative Support Services (ICASS). ICASS bills for the services it provides to agencies at overseas posts. These billings are recorded as revenue to ICASS and must cover overhead costs, operating expenses, and replacement costs for capital assets needed to carry on the operation. Proceeds from the sale of real property, vehicles, and other personal property are recognized as revenue when the proceeds are credited to the account that funded the asset. For non-capitalized property, the full amount realized is recognized as revenue. For capitalized property, revenue or loss is determined by whether the proceeds received were more or less than the net book value of the asset sold. The Department retains proceeds of sale, which are available for purchase of the same or similar category of property.

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

Generally, donations received in the form of cash or financial instruments are recognized as revenue at their fair value in the period received. Contributions of services are recognized if the services received (a) create or enhance non-financial assets, or (b) require specialized skills that are provided by individuals possessing those skills, which would typically need to be purchased if not donated. Works of art, historical treasures, and similar assets that are added to collections are not recognized at the time of donation. If subsequently sold, proceeds from the sale of these items are recognized in the year of sale. More information on earned revenues can be found in Note 15.

Allocation Transfers

Allocation transfers are legal delegations by one Federal agency of its authority to obligate budget authority and outlay funds to another agency. The Department processes allocation transfers with other Federal agencies as both a transferring (parent) agency of budget authority to a receiving (child) entity and as a receiving (child) agency of budget authority from a transferring (parent) entity. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. Subsequent obligations and outlays incurred by the child agency are charged to this allocation account as they execute the delegated activity on behalf of the parent agency.

Generally, all financial activities related to allocation transfers (i.e., budget authority, obligations, outlays) are reported in the financial statements of the parent agency. Transfers from the Executive Office of the President for which the Department is the receiving agency, is an exception to this rule. Per OMB guidance, the Department reports all activity relative to these allocation transfers in its financial statements. The Department allocates funds, as the parent, to Department of Defense, Department of Labor, Treasury, Health and Human Services, Peace Corps, and USAID. In addition, the Department receives allocation transfers, as the child, from USAID.

Fund Balances with Treasury

The Fund Balances with Treasury are available to pay accrued liabilities and finance authorized commitments relative to goods, services, and benefits. The Department does not maintain cash in commercial bank accounts for the funds reported in the Consolidated Balance Sheet, except for the Emergencies in the Diplomatic and Consular Services, Office of Foreign Missions, Foreign Service National Defined Contributions Retirement Fund, and the International Center. Treasury processes domestic receipts and disbursements.

The Department operates two Financial Service Centers located in Bangkok, Thailand, and Charleston, South Carolina. These provide financial support for the Department and other Federal agencies' operations overseas. The U.S. Disbursing Officer at each Center has the delegated authority to disburse funds on behalf of the Treasury. See Note 3 for additional information on Fund Balances with Treasury.

Accounts and Loans Receivable

Intergovernmental Accounts Receivable are due principally from other Federal agencies for ICASS services, reimbursable agreements, and Working Capital Fund (WCF) services. Accounts and Loans Receivable from non-Federal entities are primarily the result of repatriation loans and IBWC receivables for Mexico's share of IBWC activities. The U.S. and Mexican governments generally share the total costs of IBWC projects in proportion to their respective benefits in cases of projects for mutual control and utilization of the waters of a boundary river, unless the Governments have predetermined by treaty the division of costs according to the nature of a project.

The Department provides repatriation loans for destitute American citizens overseas whereby the Department becomes the lender of last resort. These loans provide assistance to pay for return transportation, food and lodging, or medical expenses. The borrower executes a promissory note without collateral. Consequently, the loans are made anticipating a low rate of recovery. Interest, penalties, and administrative fees are assessed if the loan becomes delinquent.

Accounts and Loans Receivable from non-Federal entities are subject to the full debt collection cycle and mechanisms, e.g., salary offset, referral to collection agents, and Treasury offset. In addition, Accounts Receivable from non-Federal entities are assessed interest, penalties and administrative fees if they become delinquent. Interest and penalties are assessed at the Current Value of Funds Rate established by Treasury. Accounts Receivable is reduced to net realizable value by an Allowance for Uncollectable Accounts. See Note 5 for more information on Accounts and Loans Receivable.

Interest Receivable

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

Advances and Prepayments

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

Valuation of Investments

The Department has several accounts that have the authority to invest cash resources. For these accounts, the cash resources not required to meet current expenditures are invested in interest-bearing obligations of the U.S. Government. These investments consist of U.S. Treasury special issues and securities. Special issues are unique public debt obligations for purchase exclusively by the Foreign Service Retirement and Disability Fund and for which interest is computed and paid semi-annually on June 30 and December 31. They are purchased and redeemed at par, which is their carrying value on the Consolidated Balance Sheet.

Investments by the Department's Gift, Israeli-Arab Scholarship, Eisenhower Exchange Fellowship and Middle-Eastern-Western Dialogue accounts are in U.S. Treasury securities. Interest on these investments is paid semi-annually at various rates. These investments are reported at acquisition cost, which equals the face value net of unamortized discounts or premiums. Discounts and premiums are amortized over the life of the security using the straight-line method for Gift Funds investments, and effective interest method for the other accounts. Additional information on Investments can be found in Note 4.

Property and Equipment

Real Property

Real property assets primarily consist of facilities used for U.S. diplomatic missions abroad and capital improvements to these facilities, including unimproved land; residential and functional-use buildings such as embassy/consulate office buildings; office annexes and support facilities; and construction-in-progress. Title to these properties is held under various conditions including fee simple, restricted use, crown lease, and deed of use agreement. Some of these properties are considered historical treasures and are considered multi-use heritage assets. These items are reported on the Balance Sheet, in Note 7 to the financial statements, and in the Heritage Assets Section of Other Accompanying Information.

The new consulate in Surabaya, Indonesia, completed in March 2012, is a 6.2 acre compound replacing a residence where the consulate had operated since 1950. The new facility has significantly improved security. It incorporates a storm water management system that captures downpours and slowly discharges the water to minimize flooding.

Department of State/OBO

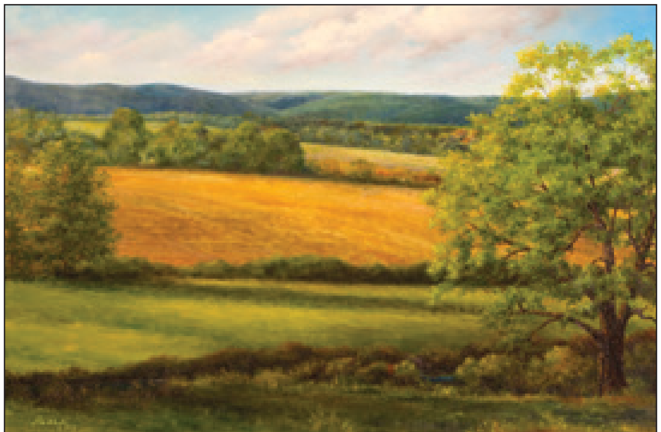
The Department also owns several domestic real properties, including the National Foreign Affairs Training Center (Arlington, Va.); the International Center (Washington, D.C.); the Charleston Financial Services Center (S.C.); the Beltsville Information Management Center (Md.); the Florida Regional Center (Ft. Lauderdale); and consular centers in Charleston, S.C., Portsmouth, N.H. and Williamsburg, Ky. The IBWC owns buildings and structures related to its boundary preservation, flood control, and sanitation programs.

Buildings and structures are carried at either actual or estimated historical cost. The Department capitalizes all costs for constructing new buildings and building acquisitions regardless of cost, and all other improvements greater than $1 million. Costs incurred for constructing new facilities, major rehabilitations, or other improvements in the design or construction stage are recorded as Construction-in-Progress. After these projects are completed, costs are transferred to Buildings and Structures or Leasehold Improvements as appropriate. Depreciation is computed on a straight-line basis, principally over a 30-year period for buildings and other structures, a 10-year period for improvements, and the lesser of the useful life or the term of the lease for leasehold improvements.

Personal Property

Personal property consists of several asset categories including aircraft, vehicles, security equipment, communication equipment, automated data processing (ADP) equipment, reproduction equipment, and software. The Department holds title to these assets, some of which are operated in unusual conditions, as described below.

The Department's Bureau of International Narcotics and Law Enforcement (INL) uses aircraft to help eradicate and stop the flow of illegal drugs. To accomplish its mission,



Art Bank work "Catoctin View" (2012)
Carol Bucklin-Loevy, oil.

INL maintains an aircraft fleet that is one of the largest Federal, nonmilitary fleets. Most of the aircraft are under direct INL air wing management. However, a number of aircraft are managed by host-countries. The Department holds title to most of the aircraft under these programs and requires congressional notification to transfer title for any aircraft to foreign governments. INL contracts with firms to provide maintenance support depending on whether the aircraft are INL air wing managed or host-country managed. INL air wing managed aircraft are maintained to Federal Aviation Administration standards that involve routine inspection, as well as scheduled maintenance and replacements of certain parts after given hours of use. Host-country managed aircraft are maintained to host-country requirements, which are less than Federal Aviation Administration standards.

The Department also maintains a large vehicle fleet that operates overseas. Many vehicles require armoring for security reasons. For some locations, large utility vehicles are used instead of conventional sedans. In addition, the Department contracts with firms to provide support in strife-torn areas, such as Iraq and Afghanistan. Contractor support includes the purchase and operation of armored vehicles. Under the terms of the contracts, the Department has title to the contractor-held vehicles.

Personal property and equipment with an acquisition cost of $25,000 or more, and a useful life of two or more years, is capitalized at cost. Additionally, all vehicles are capitalized, as well as ADP software costing over $500,000. Except for contractor-held vehicles in Iraq and Afghanistan, depreciation is calculated on a straight-line basis over the asset's estimated life and begins when the property is placed into service. Contractor-held vehicles in Iraq and Afghanistan, due to the harsh operating conditions, are depreciated on a double-declining balance basis. The estimated useful lives are as follows:

Asset Category	Estimated Useful Life
Aircraft:	
INL air wing managed	10 years
Host-country managed	5 years
Vehicles:	
Department managed	3 to 6 years
Contractor-held in Iraq and Afghanistan	2 1/2 years
Security Equipment	3 to 15 years
Communication Equipment	3 to 20 years
Automated Data Processing Equipment	3 to 6 years
Reproduction Equipment	3 to 15 years
Software	Estimated useful life or 5 years

See Note 7, *Property and Equipment, Net,* for additional information.

Capital Leases

Leases are accounted for as capital leases if they meet one of the following criteria: (1) the lease transfers ownership of the property by the end of the lease term; (2) the lease contains an option to purchase the property at a bargain price; (3) the lease term is equal to or greater than 75 percent of the estimated useful life of the property; or (4) at the inception of the lease, the present value of the minimum lease payment equals or exceeds 90 percent of the fair value of the leased property. The initial recording of the lease's value (with a corresponding liability) is the lesser of the net present value of the lease payments or the fair value of the leased property. Capital leases that meet criteria (1) and (2) are depreciated over the useful life of the asset (30 years). Capital leases that meet criteria (3) and (4) are depreciated over the term of the lease. Capital leases are amortized over the term of the lease; if the lease has an indefinite term, the term is capped at 50 years. Additional information on Capital Leases is disclosed in Note 12.

Grants

The Department awards educational, cultural exchange and refugee assistance grants to various individuals, universities, and non-profit organizations. Budgetary obligations are recorded when grants are awarded. Grant funds are disbursed in two ways: grantees draw funds commensurate with their immediate cash needs via the Department of Health and Human Services (HHS) Payments Management System (PMS); or grantees submit invoices. In both cases, the expense is recorded upon disbursement.

Accounts Payable

Accounts payable represent the amounts accrued for contracts for goods and services received but unpaid at the end of the fiscal year and unreimbursed grant expenditures. In addition to accounts payables recorded through normal business activities, unbilled payables are estimated based on historical data.

Annual, Sick and Other Leave

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. Throughout the year, the balance in the accrued annual leave liability account is adjusted to reflect current pay rates. The amount of the adjustment is recorded as an expense. Current or prior year appropriations are not available to fund annual leave earned but not taken. Funding occurs in the year the leave is taken and payment is made. Sick leave and other types of non-vested leave are expensed as taken.

Employee Benefit Plans

Retirement Plans: Civil Service employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). Members of the Foreign Service participate in either the Foreign Service Retirement and Disability System (FSRDS) or the Foreign Service Pension System (FSPS).

Employees covered under CSRS contribute 7 percent of their salary; the Department contributes 7 percent. Employees covered under CSRS also contribute 1.45 percent of their salary to Medicare insurance; the Department makes a matching contribution. On January 1, 1987, FERS went into effect pursuant to Public Law No. 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, were allowed to join FERS or remain in CSRS. Employees participating in FERS contribute 0.8 percent of their salary, with the Department making contributions of 11.2 percent. FERS employees also contribute 6.2 percent to Social Security and 1.45 percent to Medicare insurance. The Department makes matching contributions to both. A primary feature of FERS is that it offers a Thrift Savings Plan (TSP) into which the Department automatically contributes 1 percent of pay and matches employee contributions up to an additional 4 percent.

Foreign Service employees hired prior to January 1, 1984 participate in FSRDS with certain exceptions. FSPS was established pursuant to Section 415 of Public Law No. 99-335, which became effective June 6, 1986. Foreign Service employees hired after December 31, 1983 participate in FSPS with certain exceptions. FSRDS employees contribute 7.25 percent of their salary; the Department contributes 7.25 percent. FSPS employees contribute 1.35 percent of their salary; the Department contributes 20.22 percent. FSRDS and FSPS employees contribute 1.45 percent of their salary to Medicare; the Department matches their contribution. FSPS employees also contribute 6.2 percent to Social Security; the Department makes a matching contribution. Similar to FERS, FSPS also offers the TSP described above.

Foreign Service National (FSN) employees at overseas posts who were hired prior to January 1, 1984, are covered under CSRS. FSN employees hired after that date are covered under a variety of local government plans in compliance with the host country's laws and regulations. In cases where the host country does not mandate plans or the plans are inadequate, employees are covered by plans that conform to the prevailing practices of comparable employers.

Health Insurance: Most American employees participate in the Federal Employees Health Benefits Program (FEHBP), a voluntary program that provides protection for enrollees and eligible family members in cases of illness and/or accident. Under FEHBP, the Department contributes the employer's share of the premium as determined by the U.S. Office of Personnel Management (OPM).

Life Insurance: Unless specifically waived, employees are covered by the Federal Employees Group Life Insurance Program (FEGLIP). FEGLIP automatically covers eligible employees

Art Bank work "Everything Appears as It Is" (2011)
Alex Dodge, silkscreen.

for basic life insurance in amounts equivalent to an employee's annual pay, rounded up to the next thousand dollars plus $2,000. The Department pays one-third and employees pay two-thirds of the premium. Enrollees and their family members are eligible for additional insurance coverage but the enrollee is responsible for the cost of the additional coverage.

Other Post Employment Benefits: The Department does not report CSRS, FERS, FEHBP or FEGLIP assets, accumulated plan benefits, or unfunded liabilities applicable to its employees; OPM reports this information. As required by SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, the Department reports the full cost of employee benefits for the programs that OPM administers. The Department recognizes an expense and imputed financing source for the annualized unfunded portion of CSRS, post-retirement health benefits, and life insurance for employees covered by these programs. The Department recognized $160 million and $166 million for the years ended September 30, 2012 and 2011, respectively, for these benefits. The additional costs are not owed or paid to OPM, and thus are not reported on the Balance Sheet as a liability. Instead, they are reported as an imputed financing source from costs absorbed from others on the Statement of Changes in Net Position.

Future Workers' Compensation Benefits

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

The total actuarial liability for which the Department is responsible totaled $79 million and $74 million as of September 30, 2012 and 2011.

Foreign Service Retirement and Disability Fund

See Note 10 for the Department's accounting policy for Foreign Service retirement-related benefits and the Actuarial Present Value of Projected Plan Benefits for the Foreign Service Retirement and Disability Program.

Foreign Service Nationals' After-Employment Benefits

Defined Contributions Fund (DCF) – provides retirement benefits for FSN employees in countries where the Department has made a public interest determination to discontinue participation in the Local Social Security System (LSSS). Title 22, Foreign Relations and Intercourse, Section 3968, Local Compensation Plans, provides the authority to the Department to establish such benefits as part of a total compensation plan for these employees.

Defined Benefit Plans – In 12 countries, involving approximately 3,200 FSN employees, the Department has implemented various arrangements for defined benefit pension plans for the benefit of FSN employees. Some of these plans supplement the host country's equivalent to U.S. social security, others do not. While none of these supplemental plans are mandated by the host country, some are substitutes for optional tiers of a host country's social security system.

Lump Sum Retirement and Severance – Under some local compensation plans, FSN employees are entitled to receive a lump-sum separation payment when they resign, retire, or otherwise separate through no fault of their own. The amount of the payment is generally based on length of service, rate of pay at the time of separation, and the type of separation.

Net Position

The Department's net position contains the following components:

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

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

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

Foreign Currency

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

Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold. The Department's fiduciary activities are not recognized on the principal financial statements, but are reported on schedules as a note to the financial statements. The Department's fiduciary activities include receiving contributions from donors for the purpose of providing compensation for certain claims within the scope of an established agreement, investment of contributions into Treasury securities, and disbursement of contributions received within the scope of the established agreement. See Note 19 for disclosure of Fiduciary Activities.

Comparative Data

Certain Fiscal Year 2011 amounts have been reclassified to conform to the Fiscal Year 2012 presentation.

Change in Accounting Principle

The Department employs a significant number of local nationals, currently approximately 46,000, known as Foreign Service Nationals (FSNs). By statute, the Department is required to establish compensation plans for FSNs in its employ in foreign countries and the plans are to be based upon prevailing compensation practices in the locality of employment, unless the Department makes a public interest determination to do otherwise. In general, the Department follows host country (i.e., local) practices and conventions in compensating FSNs. The end result of this is that compensation for FSNs, including after-employment benefits, is typically not in accord with what would otherwise be offered or required by statute and regulations for Federal civilian employees.

Prior to FY 2012, the Department accounted for its FSN after-employment benefits under the Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*. However, the Department, in consultation with the FASAB, has determined that SFFAS No. 5 does not provide specific or sufficient guidance with regard to the FSN defined benefit plans and other after-employment benefits arrangements established outside of the United States. In particular, FASAB did not consider these types of plans in establishing SFFAS No. 5. Since SFFAS No. 5 does not explicitly address the plans established in host countries for FSNs employed overseas, and FASAB appears to have been unaware of such plans when it developed SFFAS No. 5, the guidance in SFFAS No. 34 may be relied upon to arrive at GAAP appropriate for these plans. As provided for in SFFAS No. 34, *The Hierarchy of Generally Accepted Accounting Principles*, other accounting literature, to include pronouncements by the International Accounting Standards Board (IASB), may be appropriate guidance for establishing GAAP depending upon "its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority." After considering other accounting literature, the Department determined that the provisions and guidance contained in International Accounting Standard (IAS) No. 19, *Employee Benefits*, provides a better structure for the reporting of these plans which are established in accordance with local practices in countries overseas.

Under SFFAS No. 5, the Department reported plan assets and liabilities separately for the overseas FSN defined benefit plans. The adoption of IAS No. 19 results in the Department recognizing a net defined benefit liability in the Consolidated Balance Sheet. The net defined benefit liability is comprised of the present value of the defined benefit obligation less the fair value of plan assets. Note 10 presents information for both FY 2012 and 2011 under IAS No. 19.

SFFAS No. 21, *Reporting Correction of Errors and Changes in Accounting Principles*, states that when a change in accounting principle occurs, the prior period financial statements presented for comparative purposes should be presented as previously reported. Conversely, SFFAS No. 21 requires restatement for the correction of a material error. The Department has determined that a restatement to the FY 2011 financial statements is required for the correction of an error with respect to the previously reported FSN after-employment benefit liability. Since previously reported FY 2011 amounts require restatement, they will also be adjusted to reflect the change in accounting principle. Note 20 explains the restatement and the impact on prior years' financial statements resulting from the error.

2 Assets

The Department's assets are classified as entity or non-entity. Entity assets are those assets that the Department has authority to use for its operations. Non-entity assets are those held by the Department that are not available for use in its operations. Total non-entity assets at both September 30, 2012 and 2011, were $15 million, for amounts in the Chancery Development Trust Account. These items are included in Cash and Other Monetary Assets (See Note 6, *Cash and Other Monetary Assets* for further information).

3 Fund Balances with Treasury

Fund Balances with Treasury at September 30, 2012 and 2011, are summarized below *(dollars in millions)*.

Fund Balances	2012	2011
Appropriated Funds	$ 42,484	$ 38,669
Revolving Funds	1,265	1,157
Earmarked Funds	439	398
Special Funds	34	35
Deposit & Receipt Accounts*	1	156
Total	$ 44,223	$ 40,415

Deposit and Receipt Accounts were adjusted to exclude fiduciary funds.

Status of Fund Balances	2012	2011
Unobligated Balances Available	$ 16,740	$ 12,571
Unobligated Balances Unavailable	741	889
Obligated Balances not yet Disbursed	26,741	26,799
Total Unobligated and Obligated	44,222	40,259
Deposit and Receipt Funds	1	156
Total	$ 44,223	$ 40,415

4 Investments

SUMMARY OF INVESTMENTS

Investments at September 30, 2012 and 2011, are summarized below *(dollars in millions)*. All investments are classified as Intragovernmental Securities.

At September 30, 2012:	Net Investment	Market Value	Maturity Dates	Interest Rates Range	Interest Receivable
Non-Marketable, Par Value:					
Special Issue Securities	$ 16,893	$ 16,893	2013-2027	1.375%-5.875%	$ 170
Subtotal	16,893	16,893			170
Non-Marketable, Market Based:					
Israeli-Arab Scholarship Fund	4	4	2014-2016	0.25%-0.875%	—
Eisenhower Exchange Fellowship Fund	8	8	2013-2019	3.000%-8.875%	—
Middle Eastern-Western Dialogue Fund	15	15	2012-2019	0.250%-4.250%	—
Gift Funds, Treasury Bills	8	8	2012-2019	2.625%-3.625%	—
Subtotal	35	35			—
Total Investments	$ 16,928	$ 16,928			$ 170

At September 30, 2011:	Net Investment	Market Value	Maturity Dates	Interest Rates Range	Interest Receivable
Non-Marketable, Par Value:					
Special Issue Securities	$ 16,397	$ 16,397	2012-2026	2.5%-6.875%	$ 181
Subtotal	16,397	16,397			181
Non-Marketable, Market Based:					
Israeli-Arab Scholarship Fund	4	4	2011-2012	4.5%-4.625%	—
Eisenhower Exchange Fellowship Fund	8	9	2011-2019	1.125%-8.875%	—
Middle Eastern-Western Dialogue Fund	16	16	2011-2012	4.5%-4.625%	—
Gift Funds, Treasury Bills	8	8	2012-2019	2.625-3.625%	—
Subtotal	36	37			—
Total Investments	$ 16,433	$ 16,434			$ 181

The Department's activities that have the authority to invest cash resources are earmarked funds (see Note 14, *Earmarked Funds*). The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the Department as evidence of its receipts. Treasury securities are an asset to the Department and a liability to the Treasury. Because the Department and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or liability in the U.S. Government-wide financial statements.

(continued on next page)

NOTE 4: Investments (continued)

Treasury securities provide the component entity with authority to draw upon the U.S. Treasury to make future benefits payments or other expenditures. When the Department requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. The Government finances most expenditures in this way.

5 Accounts and Loans Receivable, Net

The Department's Accounts and Loans Receivable, Net at September 30, 2012 and 2011, are summarized here *(dollars in millions)*. All are entity receivables.

	2012			2011		
	Entity Receivables	**Allowance for Uncollectible**	**Net Receivables**	**Entity Receivables**	**Allowance for Uncollectible**	**Net Receivables**
Intragovernmental Accounts Receivable	$ 374	$ (53)	$ 321	$ 379	$ (43)	$ 336
Non-Intragovernmental Accounts and Loans Receivable	175	(34)	141	174	(39)	135
Total Receivables	$ 549	$ (87)	$ 462	$ 553	$ (82)	$ 471

The allowances for uncollectable accounts are recorded using aging methodologies based on analysis of historical collections and write-offs.

The total accounts and loans receivable for FY 2012, net of allowance for uncollectable accounts, is $462 million. This balance consists of $374 million in Federal intergovernmental reimbursable agreements for providing goods and services to other Federal agencies. The $175 million in accounts and loans receivables due from non-Federal entities consists of $1 million in repatriation loans and associated administration fees. Repatriation Loans enable destitute American citizens overseas to return to the United States. The remaining $174 million consist mainly of civil monitory fines and penalties and Value Added Taxes (VAT). Civil monitory fines and penalties are assessed on individuals for such infractions as violating the terms and munitions licenses, exporting unauthorized defense articles and services, and violation of manufacturing licenses agreements. VAT receivables are for taxes paid on purchases overseas in which the Department has reimbursable agreements with the country for taxes it pays.

6 Cash and Other Monetary Assets

The Cash and Other Monetary Assets at September 30, 2012 and 2011, are summarized below *(dollars in millions)*. There are no restrictions on entity cash. Non-entity cash is restricted as discussed below.

	2012			2011 Restated		
	Entity Assets	**Non-Entity Assets**	**Total**	**Entity Assets**	**Non-Entity Assets**	**Total**
After-Employment Benefit Assets	$ 123	$ —	$ 123	$ 102	$ —	$ 102
Emergencies in the Diplomatic and Consular Service	5	—	5	5	—	5
Chancery Development						
Trust Accounts:						
Treasury Bills, at par	—	15	15	—	15	15
Unamortized Discount	—	—	—	—	—	—
Total	$ 128	$ 15	$ 143	$ 107	$ 15	$ 122

FOREIGN SERVICE NATIONAL AFTER-EMPLOYMENT BENEFIT ASSETS

The Defined Contributions Fund (FSN DCF) provides retirement benefits for FSN employees in countries where the Department has made a public interest determination to discontinue participation in the Local Social Security System (LSSS). Title 22, Foreign Relations and Intercourse, Section 3968, Local Compensation Plans, provides the authority to the Department to establish such benefits and identifies as part of a total compensation plan for these employees. The FSN DCF is administered by a third party who invests excess funds in Treasury securities on behalf of the Department. The other monetary assets reported for the FSN DCF is $123 million and $102 million as of September 30, 2012 and 2011, respectively.

CHANCERY DEVELOPMENT TRUST ACCOUNT

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

150 Years of an Official Diplomatic History Source: The Foreign Relations of the United States Series

The U.S. Department of State's Foreign Relations of the U.S. (FRUS) series is the official documentary history of U.S. foreign policy. FRUS has been an indispensible resource for anyone seeking to understand the making of U.S. foreign policy and a wide variety of related topics.

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The series captures how the highest levels of the U.S. Government made decisions on a wide range of historical foreign policy, national security and global issues.

As mandated by Congress, the series incorporates an array of sources to "thoroughly, accurately, and reliably" capture how the highest levels of the U.S. Government made decisions on a wide range of historical foreign policy, national security, and global issues.

"Historians are excavating, sifting, and...helping us know our history more fully so that we can put the past behind us and move forward together."

— Secretary of State, Hillary Rodham Clinton

The Evolution of *FRUS*

The series began in 1861, grew more scholarly after 1925, and acquired a congressional mandate in 1991. Over time, the kinds of material included in FRUS volumes changed. The original purpose of the series was to inform Congress of current (rather than historical) diplomatic activities undertaken by the executive branch.

In the early 20th Century, *FRUS* volumes began to be published years after the events described between its covers. This made the volumes less useful to Congress, but more useful for a growing academic community of international legal experts, historians, and political scientists as well as a wide range of media and public consumers, both inside and outside the United States.

The *FRUS* Sesquicentennial Initiative

FRUS recently surpassed its 150th anniversary. It is the oldest and most comprehensive series of its type anywhere in the world. To commemorate this history, the Office of the Historian has explored the story behind FRUS and discovered how it evolved into the invaluable resource and the leading example of responsible transparency that it is today. Our research sheds light on significant issues, including:

- Transformations in the organization and operation of the U.S. Government
- Changing conceptions of "transparency" and "national security"
- America's shifting role in the world

You can learn more about the history of the series and our outreach efforts by visiting our website, *http://history.state.gov/frus150*. At the website, you will find research posts, videos, and original documents that tell the story of how the U.S. Government discloses its activities to the American people. To explore the Foreign Relations series itself, visit *http://history.state.gov/historicaldocuments*, stop by your nearest university or major public library, or contact the Government Printing Office for information about purchasing individual volumes.

Did You Know...

- The U.S. Government used *FRUS* as a weapon against the Confederacy during the Civil War?
- An intentional "leak" in *FRUS* raised fears of a war with Spain in 1872?
- Franklin Delano Roosevelt and Winston Churchill vetoed publication of records from the 1919 Paris peace conferences in the middle of World War II?
- The release of records from the Yalta conference was headline news around the world in 1955?

Historic long-suppressed Yalta papers were released to Japanese newsmen after Secretary of State John Foster Dulles' decision to make them public, March 16, 1955. *©AP Image*

7 Property and Equipment, Net

Property and Equipment, Net balances at September 30, 2012 and 2011, are shown in the following table *(dollars in millions)*.

	2012			2011		
Major Classes	**Cost**	**Accumulated Depreciation**	**Net Value**	**Cost**	**Accumulated Depreciation**	**Net Value**
Real Property:						
Overseas —						
Land and Land Improvements	$ 2,131	$ (52)	$ 2,079	$ 1,984	$ (41)	$ 1,943
Buildings and Structures	13,889	(5,232)	8,657	13,013	(4,765)	8,248
Construction-in-Progress	2,685	—	2,685	2,051	—	2,051
Assets Under Capital Lease	79	(29)	50	108	(52)	56
Leasehold Improvements	407	(249)	158	372	(242)	130
Domestic —						
Structures, Facilities and Leaseholds	1,121	(347)	774	970	(317)	653
Construction-in-Progress	222	—	222	327	—	327
Land and Land Improvements	81	(7)	74	81	(7)	74
Total — Real Property	20,615	(5,916)	14,699	18,906	(5,424)	13,482
Personal Property:						
Aircraft	929	(430)	499	862	(431)	431
Vehicles	913	(424)	489	811	(363)	448
Communication Equipment	30	(23)	7	27	(23)	4
ADP Equipment	106	(75)	31	93	(74)	19
Reproduction Equipment	12	(7)	5	13	(7)	6
Security	182	(64)	118	65	(44)	21
Software	388	(296)	92	367	(271)	96
Software-in-Development	66	—	66	46	—	46
Other Equipment	176	(95)	81	179	(126)	53
Total — Personal Property	2,802	(1,414)	1,388	2,463	(1,339)	1,124
Total Property and Equipment, Net	$ 23,417	$ (7,330)	$ 16,087	$ 21,369	$ (6,763)	$ 14,606

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NOTE 7: Property and Equipment, Net (continued)

STEWARDSHIP PROPERTY AND EQUIPMENT; HERITAGE ASSETS

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

There are eight separate collections of Art and furnishings: the Diplomatic Reception Rooms, the Art Bank, Art in Embassies, Cultural Heritage Collection, the Library Rare

HERITAGE ASSETS
For the Year Ended September 30, 2012

	Diplomatic Reception Rooms Collection	Art Bank	Art in Embassies Program	Cultural Heritage Collection
Description	**Collectibles - Art and furnishings from the period 1750 to 1825**	**Collection of American works of art on paper**	**Collectibles - American works of art**	**Collections include fine and decorative arts and other cultural objects**
Acquisition and Withdrawal	Acquired through donation or purchase using donated funds. Excess items are sold.	Acquired through purchase.	Acquired through purchase or donation. Excess items are sold.	The program provides assessment, preservation, and restoration as needed.
Condition	Good to excellent	Good to excellent	Good to excellent	Good to excellent
Number of Assets - 9/30/2010	3,463	2,374	960	12,473
Acquisitions	24	28	16	392
Adjustments			(8)	2,989
Disposals	4	1		765
Number of Assets - 9/30/2011	3,483	2,401	968	15,089
Deferred Maintenance - 9/30/2011	N/A	N/A	N/A	N/A
Acquisitions	11	51	25	2,633
Adjustments	(1,718)[1]		(6)	
Disposals	9	1		852
Number of Assets - 9/30/2012	1,767	2,451	987	16,870
Deferred Maintenance - 9/30/2012	N/A	N/A	N/A	N/A

[1] *The adjustments line resulted from an effort to put all heritage assets in ILMS with a consistent counting methodology.*

(continued on next page)

and Special Book Collection, the Secretary of State's Register of Culturally Significant Property, the U.S. Diplomacy Center, and the Blair House. The collections, activity of which is shown in the following table and described more fully in the Other Accompanying Information section of this report, consist of items that were donated, purchased using donated or appropriated funds, or on loan from individuals, organizations and museums. The Department provides protection and preservation services to maintain all Heritage Assets in good condition forever as part of America's history.

HERITAGE ASSETS *(continued)*
For the Year Ended September 30, 2012

	Library Rare & Special Book Collection	Secretary of State's Register of Culturally Significant Property	U.S. Diplomacy Center	Blair House
Description	**Collectibles - Rare books and other publications of historic value**	**Noncollection - Buildings of historic, cultural, or architectural significance**	**Collectibles - Historic artifacts, art and other cultural objects**	**Collections of fine + decorative arts, furnishings, artifacts, other cultural objects, rare books + archival materials in national historic landmark buildings**
Acquisition and Withdrawal	Acquired through donation.	Acquired through purchase. Excess items are sold.	Acquired through donation or transfer. Excess items are transferred.	Acquired through purchase, donation or transfer. Excess items are transferred or disposed of via public sale.
Condition	Poor to good	Poor to excellent	Good to excellent	Good to excellent
Number of Assets - 9/30/2010	1,072	20		
Acquisitions			485	6
Adjustments	106		5,823[1]	2,011[1]
Disposals	178			
Number of Assets - 9/30/2011	1,000	20	6,308	2,017
Deferred Maintenance - 9/30/2011	N/A	$1,883,000	N/A	N/A
Acquisitions	40	5	527	9
Adjustments	32		(4,114)[1]	584[1]
Disposals	20		2	1
Number of Assets - 9/30/2012	1,052	25	2,719	2,609
Deferred Maintenance - 9/30/2012	N/A	$0	N/A	N/A

[1] *The adjustments line resulted from an effort to put all heritage assets in ILMS with a consistent counting methodology.*

8 ADVANCES, PREPAYMENTS, AND OTHER ASSETS

The Department's Other Assets include advances and prepayments in support of programs including HIV/AIDS, Global Health Programs, Diplomatic and Consular, and Overseas Buildings Operations plus salary/travel advances to employees and inventory. The Department's Other Assets as of September 30, 2012 and 2011, are summarized to the right *(dollars in millions)*.

	2012	2011
Intragovernmental Assets:		
Other Advances and Prepayments	$ 918	$ 1,065
Non-Intragovernmental Advances:		
Salary Advances	9	10
Travel Advances	13	13
Other Advances and Prepayments	608	318
Inventory	11	8
Total Other Assets	$ 1,559	$ 1,414

9 OTHER LIABILITIES

The Department's Other Liabilities at September 30, 2012 and 2011, are summarized below *(dollars in millions)*.

	2012			2011		
	Current	Non-Current	Total	Current	Non-Current	Total
Intragovernmental						
Deferred Revenue	$ 219	$ —	$ 219	$ 490	$ —	$ 490
Custodial Liability	87	—	87	83	—	83
Other Liabilities	42	—	42	39	—	39
Total Intragovernmental	348	—	348	612	—	612
Federal Employees Compensation Act Benefits	79	—	79	74	—	74
Capital Lease Liability	8	62	70	13	72	85
Accrued Salaries Payable	223	—	223	215	—	215
Contingent Liability	—	10	10	—	10	10
Pension Benefits Payable	58	—	58	55	—	55
Accrued Annual Leave	—	347	347	—	343	343
Funds Held in Trust and Deposit Accounts	—	15	15	—	15	15
Other Liabilities	153	—	153	230	—	230
Deferred Revenues	13	—	13	3	—	3
Subtotal	534	434	968	590	440	1,030
Total Other Liabilities	$ 882	$ 434	$ 1,316	$ 1,202	$ 440	$ 1,642

(continued on next page)

NOTE 9: Other Liabilities (continued)

The Department's liabilities are classified as covered by budgetary resources or not covered by budgetary resources. Liabilities not covered by budgetary resources result from the receipt of goods and services, or occurrence of eligible events in the current or prior periods, for which revenue or other funds to pay the liabilities have not been made available through appropriations or current earnings of the Department. The liabilities in this category at September 30, 2012 and 2011, are summarized to the right *(dollars in millions)*.

Liabilities Not Covered by Budgetary Resources	2012	2011 Restated
Intragovernmental Liabilities		
Unfunded FECA Liability	$ 20	$ 18
Custodial Liability	87	83
Total Intragovernmental Liabilities	107	101
International Organizations Liabilities	1,100	1,366
After-Employment Benefit Liability:		
Foreign Service Retirment Actuarial Liability	2,423	1,689
Foreign Service Nationals (FSN): Defined Contributions Fund	123	102
FSN: Defined Benefit Plans	106	141
FSN: Lump Sum Retirement and Voluntary Services	230	212
Total After-Employment Benefit Liability	2,882	2,144
Accrued Annual Leave	347	343
Contingent Liability	10	10
Other Liabilities	174	158
Total Liabilities Not Covered By Budgetary Resources	4,620	4,122
Total Liabilities Covered By Budgetary Resources	20,807	20,002
Total Liabilities	$ 25,427	$ 24,124

10 After-Employment Benefit Liability

The Department of State provides after-employment benefits to both Foreign Service Officers (FSOs) and Foreign Service Nationals (FSNs). FSOs participate in the Foreign Service Retirement and Disability pension plans. FSN employees participate in a variety of plans established by the Department in each country based upon prevailing compensation practices in the host country. The table below summarizes the liability associated with these plans *(dollars in millions)*.

For the Year Ended September 30,	2012	2011 Restated
Foreign Service Officer		
Foreign Service Retirement and Disability Fund	$ 19,434	$ 18,219
Foreign Service Nationals		
Defined Contributions Fund	123	102
Defined Benefit Plans	106	141
Lump Sum Retirement and Voluntary Severance	230	212
Total FSN	459	455
Total After-Employment Benefit Liability	$ 19,893	$ 18,674

Details for these plans are presented as follows.

FOREIGN SERVICE RETIREMENT AND DISABILITY FUND

The Foreign Service Retirement and Disability Fund finances the operations of the FSRDS and the FSPS. The FSRDS and the FSPS are defined-benefit, single-employer plans. FSRDS was originally established in 1924; FSPS in 1986. The FSRDS is a single-benefit retirement plan. Retirees receive a monthly annuity from FSRDS for the rest of their lives. FSPS provides benefits from three sources: a basic benefit (annuity) from FSPS, Social Security, and the Thrift Savings Plan.

The Department's financial statements present the Pension Actuarial Liability of the Foreign Service Retirement and Disability Program (the "Plan") as the actuarial present value of projected plan benefits, as required by SFFAS No. 33, *Pensions, Other Retirement Benefits, and other Post Employment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*. The Pension Actuarial Liability represents the future periodic payments provided for current employee and retired Plan participants, less the future employee and employing Federal agency contributions, stated in current dollars.

Future periodic payments include benefits expected to be paid to (1) retired or terminated employees or their beneficiaries; (2) beneficiaries of employees who have died; and (3) present employees or their beneficiaries, including refunds of employee contributions as specified by Plan provisions. Total projected service is used to determine eligibility for retirement benefits. The value of voluntary, involuntary, and deferred retirement benefits is based on projected service and assumed salary increases. The value of benefits for disabled employees or survivors of employees is determined by multiplying the benefit the employee or survivor would receive on the date of disability or death, by a ratio of service at the valuation date to projected service at the time of disability or death.

The Pension Actuarial Liability is calculated by applying actuarial assumptions to adjust the projected plan benefits to reflect the discounted time value of money and the probability of payment (by means of decrements such as death, disability, withdrawal or retirement) between the valuation date and the expected date of payment. The Plan uses the aggregate entry age normal actuarial cost method, whereby the present value of projected benefits for each employee is allocated on a level basis (such as a constant percentage of salary) over the employee's service between entry age and assumed exit age. The portion of the present value allocated to each year is referred to as the normal cost.

The table below presents the normal cost percentages for FY 2012 and FY 2011.

Normal Cost:	FY 2012	FY 2011
FSRDS	37.32%	35.86%
FSPS	31.15%	29.93%

Actuarial assumptions are based on the presumption that the Plan will continue. If the Plan terminates, different actuarial assumptions and other factors might be applicable for determining the actuarial present value of accumulated plan benefits. The following table presents the calculation of the combined FSRDS and FSPS Pension Actuarial Liability and the assumptions used in computing it for the year ended September 30, 2012 and 2011 *(dollars in millions)*.

For the Year Ended September 30,	2012	2011
Pension Actuarial Liability, Beginning of Year	$ 18,219	$ 17,504
Pension Expense:		
Normal Cost	498	452
Interest on Pension Liability	858	850
Actuarial (Gains) or Losses:		
From Experience	(53)	(196)
From Assumption Changes		
Interest Rate	742	357
Other Assumptions	46	87
Prior Year Service Costs	—	—
Other	(2)	(1)
Total Pension Expense	2,089	1,549
Less Payments to Beneficiaries	874	834
Pension Actuarial Liability, End of Year	19,434	18,219
Less: Net Assets Available for Benefits	17,011	16,530
Actuarial Pension Liability - Unfunded	$ 2,423	$ 1,689
Actuarial Assumptions:		
Rate of Return on Investments	4.45%	4.76%
Rate of Inflation	2.46%	2.40%
Salary Increase	2.71%	3.15%

Net Assets Available for Benefits at September 30, 2012 and 2011, consist of the following *(dollars in millions)*:

At September 30,	2012	2011
Fund Balance with Treasury	$ —	$ —
Accounts and Interest Receivable	190	202
Investments in U.S. Government Securities	16,893	16,397
Total Assets	17,083	16,599
Less: Liabilities Other Than Actuarial	72	69
Net Assets Available for Benefits	$ 17,011	$ 16,530

FOREIGN SERVICE NATIONALS' AFTER-EMPLOYMENT BENEFIT LIABILITIES

The Department of State operates overseas in over 170 countries and employs a significant number of local nationals, currently over 46,000, known as Foreign Service Nationals (FSNs).

FSNs do not qualify for any Federal civilian benefits (and therefore cannot participate) in any of the Federal civilian pension systems (e.g., Civil Service Retirement System

(CSRS), Foreign Service Retirement and Disability System (FSRDS), Thrift Savings Plan (TSP), etc.). By statute, the Department is required to establish compensation plans for FSNs in its employ in foreign countries. The plans are based upon prevailing wage and compensation practices in the locality of employment, unless the Department makes a public interest determination to do otherwise. In general, the Department follows host country (i.e., local) practices and conventions in compensating FSNs. The end result of this is that compensation for FSNs is often not in accord with what would otherwise be offered or required by statute and regulations for Federal civilian employees.

In each country, FSN after-employment benefits are included in the Post's Local Compensation Plan. Depending on the local practice, the Department offers defined benefit plans, defined contribution plans, and retirement and voluntary severance lump sum payment plans. These plans are typically in addition to or in lieu of participating in the host country's local social security system (LSSS). These benefits form an important part of the Department's total compensation and benefits program that is designed to attract and retain highly skilled and talented FSN employees.

As discussed in Note 1, the Department changed the Accounting Principle it follows to account for FSN's after-employment benefits. In FY 2012, the Department accounts for these plans under guidance contained in International Accounting Standard (IAS) No.19, *Employee Benefits*, that the Department determined provides a better structure for the reporting of these plans established in accordance with local practices in countries overseas.

FSN Defined Contributions Fund (FSN DCF)

The Department's FSN Defined Contributions Fund provides retirement benefits for FSN employees in countries where the Department has made a public interest determination to discontinue participation in the Local Social Security System (LSSS). Title 22, Foreign Relations and Intercourse, Section 3968, Local Compensation Plans, provides the authority to the Department to establish such benefits and identifies as part of a total compensation plan for these employees. The Department pays to the Fund 12 percent of each participant's salary. Participants are not allowed to make contributions to the Fund. The amount of after-employment benefit received by the employee is determined by the amount of the contributions made by the Department together with investment returns from the contributions. The Department's obligation is determined by the amounts to be contributed for the period, and no actuarial assumptions are required to measure the obligation or the expense. The FSN DCF is administered by a third party who invests contributions and funds in U.S. Treasury securities on behalf of the Department. Payroll contributions are sent to the third party administrator, while separation and retirement benefits are processed by the Department upon receipt of funds from the third party. As of September 30, 2012, approximately 12,000 FSNs in 29 countries participate in such plans.

The Department records expense for contributions to the FSN DCF when the employee renders service to the Department, coinciding with the cash contributions to the FSN DCF. Total contributions by the Department in FY 2012 and FY 2011 were $26.9 million and $22.9 million, respectively. Total liability reported for the FSN DCF is $123 million and $102 million as of September 30, 2012 and 2011, respectively.

Local Defined Contribution Plans

In 39 countries, the Department has implemented various local arrangements, primarily with third party providers, for defined contribution plans for the benefit of FSNs. Total contributions to these plans by the Department in FY 2012 and FY 2011 were $18.3 million and $17.5 million, respectively.

Defined Benefit Plans

In 12 countries, involving over 3,200 FSNs, the Department has implemented various arrangements for defined benefit pension plans for the benefit of FSNs. Some of these plans supplement the host country's equivalent to U.S. social security, others do not. While none of these supplemental plans is mandated by the host country, some are substitutes for optional tiers of a host country's social security system. Such arrangements include (but not limited to) conventional defined benefit plans with assets held in the name of trustees of the plan who engage plan administrators, investment advisors and actuaries, and plans offered by insurance companies at predetermined rates or with annual adjustments to premiums. The Department deposits funds under various fiduciary-type arrangements, purchases annuities under group insurance contracts or provides reserves to these plans. Benefits under the defined benefit plans are typically based either on years of service and/or the employee's compensation (generally during a fixed number of years immediately before retirement). The range of assumptions that are used for the defined benefit plans reflect the different economic and regulatory environments within the various countries.

As discussed in Note 1, the Department changed the Accounting Principle it follows to account for the FSN Defined Benefit Plans. In FY 2012, the Department accounted for these plans under guidance contained in International Accounting Standard (IAS) No. 19, *Employee Benefits*. In accordance with IAS No. 19, the Department reported the net defined benefit liability of $106 million and $141 million as of September 30, 2012 and 2011, respectively, as an After-Employment Liability in the Consolidated Balance Sheet. As detailed below, the net defined benefit liability is comprised of the present value of the defined benefit obligation less the fair value of plan assets. The Department recognizes the change in the net defined benefit liability for its FSN defined benefit plans on the Consolidated Statement of Net Cost as Actuarial Loss (Gain) on Pension Assumption Changes under the Executive Direction and Other Costs Not Assigned. The change was a decrease of $34.9 million in FY 2012 and an increase of $62.5 million in FY 2011.

The material FSN defined benefit plans include plans in Germany and the United Kingdom (UK) which represent 76 percent of total assets, 86 percent of total projected benefit obligations, and virtually 100 percent of net defined benefit liability at September 30, 2012. The Germany Plan's most recent evaluation report, dated September 5, 2012, is as of August 31, 2012. The UK Plan's most recent evaluation, dated October 23, 2012, is as of April 6, 2012. The cost method used for the valuation of the liabilities associated with these plans is the Projected Unit Credit (PUC) actuarial cost method. For the Germany Plan, the change in the net defined benefit liability was a decrease of $3.7 million in FY 2012 and an increase of $49.2 million in FY 2011, while for the UK Plan, the change was a decrease of $21.9 million in FY 2012 and an increase of $16.5 million in FY 2011. For FY 2011, the increases in the net defined benefit liability were primarily due to actuarial losses on assumption changes for investment return rates going from ranges of 5% - 7% to 4% - 5.8%. The decrease in FY 2012 was due to a one-time employer deficit funding contribution of $54 million for the UK Plan. Adjustments from the date of the evaluations to September 30, 2012 were determined not to be necessary.

The tables below show the changes in the projected benefit obligation and plan assets during FY 2012 and FY 2011 for the Germany and UK plans *(dollars in millions)*.

Change in Benefit Obligations:	**2012**	**2011**
Benefit obligation beginning of year	$ 288	$ 208
Service Cost	2	2
Interest Cost	8	8
Actuarial (gain) loss on assumption change	5	73
Other actuarial (gain) loss	(2)	—
Value of New Benefit	12	—
Other	$ (2)	$ (1)
Benefit obligation end of year	$ 311	$ 290

Change in Plan Assets:	**2012**	**2011**
Fair value of plan assets beginning of year	$ 147	$ 122
Return on plan assets	3	4
Contributions less Benefits Paid	43	19
Other	1	2
Fair value of plan assets end of year	194	147
Net Defined Benefit Liability	$ 117	$ 143

The table below shows the allocation of plan assets by category during FY 2012 and 2011 for the German and UK plans.

	2012	**2011**
Insurance Policies	31%	43%
Equity Securities	31%	37%
Money Market and Cash	15%	3%
Debt Securities	14%	10%
Mixed (Debt & Equity Securities)	8%	5%
Property	1%	2%
Total	100%	100%

The principal actuarial assumptions used for 2012 and 2011 for the Germany and UK plans are presented below:

Actuarial Assumptions:	2012	2011
Discount Rate	4.00 – 5.87%	4.00 – 5.80%
Salary Increase Rate	2.25 – 5.40%	2.25 – 5.10%
Pension Increase Rate	2.00 – 3.47%	2.00 – 3.10%

Retirement and Voluntary Severance Lump Sum Payments

In over 70 countries, FSN employees are provided a lump-sum separation payment when they resign, retire, or otherwise separate through no fault of their own. The amount of the payment is generally based on length of service, rate of pay at the time of separation, and the type of separation. As of September 30, 2012, approximately 23,000 FSN's participate in such plans.

The cost method used for the valuation of the liabilities associated with these plans is the Projected Unit Credit (PUC) actuarial cost method. The participant's benefit is first determined using both their projected service and salary at the retirement date. The projected benefit is then multiplied by the ratio of current service to projected service at retirement in order to determine an allocated benefit. The Projected Benefit Obligation (PBO) for the entire plan is calculated as the sum of the individual PBO amounts for each active member. Further, this calculation, requires certain actuarial assumptions be made, such as voluntary withdraws, assumed retirement age, death and disability, as well as economic assumptions. For economic assumptions, available market data was scarce for many of the countries where eligible posts are located. Due to the lack of creditable global market data, an approach consistent with that used for the September 30, 2012 FSRDF valuations under SFFAS No. 33 was adopted. Using this approach, the economic assumptions used for the Retirement and Voluntary Severance Lump Sum Payment liability as of September 30, 2012 and September 30, 2011 are:

	2012	2011
Discount Rate	4.03%	4.36%
Rate of inflation	2.46%	2.40%
Salary Increase	2.71%	2.65%

Based upon the projection, the total liability reported for the Retirement and Voluntary Severance Lump Sum Payment is $230 million and $212 million as of September 30, 2012 and 2011, respectively, as shown below *(dollars in millions)*:

At September 30,	2012	2011 Restated
Retirement	$ 73	$ 66
Voluntary Severance	157	146
Total	$ 230	$ 212

11 International Organizations Liabilities

The United States is a member of the United Nations (UN) and other international organizations and supports UN peacekeeping operations. As such, the United States contributes an assessed share of the budgets and expenses of these organizations and activities. These payments are funded through congressional appropriations to the Department of State's Contributions to International Organizations (CIO) and Contributions for International Peacekeeping Activities (CIPA) Accounts. The purpose of these appropriations is to ensure continued American leadership within those organizations and activities that serve important U.S. interests. Within the Department, the Bureau of International Organizations (IO) develops and implements U.S. policy in the UN, international organizations, and UN peacekeeping operations.

Funding by appropriations for dues assessed for certain international organizations is not received until the fiscal year following assessment. These financial commitments are regarded as funded only when monies are authorized and appropriated by Congress. For financial reporting purposes, the amounts assessed but unfunded are reported as liabilities of the Department, since authorization for payment is expected. In some cases, Congress in the past has mandated withholding of dues payments because of policy restrictions or caps on the percentage of the organization's operating costs financed by the United States. Without authorization from Congress, the Department cannot pay certain arrears in dues. The amounts assessed that will likely not be authorized to be paid do not appear as liabilities on the Balance Sheet of the Department.

IO also provides support to international organizations through the Department's International Organizations and Programs (IO&P) Account. For this support, a payable exists when a pledge, generally considered a voluntary contribution, to an international organization has been accepted by the recipient organization inclusive of restrictions denoted by the U.S. Government.

Amounts presented in this Note represent amounts that are paid through the CIO, CIPA and IO&P Accounts and administered by IO. Payables to international organizations by the Department that are funded through other appropriations are included in Accounts Payable to the extent such payables exist at September 30, 2012 and 2011.

Further information about the Department's mission to the UN is at *www.usunnewyork.usmission.gov*. Details of the IO Liabilities follow *(dollars in millions)*:

As of September 30,	2012	2011
Regular Membership Assessments Payable to UN	$ 744	$ 757
Dues Payable to UN Peacekeeping Missions	353	433
International Organization Liabilities	1,043	1,107
	2,140	2,297
Less Amounts not Authorized to be Paid	715	639
International Organization Liabilities	$ 1,425	$ 1,658
Funded Amounts	$ 325	$ 292
Unfunded Amounts	1,100	1,366
Total International Organization Liabilities	$ 1,425	$ 1,658

12 Leases

The Department is committed to over 9,000 leases, which cover office and functional properties, and residential units at diplomatic missions overseas. The majority of these leases are short-term operating leases. In most cases, management expects that the leases will be renewed or replaced by other leases. Personnel from other U.S. Government agencies occupy some of the leased facilities (both residential and non-residential). These agencies reimburse the Department for the use of the properties. Reimbursements are received for approximately $87 million of the lease costs.

CAPITAL LEASES

The Department has various leases for overseas real property that meet the criteria for a capital lease in accordance with SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. Assets that meet the definition of a capital lease and their related lease liability are initially recorded at the present value of the future minimum lease payments or fair market value, whichever is lower. In general, capital leases are depreciated over the estimated useful life or lease term depending on which capitalization criteria the capital leases meet at inception. The related liability is amortized over the term of the lease, which can result in a different value in the asset versus the liability.

The following is a summary of Net Assets under Capital Leases and Future Minimum Lease payments as of September 30, 2012 and 2011 *(dollars in millions)*. Lease liabilities are not covered by budgetary resources.

	2012	2011
Net Assets Under Capital Leases:		
Land and Buildings	$ 79	$ 108
Accumulated Depreciation	(29)	(52)
Net Assets under Capital Leases	$ 50	$ 56

Future Minimum Lease Payments:

2012

Fiscal Year	Lease Payments
2013	$ 8
2014	8
2015	8
2016	8
2017	8
2018 and thereafter	156
Total Minimum Lease Payments	196
Less: Amount Representing Interest	(126)
Obligations under Capital Leases	$ 70

2011

Fiscal Year	Lease Payments	
2012	$	13
2013		13
2014		12
2015		10
2016		8
2017 and thereafter		159
Total Minimum Lease Payments		215
Less: Amount Representing Interest		(130)
Obligations under Capital Leases	$	85

OPERATING LEASES

The Department leases real property in overseas locations under operating leases. These leases expire in various years. Minimum future rental payments under operating leases have remaining terms in excess of 1 year as of September 30, 2012 and 2011 for each of the next 5 years and in aggregate are as follows *(dollars in millions)*:

Year Ended September 30, 2012	Operating Lease Amounts	
2013	$	487
2014		372
2015		268
2016		146
2017		93
2018 and thereafter		225
Total Minimum Future Lease Payments	$	1,591

Year Ended September 30, 2011	Operating Lease Amounts	
2012	$	418
2013		303
2014		205
2015		132
2016		88
2017 and thereafter		221
Total Minimum Future Lease Payments	$	1,367

13 CONTINGENCIES AND COMMITMENTS

CONTINGENCIES

The Department is a party in various material legal matters (litigation, claims, assessments, including pending or threatened litigation, unasserted claims, and claims that may derive from treaties or international agreements) brought against it. We periodically review these matters pending against us. As a result of these reviews, we classify and adjust our contingent liability when we think it is probable that there will be an unfavorable outcome and when a reasonable estimate of the amount can be made.

Additionally, as part of our continuing evaluation of estimates required in the preparation of our financial statements, we evaluated the materiality of cases determined to have a reasonably possible chance of an adverse outcome. These cases involve contract disputes, claims related to embassy construction, Equal Employment Opportunity Commission claims, and international claims made against the United States being litigated by the Department. As a result of these reviews, the Department believes these claims could result in potential estimable losses of $10 to $67 million if the outcomes were adverse to the Department; these amounts are considered by management to be immaterial to our financial statements taken as a whole.

Certain legal matters to which the Department is a party are administered and, in some instances, litigated and paid by other U.S. Government agencies. Generally, amounts to be paid under any decision, settlement, or award pertaining to these legal matters are funded from the Judgment Fund.

None of the amounts paid under the Judgment Fund on behalf of the Department in 2012 and 2011 had a material effect on the financial position or results of operations of the Department.

As a part of our continuing evaluation of estimates required for the preparation of our financial statements, we recognize settlements of claims and lawsuits and revised other

estimates in our contingent liabilities. Management and the Legal Adviser believe we have made adequate provision for the amounts that may become due under the suits, claims, and proceedings we have discussed here.

COMMITMENTS

In addition to the future lease commitments discussed in Note 12, *Leases*, the Department is committed under obligations for goods and services which have been ordered but not yet received at fiscal year end. These are termed undelivered orders – see Note 16, *Statement of Budgetary Resources*.

Rewards Programs: The Department operates three rewards programs for information that have been critical to combating international terrorism, narcotics trafficking, and war crimes for over 20 years. The Rewards for Justice Program offers and pays rewards for information leading to the arrest or conviction in any country of persons responsible for acts of international terrorism against United States persons or property, or to the location of key terrorist leaders. See further details at *www.rewardsforjustice.net*. The Narcotics Rewards Program has the authority under 22 U.S.C. 2708 to offer rewards for information leading to the arrest or conviction in any country of persons committing major foreign violations of U.S. narcotics laws or the killing or kidnapping of U.S. narcotics law enforcement officers or their family members. The War Crimes Information Rewards Program offers rewards for information leading to the arrest, transfer, or conviction of persons indicted by a judge of the International Criminal Tribunal for the former Yugoslavia, the International Criminal Tribunal for Rwanda, or the Special Court of Sierra Leone for serious violations of international humanitarian law. Pending reward offers under the three programs total $723 million. Under the programs, we have paid out $175 million since FY 2003. Reward payments are funded with current year appropriations as necessary and, in the opinion of management and legal counsel, no further contingent liability is required because probable payments will not materially affect the financial position or results of operations of the Department.

14 EARMARKED FUNDS

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and accounted for separately from the Government's general revenues. See Note 4 *Investments* for further information on investments in U.S. Treasury securities for earmarked funds. There are no intradepartmental transactions between the various earmarked funds.

The Department administers fourteen earmarked funds as listed on the next page. A brief description of the individually reported earmarked funds and their purposes follows.

Treasury Fund Symbol	Description	Statute
19X5497	Foreign Service National Defined Contributions Fund	22 USC 3968(a)(1)
19X5515	H1-B and L Visas Fraud Detection and Prevention	118 Stat. 3357
19X8166	American Studies Endowment Fund	108 Stat. 425
19X8167	Trust Funds	22 USC 1479
19X8186	Foreign Service Retirement and Disability Fund	22 USC 4042-4065
19X8271	Israeli-Arab Scholarship Programs	105 Stat. 696, 697
19X8272	Eastern Europe Student Exchange Endowment Fund	105 Stat. 699
19X8340	Foreign Service National Separation Liability Trust Fund	105 Stat. 672
19X8341	Foreign Service National Separation Liability Trust Fund	105 Stat. 672
19X8812	Gifts and Bequests, National Commission on Educational, Scientific, and Cultural Cooperation	22 USC 287q
19X8813	Center for Middle Eastern-Western Dialogue Trust Fund	118 Stat. 84
19X8821	Unconditional Gift Fund	22 USC 809, 1046
19X8822	Conditional Gift Fund	22 809, 1046
95X8276	Eisenhower Exchange Fellowship Program Trust Fund	PL 101-454

FOREIGN SERVICE RETIREMENT AND DISABILITY FUND (19X8186)

The Foreign Service Retirement and Disability Fund (FSRDF) was established in 1924 to provide pensions to retired and disabled members of the Foreign Service. The FSRDF's revenues consist of contributions from active participants and their U.S. Government agency employers; appropriations; and interest on investments. Monthly annuity payments are made to eligible retired employees or their survivors. Separated employees without title to an annuity may take a refund of their contributions. Public Law No. 96-465 limits the amount of administrative expense that can be charged to the fund to $5,000. Cash is invested in U.S. Treasury securities until it is needed for disbursement.

FOREIGN SERVICE NATIONAL SEPARATION LIABILITY TRUST FUNDS (FSNSLTF) (19X8340 AND 19X8341)

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

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

The VFDPF are supported by fees paid by employers applying for foreign workers under the American Competitiveness and Workforce Improvement Act of 1998 (Public Law No. 105-277) and the Global War on Terrorism and Tsunami Relief Act, 2005 (Public Law No. 109-13). Section 426 of the Consolidated Appropriations Act, 2005 (Public Law No. 108-447), authorizes one-third of the fees collected for H-1B, L, and H-2B visa applications to be available to the Department of State for fraud prevention and detection activities. These fees help finance the Department's Border Security Program.

CONDITIONAL AND UNCONDITIONAL GIFT FUNDS (19X8821 AND 19X8822)

The Department maintains two Trust Funds for receiving and disbursing donations. It is authorized to accept gifts from private organizations and individuals in the form of cash, gifts-in-kind, and securities. Gifts are classified as Restricted or Unrestricted Gifts.

Restricted Gifts must be used in the manner specified by the donor. Unrestricted Gifts can be used for any expense normally covered by an appropriation, such as representational purposes or embassy refurbishment.

(continued on next page)

NOTE 14: Earmarked Funds (continued)

Condensed Financial Information for Earmarked Funds *(dollars in millions)*	**FSRDF**	**FSNSLTF**	**VFDPF**	**GIFT**	**All Other Earmarked**	**Total Amt Earmarked Funds**
Balance Sheet As of September 30, 2012:						
Assets:						
Fund Balances with Treasury	$ —	$ 290	$ 114	$ 31	$ 4	$ 439
Investments	16,893	—	—	8	27	16,928
Taxes and Interest Receivable	170	—	—	—	—	170
Other Assets	20	—	—	98	122	240
Total Assets	**$ 17,083**	**$ 290**	**$ 114**	**$ 137**	**$ 153**	**$ 17,777**
Liabilities:						
Actuarial Liability	$ 19,434	$ 220	$ —	$ —	$ —	$ 19,654
Other Liabilities	72	—	—	—	123	195
Total Liabilities	**$ 19,506**	**$ 220**	**$ —**	**$ —**	**$ 123**	**$ 19,849**
Net Position:						
Unexpended Appropriations	—	—	—	—	—	—
Cumulative Results of Operations	(2,423)	70	114	137	30	(2,072)
Total Liabilities and Net Position	**$ 17,083**	**$ 290**	**$ 114**	**$ 137**	**$ 153**	**$ 17,777**
Statement of Net Cost for the Year Ended September 30, 2012:						
Gross Program Costs	$ —	$ 39	$ 37	$ 13	$ 1	$ 90
Less: Earned Revenues	1,355	47	—	—	27	1,429
Net Program Costs	(1,355)	(8)	37	13	(26)	(1,339)
Costs Not Attributable to Program Costs	2,089	—	—	—	27	2,116
Less Earned Revenues Not Attributable to Program Costs	—	—	—	—	—	—
Net Cost of Operations	**$ 734**	**$ (8)**	**$ 37**	**$ 13**	**$ 1**	**$ 777**
Statement of Changes in Net Position for the Year Ended September 30, 2012:						
Net Position Beginning of Period	$ (1,689)	$ 61	$ 106	$ 131	$ 32	$ (1,359)
Budgetary Financing Sources	—	—	—	—	—	—
Other Financing Sources	—	—	45	19	—	64
Net Cost of Operations	(734)	8	(37)	(13)	(1)	(777)
Taxes and Other Nonexchange Revenue	—	—	—	—	—	—
Change in Net Position	(734)	8	8	6	(1)	(713)
Net Position End of Period	**$ (2,423)**	**$ 69**	**$ 114**	**$ 137**	**$ 31**	**$ (2,072)**

(continued on next page)

NOTE 14: Earmarked Funds (continued)

Condensed Financial Information for Earmarked Funds *(dollars in millions)*	**FSRDF**	**FSNSLTF**	**VFDPF**	**GIFT**	**All Other Earmarked**	**Total Amt Earmarked Funds**
Balance Sheet As of September 30, 2011:						
Assets:						
Fund Balances with Treasury	$ —	$ 264	$ 106	$ 25	$ 3	$ 398
Investments	16,397	—	—	8	28	16,433
Taxes and Interest Receivable	181	—	—	—	—	181
Other Assets	21	—	—	98	103	222
Total Assets	**$ 16,599**	**$ 264**	**$ 106**	**$ 131**	**$ 134**	**$ 17,234**
Liabilities:						
Actuarial Liability	$ 18,219	$ 203	$ —	$ —	$ —	$ 18,422
Other Liabilities	69	—	—	—	102	171
Total Liabilities	**$ 18,288**	**$ 203**	**$ —**	**$ —**	**$ 102**	**$ 18,593**
Net Position:						
Unexpended Appropriations	—	—	—	—	—	—
Cumulative Results of Operations	(1,689)	61	106	131	32	(1,359)
Total Liabilities and Net Position	**$ 16,599**	**$ 264**	**$ 106**	**$ 131**	**$ 134**	**$ 17,234**
Statement of Net Cost for the Year Ended September 30, 2011:						
Gross Program Costs	$ —	$ 17	$ 34	$ 10	$ 25	$ 86
Less: Earned Revenues	1,367	81	—	—	24	1,472
Net Program Costs	(1,367)	(64)	34	10	1	(1,386)
Costs Not Attributable to Program Costs	1,549	3	—	—	—	1,552
Less Earned Revenues Not Attributable to Program Costs	—	—	—	—	—	—
Net Cost of Operations	**$ 182**	**$ (61)**	**$ 34**	**$ 10**	**$ 1**	**$ 166**
Statement of Changes in Net Position for the Year Ended September 30, 2011:						
Net Position Beginning of Period	$ (1,507)	$ —	$ 223	$ 121	$ 32	$ (1,131)
Budgetary Financing Sources	—	—	(83)	20	1	(62)
Net Cost of Operations	(182)	61	(34)	(10)	(1)	(166)
Taxes and Other Nonexchange Revenue	—	—	—	—	—	—
Change in Net Position	(182)	61	(117)	10	—	(228)
Net Position End of Period	**$ (1,689)**	**$ 61**	**$ 106**	**$ 131**	**$ 32**	**$ (1,359)**

15 Statement of Net Cost

The Consolidated Statement of Net Cost reports the Department's gross cost and net cost for its 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 execute a mission or major line of activity, and whose managers report directly to top management. For the Department, a bureau

CONSOLIDATING SCHEDULE OF NET COST

For the Year Ended September 30, 2012
(dollars in millions)

	Under Secretary for							
STRATEGIC GOAL	**Arms Control, Int'l Security**	**Economic Growth, Energy and Environment**	**Civilian Security, Democracy and Human Rights**	**Political Affairs**	**Public Diplomacy and Public Affairs**	**Management-Consular Affairs**	**Intra-Departmental Eliminations**	**Total**
Achieving Peace and Security								
Total Cost	$ 764	$ 40	$ 2,729	$ 6,413	$ 57	$ 1	$ (830)	$ 9,174
Earned Revenue	(205)	(9)	(402)	(1,114)	(2)	—	830	(902)
Net Program Costs	559	31	2,327	5,299	55	1	—	8,272
Governing Justly and Democratically								
Total Cost	111	6	38	788	1	—	(112)	832
Earned Revenue	(35)	(1)	(8)	(178)	—	—	112	(110)
Net Program Costs	76	5	30	610	1	—	—	722
Investing in People								
Total Cost	1,418	76	388	5,950	—	1	(66)	7,767
Earned Revenue	(16)	(1)	(4)	(101)	—	—	66	(56)
Net Program Costs	1,402	75	384	5,849	—	1	—	7,711
Promoting Economic Growth and Prosperity								
Total Cost	181	10	59	1,165	—	—	(186)	1,229
Earned Revenue	(58)	(2)	(13)	(294)	—	—	186	(181)
Net Program Costs	123	8	46	871	—	—	—	1,048
Providing Humanitarian Assistance								
Total Cost	—	—	1,627	6	4	—	(18)	1,619
Earned Revenue	—	—	(17)	(1)	—	—	18	—
Net Program Costs	—	—	1,610	5	4	—	—	1,619
Promoting International Understanding								
Total Cost	214	12	57	842	1,014	—	(196)	1,943
Earned Revenue	(70)	(3)	(15)	(322)	(120)	—	196	(334)
Net Program Costs	144	9	42	520	894	—	—	1,609
Strengthening Consular and Management Capabilities								
Total Cost	—	—	1	2,908	555	3,744	(1,322)	5,886
Earned Revenue	—	—	—	(920)	(123)	(3,897)	1,322	(3,618)
Net Program Costs	—	—	1	1,988	432	(153)	—	2,268
Executive Direction and Other Costs Not Assigned								
Total Cost	5	6	140	6,574	765	4	(3,514)	3,980
Earned Revenue	(4)	(4)	(87)	(4,359)	(499)	(2)	3,412	(1,543)
Net Program Costs before Assumption Changes	1	2	53	2,215	266	2	(102)	2,437
Actuarial Loss on Pension Assumption Changes	1	1	14	675	79	—	—	770
Net Program Costs	2	3	67	2,890	345	2	(102)	3,207
Total Cost	2,694	151	5,053	25,321	2,475	3,750	(6,244)	33,200
Total Revenue	(388)	(20)	(546)	(7,289)	(744)	(3,899)	6,142	(6,744)
Total Net Cost	$ 2,306	$ 131	$ 4,507	$ 18,032	$ 1,731	$ (149)	$ (102)	$ 26,456

(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).

Certain Fiscal Year 2011 amounts in the Consolidated Statement of Net Cost have been reclassified to conform to the Fiscal Year 2012 presentation.

The presentation of program results by 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 strategic goals and strategic priorities are defined in the Management's Discussion and Analysis section of this Report.

Executive Direction and Other Costs Not Assigned relate to high-level executive direction (e.g., Office of the Secretary, Office of the Legal Adviser), international commissions, general management, and certain administrative support costs that cannot be directly traced or reasonably allocated to a particular program. For the years ended September 30, 2012 and 2011, these consist of costs and earned revenue summarized below *(dollars in millions)*:

	2012			2011 Restated		
Program	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**
Costs:						
Executive Direction & Other	$ 3,809	$ 1,148	$ 2,661	$ 3,572	$ 775	$ 2,797
FSRDF	1,301	565	736	1,105	547	558
ICASS	2,244	1,800	444	1,948	1,456	492
International Commissions	140	1	139	142	1	141
Total Costs	7,494	3,514	3,980	6,767	2,779	3,988
Earned Revenue:						
Executive Direction & Other	1,137	1,046	91	946	673	273
FSRDF	1,355	565	790	1,367	547	820
ICASS	2,449	1,800	649	2,079	1,456	623
International Commissions	14	1	13	18	1	17
Total Earned Revenue	4,955	3,412	1,543	4,410	2,677	1,733
Actuarial Loss on Pension Assumption Changes	770	—	770	421	—	421
Total Net Cost for Executive Direction and Other Costs Not Assigned	$ 3,309	$ 102	$ 3,207	$ 2,778	$ 102	$ 2,676

PROGRAM COSTS

These costs include the full cost of resources consumed by a program, both direct and indirect, to carry out its activities. Direct costs can be specifically identified with a program. Indirect costs include resources that are commonly used to support two or more programs and are not specifically identified with any program. Indirect costs are assigned to programs through allocations. Full costs also include the costs of goods or services received from other Federal entities (referred to as inter-entity costs) regardless of whether the Department reimburses that entity.

Indirect Costs: Indirect costs consist primarily of Strengthening Consular and Management Capabilities charges for central support functions performed in 2012 and 2011 under the Under Secretary for Management by the following organizations *(dollars in millions)*:

Bureau (or equivalent)	**2012**	**2011**
Bureau of Diplomatic Security	$ 3,611	$ 2,576
Office of Overseas Buildings Operations	1,627	1,402
Bureau of Administration	1,172	979
Bureau of the Comptroller and Global Financial Services	988	639
Bureau of Personnel	681	617
Bureau of Information Resource Management	580	1,076
Foreign Service Institute	221	225
Medical Services and Other	103	122
Total Central Support Costs	$ 8,983	$ 7,636

These support costs were distributed to programs on the basis of a program's total base salaries for its full-time employees, as a percentage of total base salaries for all full-time employees, except for the Office of Overseas Buildings Operations. Since the Office of Overseas Buildings Operations supports overseas operations, its costs were allocated based on the percentage of budgeted cost by program for the regional bureaus. The distribution of support costs to programs in 2012 and 2011 was as follows *(dollars in millions)*:

Program Receiving Allocation	2012	2011
Achieving Peace and Security	$ 1,965	$ 1,823
Governing Justly and Democratically	314	296
Investing in People	179	163
Promoting Economic Growth and Prosperity	519	489
Providing Humanitarian Assistance	35	2
Promoting International Understanding	562	538
Strengthening Consular and Management Capabilities	3,112	2,303
Executive Direction and Other Costs Not Assigned	2,297	2,022
Total	$ 8,983	$ 7,636

Since the costs incurred by the Under Secretary for Management and the Secretariat are primarily support costs, these costs were distributed to the other Under Secretaries to show the full costs under the responsibility segments that have direct control over the Department's programs. One exception within the Under Secretary for Management is the Bureau of Consular Affairs, which is responsible for the American Citizens program. As a result, these costs were not allocated and continue to be reported as the Under Secretary for Management.

The Under Secretary for Management/Secretariat costs (except for the Bureau of Consular Affairs) were allocated to the other Department responsibility segments based on the percentage of total costs by organization for each program. The allocation of these costs to the other Under Secretaries and to the Bureau of Consular Affairs in 2012 and 2011 was as follows *(dollars in millions)*:

Under Secretary	2012	2011
Political Affairs	$ 14,837	$ 12,177
Management (Consular Affairs)	2,015	2,032
Public Diplomacy	1,667	1,516
Arms Control, International Security Affairs	1,968	1,385
Civilian Security, Democracy and Human Rights	712	585
Economic Growth, Energy and Environment	112	87
Total	$ 21,311	$ 17,782

Inter-Entity Costs and Imputed Financing: To measure the full cost of activities, SFFAS No. 4, *Managerial Cost Accounting*, requires that total costs of programs include costs that are paid by other U.S. Government entities, if material. As provided by SFFAS No. 4, OMB issued a Memorandum in April 1998, entitled "Technical Guidance on the Implementation of Managerial Cost Accounting Standards for the Government." In that Memorandum, OMB established that reporting entities should recognize inter-entity costs for (1) employees' pension benefits; (2) health insurance, life insurance, and other benefits for retired employees; (3) other post-retirement benefits for retired, terminated and inactive employees, including severance payments, training and counseling, continued health care, and unemployment and workers' compensation under the Federal Employees' Compensation Act; and (4) payments made in litigation proceedings.

The Department recognizes an imputed financing source on the Statement of Changes in Net Position for the value of inter-entity costs paid by other U.S. Government entities. This consists of all inter-entity amounts as reported below, except for the Federal Workers' Compensation Benefits (FWCB). For FWCB, the Department recognizes its share of the change in the actuarial liability for FWCB as determined by the Department of Labor (DOL). The Department reimburses DOL for FWCB paid to current and former Department employees.

The following inter-entity costs and imputed financing sources were recognized in the Statement of Net Cost and Statement of Changes in Net Position, for the years ended September 30, 2012 and 2011 *(dollars in millions)*:

Inter-Entity Cost	2012	2011
Other Post-Employment Benefits:		
Civil Service Retirement Program	$ 33	$ 39
Federal Employees Health Benefits Program	126	125
Federal Employees Group Life Insurance Program	1	2
Litigation funded by Treasury Judgment Fund	—	—
Subtotal – Imputed Financing Source	160	166
Future Workers' Compensation Benefits	16	15
Total Inter-Entity Costs	$ 176	$ 181

Intra-departmental Eliminations: Intra-departmental eliminations of cost and revenue were recorded against the program that provided the service. Therefore, the full program cost was reported by leaving the reporting of cost with the program that received the service.

EARNED REVENUES

Earned revenues occur when the Department provides goods or services to the public or another Federal entity. Earned revenues are reported regardless of whether the Department is permitted to retain all or part of the revenue. Specifically, the Department collects, but does not retain passport, visa, and certain other consular fees. Earned revenues for the years ended September 30, 2012 and 2011, consist of the following *(dollars in millions)*:

	2012			2011		
Program	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**	**Total Prior to Eliminations**	**Intra-Departmental Eliminations**	**Total**
Consular Fees:						
Passport, Visa and Other Consular Fees	$ 705	$ —	$ 705	$ 858	$ —	$ 858
Machine Readable Visa	1,473	—	1,473	1,273	—	1,273
Expedited Passport	164	—	164	163	—	163
Passport, Visa and Other Surcharges	768	—	768	757	—	757
Fingerprint Processing, Diversity Lottery, and Affadavit of Support	16	—	16	28	—	28
Subtotal – Consular Fees	3,126	—	3,126	3,079	—	3,079
FSRDF	1,355	565	790	1,367	547	820
ICASS	2,449	1,800	649	2,079	1,456	623
Other Reimbursable Agreements	4,631	2,743	1,888	3,948	1,897	2,051
Working Capital Fund	1,055	959	96	784	658	126
Other	270	75	195	159	23	136
Total	$ 12,886	$ 6,142	$ 6,744	$ 11,416	$ 4,581	$ 6,835

PRICING POLICIES

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

The FSRDF finances the operations of the Foreign Service Retirement and Disability System (FSRDS) and the Foreign Service Pension System (FSPS). The FSRDF receives revenue from employee/employer contributions, a U.S. Government contribution, and interest on investments. By law, FSRDS participants contribute 7.25 percent of their base salary, and each employing agency contributes 7.25 percent; FSPS participants contribute 1.35 percent of their base salary and each employing agency contributes 20.22 percent. Employing agencies report employee/employer contributions biweekly. Total employee/employer contributions for 2012 and 2011 were $343 million and $336 million, respectively.

The FSRDF also receives a U.S. Government contribution to finance (1) FSRDS benefits not funded by employee/employer contributions; (2) interest on the FSRDS unfunded liability; (3) the FSRDS disbursements attributable to military service; and (4) the FSPS supplemental liability payment. The U.S. Government contributions for 2012 and 2011 were $297 million and $286 million, respectively. FSRDF cash resources are invested in special non-marketable securities issued by the Treasury. Total interest earned on these investments for 2012 and 2011 were $715 million and $744 million, respectively.

Consular Fees are established primarily on a cost recovery basis and are determined by periodic cost studies. Certain fees, such as the machine readable Border Crossing Cards, are determined statutorily. Reimbursable

Agreements with Federal agencies are established and billed on a cost-recovery basis. ICASS billings are computed on a cost recovery basis; billings are calculated to cover all operating, overhead, and replacement costs of capital assets, based on budget submissions, budget updates, and other factors. In addition to services covered under ICASS, the Department provides administrative support to other agencies overseas for which the Department does not charge. Areas of support primarily include buildings and facilities, diplomatic security (other than the local guard program), overseas employment, communications, diplomatic pouch, receptionist and selected information management activities. The Department receives direct appropriations to provide this support.

16 Statement of Budgetary Resources

The Statement of Budgetary Resources reports information on how budgetary resources were made available and their status as of and for the years ended September 30, 2012 and 2011. Intra-departmental transactions have not been eliminated in the amounts presented.

The Budgetary Resources section presents the total budgetary resources available to the Department. For the years ended September 30, 2012 and 2011, the Department received approximately $57.5 billion and $53.3 billion in budgetary resources, respectively, primarily consisting of the following:

Source of Budgetary Resources

(dollars in billions)	2012	2011
Budget Authority:		
Direct or related appropriations	$ 30.7	$ 28.0
Authority financed from Trust Funds	1.0	1.5
Spending authority from providing goods and services	10.3	9.6
Unobligated Balances – Beginning of Year	13.1	13.3
Other	2.4	.9
Total Budgetary Resources	$ 57.5	$ 53.3

Apportionment Categories of Obligations Incurred
(dollars in millions)

	Direct Obligations	Reimbursable Obligations	Total Obligations Incurred
For the Fiscal Year Ended September 30, 2012			
Obligations Apportioned Under			
Category A	$ 7,118	$ 3,523	$ 10,641
Category B	23,066	6,345	29,411
Exempt from Apportionment	—	—	—
Total	$ 30,184	$ 9,868	$ 40,052

	Direct Obligations	Reimbursable Obligations	Total Obligations Incurred
For the Fiscal Year Ended September 30, 2011			
Obligations Apportioned Under			
Category A	$ 10,265	$ 3,358	$ 13,623
Category B	20,785	5,424	26,209
Exempt from Apportionment	—	—	—
Total	$ 31,050	$ 8,782	$ 39,832

Per OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, revised, Category A obligations represent resources apportioned for calendar quarters. Category B obligations represent resources apportioned for other time periods; for activities, projects, and objectives or for a combination, thereof.

STATUS OF UNDELIVERED ORDERS

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

The amount of budgetary resources obligated for UDO for all activities as of September 30, 2012 and 2011 was approximately $24.6 billion and $24.7 billion, respectively. This includes amounts of $1.0 billion for September 30, 2012 and $828.6 million for September 30, 2011, pertaining to revolving funds, trust funds, and substantial commercial activities.

PERMANENT INDEFINITE APPROPRIATIONS:

A permanent indefinite appropriation is open-ended as to both its period of availability (amount of time the agency has to spend the funds) and its amount. The Department received permanent indefinite appropriations of $138.2 million and $127.2 million for 2012 and 2011, respectively. The permanent indefinite appropriation provides payments to the Foreign Service Retirement and Disability Fund to finance the interest on the unfunded pension liability for the year, Foreign Service Pension System, and disbursements attributable to the liability from military service.

RECONCILIATION OF THE STATEMENT OF BUDGETARY RESOURCES TO THE BUDGET OF THE UNITED STATES GOVERNMENT:

The reconciliation of the Statement of Budgetary Resources and the actual amounts reported in the Budget of the United States Government (Budget) as of September 30, 2011 is presented in the table below. Since these financial statements are published before the Budget, this reconciliation is based on the FY 2011 Statement of Budgetary Resources because actual amounts for FY 2011 are in the most recently published Budget (i.e., FY 2013). The Budget with actual numbers for September 30, 2012 will be published in the FY 2014 Budget and available in early February 2013. The Department of State's Budget Appendix includes this information and is available on OMB's website (*http://www.whitehouse.gov/omb/budget*).

For the Fiscal Year Ended September 30, 2011 *(dollars in millions)*	**Budgetary Resources**	**Obligations Incurred**	**Distributed Offsetting Receipts**	**Net Outlays**
Statement of Budgetary Resources (SBR)	$ 53,292	$ 39,832	$ 299	$ 26,000
Funds not Reported in the Budget:				
Expired Funds	(757)	(90)	—	299
International Assistance Program	(2,308)	(1,677)	—	(1,412)
Other	(434)	(200)	—	1
Budget of the United States	$ 49,793	$ 37,865	$ 299	$ 24,888

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

17 CUSTODIAL ACTIVITY

The Department administers certain activities associated with the collection of non-exchange revenues, which are deposited and recorded directly to the General Fund of the Treasury. The Department does not retain the amounts collected. Accordingly, these amounts are not considered or reported as financial or budgetary resources for the Department. At the end of each fiscal year, the accounts are closed and the balances are brought to zero by Treasury. Specifically, the Department collects interest, penalties and handling fees on accounts receivable; fines, civil penalties and forfeitures; and other miscellaneous receipts. In 2012 and 2011, the Department collected $52 million and $41 million, respectively, in custodial revenues that were transferred to Treasury.

18 Reconciliation of Net Cost of Operations to Budget

Budgetary accounting used to prepare the Statement of Budgetary Resources and proprietary accounting used to prepare the other principal financial statements are complementary, but both the types of information about assets, liabilities, net cost of operations and the timing of their recognition are different. The reconciliation of budgetary resources obligated during the current period to the net cost of operations explains the difference between the sources and uses of resources as reported in the budgetary reports and in the net cost of operations.The first section of the reconciliation below presents total resources used in the period to incur obligations. Generally, those resources are appropriations, net of offsetting collections and receipts. The second section adjusts the resources. Some resources are used for items that will be reflected in future net cost. Some are used for assets that are reported on the Balance Sheet, not as net cost. The final section adds or subtracts from total resources those items reported in net cost that do not require or generate resources. As an example, the Department collects regular passport fees that are reported as revenue on the Statement of Net Cost. However, these fees are not shown as a resource because they are returned to Treasury and cannot be obligated or spent by the Department.

For the Year Ended September 30, *(dollars in millions)*	**2012**	**2011**
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 40,052	$ 39,832
Spending Authority from Offsetting Collections and Recoveries	(11,945)	(11,211)
Offsetting Receipts	(394)	(299)
Net Obligations	27,713	28,322
Imputed Financing	160	166
Other Resources	648	347
Total Resources Used to Finance Activities	**28,521**	**28,835**
Resources Used to Finance Items not Part of Net Cost:		
Resources Obligated for Future Costs - goods ordered but not yet provided	266	(1,763)
Resources that Finance the Acquisition of Assets	(2,311)	(2,400)
Resources that Fund Expenses Recognized in Prior Periods	(1,229)	(682)
Other	581	(435)
Total Resources Used to Finance Items not Part of Net Cost	**(2,693)**	**(5,280)**
Total Resources Used to Finance the Net Cost of Operations	**25,828**	**23,555**
Components of the Net Cost of Operations that will not require or generate Resources in the Current Period:		
Increase in Actuarial Liability	1,215	692
Passport Fees Reported as Revenue Returned to Treasury General Fund	(719)	(1,013)
Depreciation and Amortization	758	688
Interest Income of Trust Funds	(716)	(745)
Other	90	60
Total Components of the Net Cost of Operations that will not require or generate Resources in the Current Period	**628**	**(318)**
Net Cost of Operations	**$ 26,456**	**$ 23,237**

19 Fiduciary Activities

The Resolution of the Iraqi Claims deposit fund 19X6038, Libyan Claims deposit fund 19X6224, and the Saudi Arabia Claims deposit fund 19X6225 are presented in accordance with SFFAS No. 31, *Accounting for Fiduciary Activities*, and OMB Circular A-136, *Financial Reporting Requirements,* revised. These deposit funds were authorized by claims settlement agreements between the United States and the Governments of Iraq, Libya, and Saudi Arabia. The agreements authorized the Department to collect contributions from donors for the purpose of providing compensation for certain claims within the scope of the agreements, investment of contributions into Treasury securities, and disbursement of contributions received in accordance with the agreements. As specified in the agreements, donors could include governments, institutions, entities, corporations, associations, and individuals. The Department manages these funds in a fiduciary capacity and does not have ownership rights against its contributions and investments; the assets and activities summarized in the schedules below do not appear in the financial statements. The Department's fiduciary activities are disclosed in this note.

Schedule of Fiduciary Activity

As of September 30, *(dollars in millions)*	**2012 19-X-6038**	**2012 19-X-6224**	**2012 19-X-6225**	**2012 Total**	**2011 19-X-6038**	**2011 19-X-6224**	**2011 19-X-6225**	**2011 Total**
Fiduciary Net Assets, Beginning of Year	$ 220	$ 10	$ 1	$ 231	$ —	$ 10	$ 1	$ 11
Contributions	—	—	49	49	400	—	76	476
Disbursements to and on behalf of beneficiaries	(88)	(10)	(49)	(147)	(180)	—	(76)	(256)
Increases/(Decreases) in Fiduciary Net Assets	(88)	(10)	(—)	(98)	220	—	(—)	220
Fiduciary Net Assets, End of Year	$ 132	$ —	$ 1	$ 133	$ 220	$ 10	$ 1	$ 231

Fiduciary Net Assets

As of September 30, *(dollars in millions)*	**2012**	**2012**	**2012**	**2012**	**2011**	**2011**	**2011**	**2011**
Fiduciary Assets	**19-X-6038**	**19-X-6224**	**19-X-6225**	**Total**	**19-X-6038**	**19-X-6224**	**19-X-6225**	**Total**
Cash & Cash Equivalents	$ 9	$ —	$ 1	$ 10	$ 54	$ —	$ 1	$ 55
Investments	123	—	—	123	166	10	—	176
Total Fiduciary Net Assets	$ 132	$ —	$ 1	$ 133	$ 220	$ 10	$ 1	$ 231

20 Restatements

By statute, the Department establishes compensation plans, including after-employment benefits, for Foreign Service Nationals (FSN) we employ in foreign countries based on prevailing laws and practices in the host country (see Note 1 and Note 10 for additional information). Accounting for the financial aspects of these complex compensation plans throughout the world presents unique challenges, especially in regards to reporting the future liability for defined benefit, and lump sum retirement and severance benefits.

Late in FY 2011, several issues were identified relating to the management, oversight and financial reporting of after-employment benefits for FSNs we employ around the world. These issues relate to (1) lack of a comprehensive and accurate inventory of FSN after-employment benefits for Posts, (2) lack of policies and procedures to ensure that FSN after-employment liabilities are continually and consistently estimated, based on acceptable assumptions, and based on complete underlying data, and (3) lack of sufficient monitoring and oversight of FSN after-employment benefits. As a result, for FY 2011 the Department and our Independent Auditor reported a material weakness for the management, oversight and financial reporting of after-employment benefits for FSNs. While the Department took a number of actions to estimate and record amounts in the financial statements in FY 2011, there was insufficient time to fully support and substantiate the amounts reported. In addition, the Department adopted SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, but believed that SFFAS No. 5 did not provide sufficient guidance with regard to the FSN defined benefit plans and other after-employment benefits arrangements established in countries overseas.

In FY 2012, the Department took actions to address the material aspects of the weaknesses. These actions included (but not limited to) (1) reviewing Local Compensation Plans and conducting surveys to develop an inventory of after-employment benefits by Post, (2) conducting updated actuarial valuations for the material FSN defined benefit plans, (3) engaging an actuary to help develop and determine the after-employment liability associated with retirement and voluntary severance lump sum payments, and (4) obtaining guidance and concurrence from FASAB on the accounting treatment for FSN defined benefit after-employment plans. As a result, this area was downgraded to a significant deficiency.

REPORTING FOR FSN AFTER-EMPLOYMENT PLANS

Prior to FY 2012, the Department accounted for its FSN after-employment benefits under SFFAS No. 5. However, the Department, in consultation with the Federal Accounting Standards Advisory Board (FASAB), has determined that SFFAS No. 5 does not provide specific or sufficient guidance with regard to the FSN defined benefit plans and other after-employment benefits arrangements established outside of the United States. In particular, the FASAB did not consider these types of plans in establishing SFFAS No. 5. Since SFFAS No. 5 does not explicitly address the plans established in host countries for FSNs employed overseas, and the FASAB appears to have been unaware of such plans when it developed SFFAS No. 5, the guidance in SFFAS No. 34, *The Hierarchy of Generally Accepted Accounting Principles*, may be relied upon to arrive at GAAP appropriate for these plans. As provided for in SFFAS No. 34, other accounting literature, to include pronouncements by the International Accounting Standards Board, may be appropriate guidance for establishing GAAP depending upon "its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority." After considering other accounting literature, the Department determined that the provisions and guidance contained in International Accounting Standard (IAS) No. 19, *Employee Benefits*, provides a better structure for the reporting of these plans which are established in accordance with local practices in countries overseas.

Under SFFAS No. 5, the Department reported plan assets and liabilities separately for the overseas FSN defined benefit plans. The adoption of IAS No. 19 results in the Department recognizing a net defined benefit liability in the Consolidated Balance Sheet. The net defined benefit liability is comprised of the present value of the defined benefit obligation less the fair value of plan assets. Note 10 presents information for both FY 2012 and 2011 under IAS No. 19.

SFFAS No. 21 requires restatement for the correction of a material error. The Department has determined that a restatement to the FY 2011 financial statements is required for the correction of an error with respect to the previously reported FSN after-employment benefit liability. Since previously reported FY 2011 amounts require restatement, they will also be adjusted to reflect the change in accounting principle.

The Department has restated its Fiscal Year 2011 Consolidated Balance Sheet, Consolidated Statement of Changes in Net Position, and Consolidated Statement of Net Cost and associated footnotes for the effect of the changes. The following is a summary of the line items impacted by the restatement for the FY 2011 financial statements.

Consolidated Balance Sheet:

(dollars in millions)	As of September 30, 2011 As Previously Reported	Restatement	As Restated
Cash and Other Monetary Assets	$ 291	$ (169)	$ 122
Total Assets	73,811	(169)	73,642
After-Employment Benefit Liability	19,425	(751)	18,674
Total Liabilities	24,875	(751)	24,124
Cumulative Results of Operations - Earmarked Funds	(1,418)	59	(1,359)
Cumulative Results of Operations - Other Funds	18,439	523	18,962
Total Net Position	48,936	582	49,518
Total Liabilities and Net Position	73,811	(169)	73,642

The changes to the Consolidated Balance Sheet are reflected in Notes 2, 6, 9, 10, and 14 of the financial statements.

Consolidated Statement of Changes in Net Position:

(dollars in millions)	For the Year Ended September 30, 2011 As Previously Reported	Restatement	As Restated
Cumulative Results of Operations			
Beginning Balances	$ 15,463	$ 559	$ 16,022
Net Cost of Operations	(23,260)	23	(23,237)
Total Cumulative Results of Operations	17,021	582	17,603
Net Position	48,936	582	49,518

Consolidated Statement of Net Cost:

(dollars in millions)	For the Year Ended September 30, 2011 As Previously Reported	Restatement	As Restated
Actuarial Loss on Pension Assumption Changes	$ 444	$ (23)	$ 421
Total Net Cost	23,260	(23)	23,237

The changes to the Consolidated Statement of Net Cost are reflected in Notes 15 and 18 of the financial statements.

Required Supplementary Information

COMBINING SCHEDULE OF BUDGETARY RESOURCES

For the Year Ended September 30, 2012 *(dollars in millions)*

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Budgetary Resources:						
Unobligated balance brought forward, October 1	$ 6,223	$ 276	$ 52	$ 631	$ 6,278	$ 13,460
Adjustment to unobligated balance brought forward, October 1	1	—	—	—	(337)	(336)
Unobligated balance brought forward, October 1, as adjusted	6,224	276	52	631	5,941	13,124
Recoveries of prior year unpaid obligations	1,167	7	7	54	395	1,630
Other changes in unobligated balance	(46)	(5)	(1)	(43)	786	691
Unobligated balance from prior year budget authority, net	7,345	278	58	642	7,122	15,445
Appropriations (discretionary and mandatory)	14,672	3,379	124	2,305	11,292	31,772
Borrowing authority (discretionary and mandatory)	1	—	—	—	—	1
Contract authority (discretionary and mandatory)	—	—	—	—	—	—
Spending authority from offsetting collections (discretionary and mandatory)	9,968	2	30	85	230	10,315
Total Budgetary Resources	**$31,986**	**$ 3,659**	**$ 212**	**$ 3,032**	**$18,644**	**$ 57,533**
Status of Budgetary Resources:						
Obligations incurred	$23,376	$ 3,595	$ 121	$ 1,585	$11,375	$ 40,052
Apportioned	7,950	64	86	1,352	6,998	16,450
Exempt from apportionment	286	—	—	—	4	290
Unapportioned	374	—	5	95	266	741
Unobligated balance, end of year	8,610	64	91	1,447	7,269	17,481
Total Status of Budgetary Resources	**$31,986**	**$ 3,659**	**$ 212**	**$ 3,032**	**$18,644**	**$ 57,533**
Change in Obligated Balance:						
Unpaid obligations, brought forward, Oct 1 (gross)	$11,944	$ 140	$ 108	$ 1,298	$13,745	$ 27,235
Uncollected customer payments from Federal sources, brought forward, October 1 (-)	(331)	—	(3)	(2)	(80)	(416)
Obligated balance, start of year (net), before adjustments (+ or -)	11,613	140	105	1,296	13,665	26,819
Adjustments to obligated balance, start of year (+ or -)	(1)	—	—	—	337	336
Obligated balance, start of year (net), as adjusted	11,612	140	105	1,296	14,002	27,155
Obligations incurred	23,376	3,595	120	1,586	11,375	40,052
Outlays (gross) (-)	(21,357)	(3,570)	(151)	(1,508)	(11,864)	(38,450)
Change in uncollected customer payments from Federal sources (+ or -)	(349)	—	—	1	(20)	(368)
Actual transfers, unpaid obligations (net) (+ or -)	—	—	—	—	—	—
Actual transfers, uncollected payments from Federal source (net) (+ or -)	—	—	—	—	—	—
Recoveries of prior year unpaid obligations (-)	(1,168)	(9)	(6)	(52)	(395)	(1,630)
Unpaid obligations, end of year (gross)	12,794	156	71	1,324	13,198	27,543
Uncollected customer payments from Federal sources, end of year (-)	(680)	—	(3)	(1)	(100)	(784)
Obligated balance, end of year (net)	**$12,114**	**$ 156**	**$ 68**	**$ 1,323**	**$13,098**	**$ 26,759**

(continued on next page)

COMBINING SCHEDULE OF BUDGETARY RESOURCES *(continued)*

	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
Budget Authority and Outlays, Net:						
Budget authority, gross (discretionary and mandatory)	$24,641	$ 3,381	$ 153	$ 2,390	$11,523	$ 42,088
Actual Offsetting collections (discretionary and mandatory) (-)	(9,620)	(2)	(29)	(85)	(211)	(9,947)
Change in uncollected customer payments from Federal sources (discretionary and mandatory) (+ or -)	(349)	—	—	1	(20)	(368)
Anticipated offsetting collections (discretionary and mandatory) (+ or -)	—	—	—	—	—	—
Budget authority, net (discretionary and mandatory)	14,673	3,379	124	2,305	11,292	31,773
Outlays, gross (discretionary and mandatory)	21,357	3,570	151	1,508	11,864	38,450
Actual Offsetting collections (discretionary and mandatory) (-)	(9,620)	(2)	(29)	(85)	(211)	(9,947)
Outlays, net (discretionary and mandatory)	11,737	3,568	122	1,423	11,653	28,503
Distributed offsetting receipts (-)	(394)	—	—	—	—	(394)
Agency outlays, net (discretionary and mandatory)	**$11,343**	**$ 3,568**	**$ 122**	**$ 1,423**	**$11,653**	**$ 28,109**

Deferred Maintenance for the Fiscal Year Ended September 30, 2012

The Department occupies more than 3,000 government-owned or long-term leased real properties at more than 270 overseas locations. It uses a condition assessment survey method to evaluate the asset's condition, and determine the repair and maintenance requirements for its overseas buildings.

The new embassy was completed in October 2011 and the office annex was completed in July 2012. Both buildings were built on a 12-acre site in the capital city of Kyiv, Ukraine. The design creates an image of a gateway to the United States combining cordiality and security while representing both cultures.
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SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, requires that deferred maintenance (measured using the condition survey method) and the description of the requirements or standards for acceptable operating condition be disclosed. Fundamentally, the Department considers all of its overseas facilities to be in an "acceptable condition" in that they serve their required mission. Adopting standard criteria for a classification of acceptable condition is difficult due to the complex environment in which the Department operates.

From a budgetary perspective, funding for maintenance and repair has been insufficient in the past. As a result, the Department has identified current maintenance and repair backlogs of $143 million and $185 million in 2012 and 2011 for buildings and facilities-related equipment and heritage assets that have not been funded.

Other Accompanying Information

Financial Management Plans and Reports

Overview

INTRODUCTION

The Department of State's financial activities operate in approximately 270 locations in 180 countries. We conduct business transactions in over 135 currencies and even more languages and cultures. Hundreds of financial and management professionals around the globe allocate, disburse, and account for billions of dollars in annual appropriations, revenues, and assets. Among the Department's customers are 45 U.S. Government agencies in every corner of the world, served twenty-four hours a day, seven days a week.

In FY 2012 the Department reorganized the Bureau of Resource Management into two separate bureaus--the Bureau of the Comptroller and Global Financial Services (CGFS) headed by the Department's Comptroller and the Bureau of Budget and Planning (BP). These two new entities each report to the Under Secretary for Management, who under the new organization takes on the designation of Chief Financial Officer.

CGFS has overall responsibility for financial systems, reporting and internal controls, global financial operations and services, and interagency administrative support cost sharing related to overseas missions. CGFS also produces a number of essential documents, in particular the Department's Annual Financial Statements. CGFS employs over 400 people around the globe, primarily in Washington, Charleston, South Carolina and Bangkok, Thailand. CGFS' services to its customers are critical to carry out the Department's mission effectively.

The CGFS management team and staff have a proven record of outstanding achievement as evidenced by (but not limited to):

- Successful implementation of new financial management systems;
- Successful implementation of a grading system to measure transparency and quality of budget requests for all interagency activities at post (ICASS);
- Growth in requests for and use of the Post Support Unit as a centralized financial processing unit for overburdened post financial management staff; and
- Implementation of Quality Management System under ISO 9001 standards and Capability Maturity Model Integration (CMMI) frameworks for core financial operations and systems.

CGFS efforts are guided by two overarching goals: providing world class financial services that support strategic decision-making, mission performance, and improved accountability and transparency to the American people; and supporting the achievement of Department and other agency strategic goals by enabling interagency planning and coordination. Performance measures related to these goals include timely financial reporting, elimination of material weaknesses in internal control, the achievement of unqualified ("clean") audit opinions, elimination of improper payments, and implementing financial systems and processes that meet Federal requirements. In addition to these, CGFS endeavors to consolidate and standardize financial operations, leverage best business practices and electronic technologies, and build a first-rate finance team.

FY 2012 RESULTS

Providing World Class Customer Service.

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

We continue to receive high marks on the Overseas Customer Survey. Overall satisfaction with financial applications rose to 86 percent in 2012 from 85 percent in 2011. Consolidated Overseas Accountability Support Toolbox (COAST) reporting remains the leader in customer satisfaction, with 94 percent of respondents reporting favorably (up from 90 percent in 2011). COAST Encryption showed the greatest improvement, rising eight percentage points from 85 percent to 93 percent. In FY 2012, CGFS for the first time conducted a Domestic Customer Survey in an effort to improve its service to users of a broad range of resource management systems. The overall satisfaction rate of 78 percent provides a baseline for ongoing discussions and future surveys.

Implementing Resource Management Systems and Processes that Meet Federal Requirements.

To further improve controls and the accuracy of financial transactions which reference funding across our regional and domestic systems, a multi-phase project to provide real time integration between the Global Financial Management System (GFMS) and Regional Financial Management System (RFMS) was started in fiscal year 2011. This integration will eliminate complex, offline interfaces; ensure timely fiscal data and funds availability checks; and improve operational efficiency by avoiding costly rework generated by rejected batch transactions.

The first phase of this project was to integrate GFMS invoices, payments, direct disbursements to other agencies, and Working Capital Fund (WCF) charges. As transactions are entered in GFMS, real time referencing occurs verifying funding and accounting information. If the RFMS obligation does not have sufficient funds or the accounting information does not match, the document will not process.

The second phase of this project was to integrate GFMS contracts/delivery orders referencing overseas funding. As transactions are entered in GFMS, real time processing occurs in RFMS to record obligations in RFMS. If the RFMS obligation does not process, the GFMS contract/delivery order will not process. This functionality will be tested in a pilot phase in the first quarter of FY 2013.

When the Global Financial Management System (GFMS) was implemented in 2007, migration of accounts receivable from the existing legacy system (Domestic Accounts Receivable Tracking System - DARTS) was excluded to mitigate risk and keep the implementation scope manageable. Momentum Accounts Receivable was implemented in January of 2012. It eliminated the custom DARTS interface and provided a cohesive fully integrated accounts receivable capability.

Standardized Solutions Supported by a Global Architecture Framework.

FY 2012 also saw continued focus on consolidation of financial and other administrative systems as part of our ongoing efforts to standardize resource management systems, provide consistency across applications, and uniformly apply best practices for development and maintenance of our critical support systems.

COAST is an overseas application suite which is deployed to more than 180 posts around the world as well as Department of State and other agency headquarters offices domestically. COAST provides a consolidated solution to capture and maintain accurate, meaningful financial information, and provide it to decision makers in a timely fashion. The current COAST suite consists of COAST Reporting, COAST Encryption, and COAST Cashiering.

COAST Encryption replaces the Electronic Certification System (ECS) to provide the security necessary to protect digitally transmitted data. It enhances the security and protection of the transmitted data, and consolidates another post-level application into the COAST application suite. The global deployment of COAST Encryption was completed in the fourth quarter of FY 2012.

COAST Cashiering, the latest major enhancement to the COAST suite, will replace the legacy WinACS cashiering system. It improves upon the core functionality of WinACS including improved security for cashiering activities by enforcing greater adherence to the Department's Foreign Affairs Manual and Foreign Affairs Handbook regulations and providing greater controls to financial management officers overseas. As part of the COAST suite of applications, COAST Cashiering seamlessly integrates with COAST Encryption, streamlining the certification, encryption, and submission of Cashiering transactions to the Global Financial Service Centers. Pilots have been completed in Rome, Buenos Aires, Copenhagen, Berlin, Bangkok, and Beijing. Full deployment is targeted to start in the first quarter of FY 2013.

GFMS established the Planning and Budgeting Line of Business (PBLoB) as the organizational element to define and implement strategies to provide solutions for standardized, consolidated, and simplified systems for Department-wide budget formulation, planning, and execution. In the near term, this organization oversees the Department's Central Resource Management System (CRMS), the Resource Allocation and Budget Integration Toolkit (WebRABIT) and the International Cooperative Administrative Support Services (ICASS) system.

CRMS was brought into CGFS' existing portfolio of systems, incorporating each into CGFS's disciplined and certified system development and maintenance organization. CRMS is used by all bureaus to receive allotment notifications. Many bureaus use the application's Budget Resource Management System (BRMS) component to allot funds to posts and internal domestic organizations. The Bureau of Budget and Planning (BP) uses the system to provide internal controls over all of the Department's budget authority distribution, as well as collect reimbursement documentation, plan operating account usage, and forecast the impact of foreign currency exchange rates on annual financial plans.

WebRABIT is an application used by all the regional bureaus for program and Public Diplomacy execution year budgets at their posts. Functionality was added to include the Bureau of Consular Affairs to collect FY 2013 budgets for their planning of four separate funds. WebRABIT also provides functionality for post spreading of resources by program and theme for Public Diplomacy funding, as well as providing Overseas Buildings Operations with functionality for domestic multi-year budgeting.

The ICASS or WebICASS system is the principal means by which the U.S. Government provides and shares the cost of common administrative support at its more than 270 diplomatic and consular posts overseas. The Department of State is the primary service provider and it offers these administrative support services to other agencies under its non-Economy Act authorities contained in 22 U.S.C. 2695 and 2684. In FY 2012, we implemented the first stage of a strategy to rebuild the ICASS Software Platform to better meet the needs of its post and agency users. This first phase was completed in June 2012 and will operate as a stand-alone application at post. It will include a new user interface to facilitate navigation through the application, new cost centers for Diplomatic Security (DS) residential guards, and technical architecture upgrades.

Leveraging Best Business Practices and E-Government.

The Global eTravel initiative achieved significant migration success in FY 2012 by continuing to expand the use of a web-based commercially available off-the-shelf (COTS) system software. As of September 2012, all domestic bureaus and 180 posts have been migrated. These entities collectively generate over 99 percent of the Department's temporary duty (TDY) travel volume. In the last 12 months, twelve customer-driven enhancements were delivered with new software releases. The Department worked with the Global eTravel vendor and other agencies to identify user interface changes to the system. In February 2012, the resulting version 11.3 of the Global eTravel system introduced a new look and feel to the application, one that was more intuitive and user-friendly than earlier versions. Resources are now focused on leveraging the COTS software to automate the Department's local travel reimbursement process.

The Department continued to make significant progress migrating to a Grants Management Line of Business (GMLoB) solution in FY 2012. The OMB's lines of business initiative seeks to cut costs and improve service by consolidating computer networks and functions into a few agencies that would act as service providers to other agencies. Implementation of the Department of Health and Human Services' (HHS) GrantSolutions system as the single, standard system for the Department will replace the collection of separate, stovepipe Federal assistance systems used across the Bureaus. Internally, we refer to this system as the State Assistance Management System (SAMS).

During FY 2012, the Department expanded deployment to eighteen bureaus. By the end of FY 2013 the Department anticipates deployment of SAMS to approximately nine additional bureaus and offices. The result is a single automated system that is integrated with the GFMS. It will standardize the Department's assistance-related business process from solicitation through award and close-out ensuring a high degree of consistency and manageability as well as compliance with key U.S. Government initiatives such as Grants.gov and GMLoB and reporting requirements such as the Federal Funding Accountability and Transparency Act of 2006 (FFATA) and the Federal Assistance Award Data System (FAADS). Requirements analysis is to begin in FY 2013 for overseas use of SAMS. A pilot overseas implementation may occur in FY 2014, with deployments targeted for FY 2015.

The Department continued to execute a phased deployment strategy that — when completed — will completely replace six legacy payroll systems with a single, COTS-based solution that is better suited to address the widely diverse requirements of the Department and the other 45 civilian agencies that rely on the Department for overseas payroll. Not only will the Global Foreign Affairs Compensation System (GFACS) address common requirements in a more consistent and efficient manner, it will leverage a rules-based, table-driven architecture to promote compliance with the statutory differences found across the Foreign and Civil Service Acts and, perhaps more importantly, the local laws and practices applicable to the many countries in which civilian agencies operate.

December 2010 saw the first phase of GFACS placed into production with the implementation of the Foreign Service Annuitant payroll, replacing the legacy Foreign Affairs Retirement and Disability System (FARADS). Beginning calendar year 2011, 16,000 Foreign Service Annuitants and their beneficiaries have been paid monthly as a result of pension processing in GFACS. In addition to leveraging GFACS for our Foreign Service retirees, we continue working on the next phases, with a first quarter pilot planned for the Locally Employed (LE) Staff module. Subsequent efforts will focus on American payroll and Time and Attendance (T&A) reporting.

The new embassy in Libreville, Gabon, completed in July 2012, was constructed on a 10-acre site. This striking Chancery design is metal in white granite. The compound is richly landscaped with native trees and plants accentuated by lighting.

Department of State/OBO

In FY 2011, the Sofia Post Support Unit (PSU) was opened. The PSU supports financial processing operations at posts abroad, remotely taking on the lower level financial transaction processing work for a post and allowing at-post financial management personnel to perform higher value-added and location- specific tasks. With the addition of the Sofia PSU, CGFS has further expanded its capabilities to provide centralized processing services to support additional posts and enable the wholesale systematic consolidation of some financial processes. In FY 2013 and beyond, CGFS will continue to expand its centralized processing services to support additional posts and wholesale systematic consolidation of some financial processes.

The International Cooperative Administrative Support Services (ICASS) system began transition to a centrally hosted system by separating from the Post Administrative Support System. As a first step, this required installing a separate instance of upgraded software at every ICASS post.

Looking Forward.

CGFS will continue to work to ensure fundamental financial management "compliance" results – on time, accurate financial statements that achieve an unqualified ("clean") audit opinion, financial systems and processes that meet Federal requirements, and effective internal controls.

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

In FY 2013, CGFS will test the submission of the new bulk files for the Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS) in preparation for the first live submission in December 2013. CGFS will also modify transaction posting rules to capture Business Event Type Codes (BETC) for submission on payment files to meet the Payment Application Modernization (PAM) reporting requirements. To support the President's initiative to enhance payment accuracy and reduce improper payments, CGFS will be transmitting vendor and payment files to the "Do Not Pay" portal to identify vendor payments that should not be sent to Treasury. GTAS will replace the FACTS I, FACTS II, IFCS, and IRAS reporting systems as the primary means of reporting agency trial balance data. A single data collection system will pave the way for more consistent and complete financial data and will allow for better analytical reporting.

CGFS will also undertake activities that support effective strategic decision-making and mission performance. These activities include strengthening the Department's financial management analytic capabilities. With its financial data warehouse, CGFS will work to expand its analytical capability to provide the Department's senior management with timely and thorough financial/cost analysis to support funding decisions. At a time when the U.S. Government is facing a significant deficit, the Department will undoubtedly be faced with some difficult choices over critical but competing priorities. Having the Comptroller establish or independently verify the fully loaded costs of programs or initiatives, with affordable cost alternatives and expected results, will be essential in maximizing the effectiveness of the Department's funding. This ability to better quantify costs with results will also bolster the Department's credibility with Congress and OMB.

Our long-term goal for resource management is a standardized and integrated set of worldwide systems that support process improvement and uniform delivery of timely, accurate, and meaningful information. We want to do this in an incremental way that builds on our successes. For our corporate resource management system investments, OMB has reviewed and approved our approach as part of its review of all agency financial system investments across the Federal Government.

We have embarked on a multi-year effort to consolidate resource management systems within CGFS and specifically within the CGFS/DCFO systems area. This includes budget systems, cost distribution systems, and post-level applications that were developed independently in the past. Ultimately, we expect our resource management systems to:

- Meet user requirements;
- Share a common platform and architecture;
- Reflect rationalized standard business processes;
- Be developed using CMMI similar to ISO 9000; and
- Be compliant, controlled and secure.

In FY 2013, CGFS financial system initiatives include:

- ***COTS Software Update – Global Financial Management System (GFMS).*** Each year CGI Federal (CGI), the vendor of Momentum the commercially available off-the-shelf system (COTS) software for GFMS, releases a new version of Momentum. The Momentum releases include functionality to meet new mandatory Federal requirements, technology framework improvements, and enhancements that the user community has ranked as high priority. Currently, GFMS operates on release 6.0.9 and will be updated to release 7.0 in FY 2013. In order to update GFMS from release 6.0.9 to release 7.0, various implementation tasks were completed. In FY 2012, the functional and technical impacts of the Momentum enhancements were analyzed, changes to configuration settings were documented, Quality Work Instructions were updated, and changes to interfaces, reports, extracts, and utilities were developed and tested to make them 7.0 compatible. Enhancements were made to user input screens to remove unused fields and rearrange fields to improve the data entry process. Performance load tests were executed to identify and resolve any performance processing issues.
- ***Integration Improvements.*** Through the GFMS/RFMS Virtual Merge initiative, CGFS will continue to leverage the Momentum platform's integration software tools to improve business processes and lower the total cost of ownership of its financial systems. The next phase of the project will integrate GFMS and RFMS for vendor information and obligation documents. As GFMS references overseas allotments, the vendor and the obligation will be processed in RFMS automatically through the integration framework.

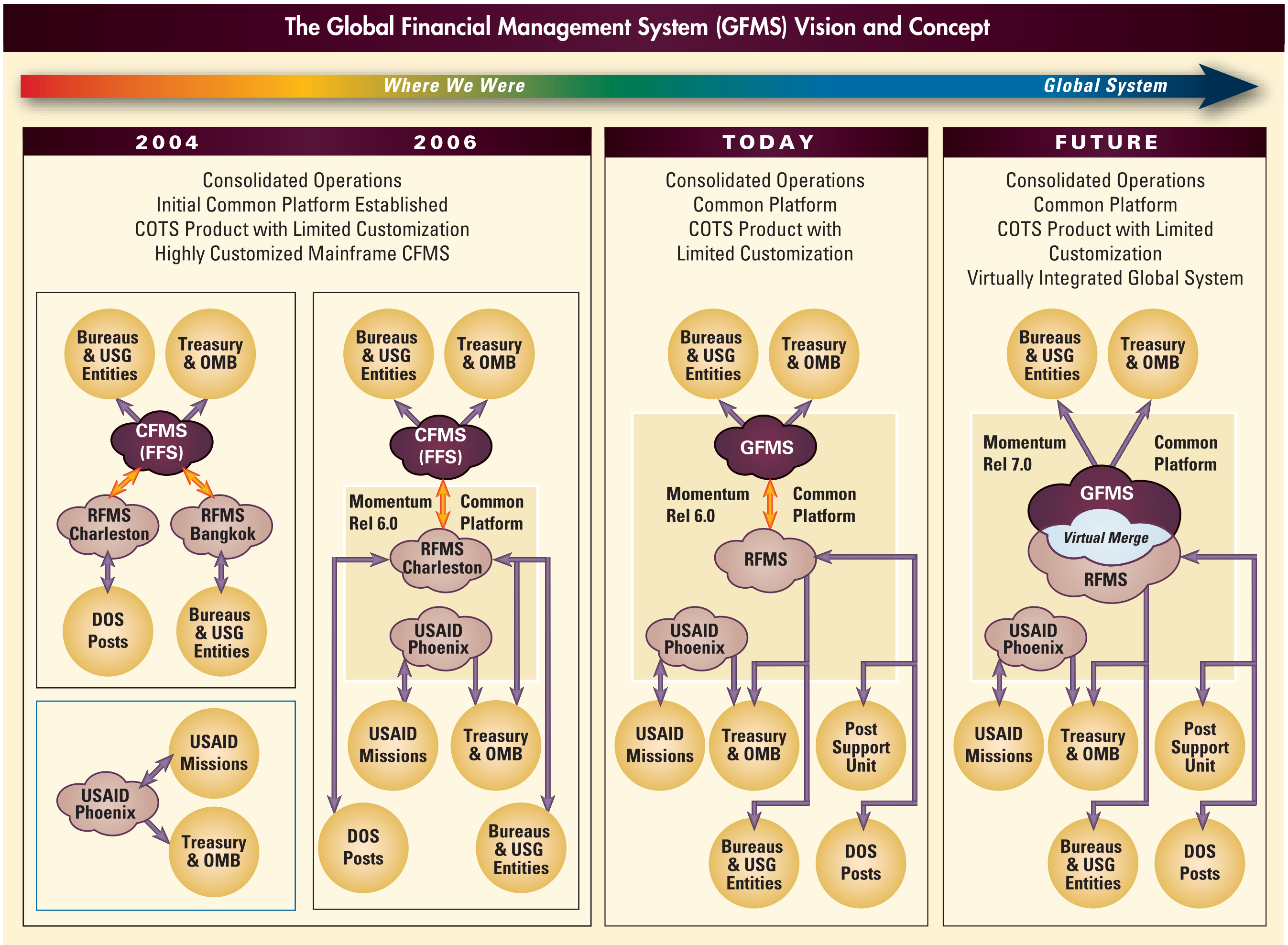
  We are also planning next steps for the integration of the Department's Integrated Logistics Management Systems (ILMS) with RFMS, and have a standard procurement-to-pay business model.
- ***COAST Offerings.*** Full deployment of cashiering is targeted to start in the first quarter of FY 2013. The implementation of COAST Payroll Reporting (CPR) is targeted to start in the third quarter of FY 2013. It will streamline the existing payroll report preparation process, and provide comprehensive payroll expenditure reporting capabilities.

Work will continue on deployment of the Global Foreign Affairs Compensation System (GFACS) deployment. Next will be the payroll module for Locally Employed (LE) Staff, with pilots scheduled to begin in calendar year 2012. As part of the GFACS investment, we also plan to implement the GFACS American payroll module, currently scheduled to occur in FY 2014. Looking out further, a new web-based global Time and Attendance (T&A) product that has the capability of electronic routing, signature, and self-service features is scheduled for later in FY 2014.

FINANCIAL MANAGEMENT SYSTEMS

Through the Joint Financial Management System Program, the Department is integrating its overseas and domestic financial operations onto a common, global financial management software platform in Charleston, South Carolina. This is dramatically improving operations and reducing costs by eliminating system redundancies and replacing obsolete and unsupported financial systems. It is also providing the infrastructure for integrating other administrative activities within the Department, such as the Integrated Logistics Management System, Global eTravel, State Assistance Management System, and other domestic and post-level systems. The diagram on the next page depicts the state of our vision, a virtual global financial management system.

The common platform underlying the Department's global financial management solution is CGI-Federal's Momentum™ financial management system. This solution uses the same software and technical platform to support the Global Financial Management System (GFMS) domestically, the Regional Financial Management System (RFMS)



overseas, and USAID's Phoenix financial management system. With the completion of Global Direct Connect in FY 2011, State has achieved a single integrated view of financial data through data standardization, common business processes, and the seamless exchange of information through the Department's financial and administrative sectors. The GFMS and RFMS components of State's solution are further described below.

Global Financial Management System.

The Global Financial Management System (GFMS) centrally accounts for billions of dollars recorded through over 5 million annual transactions by 1000+ users and over 25 "handshakes" with other internal and external systems.

GFMS is critical to State's day-to-day operations. The GFMS supports execution of State's mission by effectively accounting for business activities and recording associated financial information, including obligations and costs, performance, financial assets, and other data. It supports the Department's domestic offices and serves as State's repository of corporate data.

Regional Financial Management System.

RFMS is the global accounting and disbursing system that has been implemented for posts around the world. RFMS includes a common accounting system for funds management, obligation and voucher processing; the RFMS/D system to provide disbursing services; and the Consolidated Overseas Accountability Support Toolbox

(COAST) post-based system for analysis, reporting and other post-level activities. The system incorporates State's standard account structure and improves transaction standardization and timeliness between post and headquarters, which results in the consistent, timely processing and recording of financial data on a worldwide basis.

Financial Management Information to Improve Decision Making.

With the consolidation and streamlining of our worldwide financial systems operations, the ability to capture and maintain accurate, meaningful financial information, and provide it to decision makers in a timely fashion, has vastly improved.

To support overseas financial management officers and post decision makers, COAST reporting was implemented in late FY 2006. In subsequent years, improvements were added to provide the capability to develop budget plans and monitor execution of those plans. Improvements were also made to the information "drill down" to allow significant flexibility in filtering and summarizing financial transactions. CGFS continues to enhance its COAST reporting tool, which provides daily updates on all financial transactions to more than 180 posts overseas and domestic bureaus, allowing them to analyze, and "slice and dice" their financial data for local reporting purposes using modern reporting and query tools on their local workstation. Coast Payroll Reporting (CPR) will allow for access to payroll specific data at the post and bureau level, and will take advantage of COAST's existing "drill down" and other reporting functionality. This will give Department financial managers far greater insight into payroll costs, including providing detailed reporting on overtime and other premium pay types.

Domestically, and in support of Department-wide reporting, the GFMS Data Warehouse was implemented in FY 2007. Based on a modern, browser-based technology platform, the GFMS Data Warehouse enables users to access financial information from standard, prepared reports or customize queries and reports in real time to compile the financial information needed for informed decision making on a day-to-day basis. The GFMS Data Warehouse also provides, on a daily basis, critical financial information to the Department's Enterprise Data Warehouse. In addition to adding and improving reports and queries, managerial cost accounting and acquisitions reporting modules have been added to the GFMS Data Warehouse since its inception. In FY 2012, an accounts receivable module was added and the first executive-level dashboards were introduced. Plans for FY 2013 include expanding available content and further enhancing management reporting capabilities, including new bureau manager-level dashboard reporting and a new travel dashboard/reporting module. Development for upgrades to more current technology platforms was conducted in FY 2012, with implementation scheduled for FY 2013. The GFMS Data Warehouse will also implement changes required to comply with changes made with the GFMS Momentum Update.

Management of Departmental Obligations

Federal Civil Penalties Inflation Adjustment Act

The Federal Civil Penalties Inflation Adjustment Act of 1990 established annual reporting requirements for civil monetary penalties assessed and collected by Federal agencies. The Department assesses civil fines and penalties on individuals for such infractions as violating the terms and munitions licenses, exporting unauthorized defense articles and services, and valuation of manufacturing licenses agreements. In FY 2012, the Department assessed $55 million of penalties against one company, and collected $37 million of outstanding penalties from five companies. Balance outstanding at September 30, 2012, was $86 million.

Debt Management

Outstanding debt from non-Federal sources (net of allowance) increased from $109 million in FY 2011 to $111.7 million in FY 2012. Civil Monetary Penalties increased by $1 million in FY 2012, resulting in an increase overall to the non-Federal source figures.

Non-Federal receivables consist of debts owed to the International Boundary and Water Commission, Civil Monetary Fund, and amounts owed for Repatriation Loans, medical costs, travel advances, and other miscellaneous receivables.

The Department uses installment agreements, salary offset, and restrictions on passports as tools to collect its receivables. It also receives collections through its cross-servicing agreement with the Department of the Treasury. In 1998, the Department entered into a cross-servicing agreement with the Department of the Treasury for collections of delinquent receivables. In accordance with the agreement and the Debt Collection Improvement Act of 1996 (Public Law No. 104-134), the Department referred $3.6 million to Treasury for cross-servicing in FY 2012. Of the current and past debts referred to Treasury, $931.7 thousand was collected in FY 2012.

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

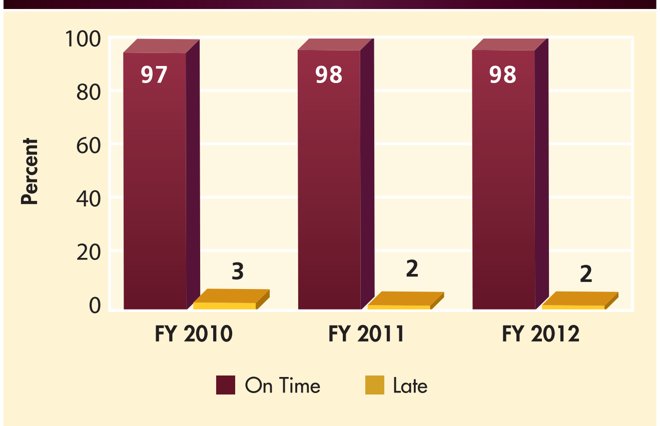
	FY 2012	FY 2011	FY 2010
Number of Accounts	1,189	920	772
Amounts Referred *(dollars in millions)*	$3.6	$2.1	$2.0

Prompt Payment Act

Timeliness of Payments

The Prompt Payment Act (PPA) requires Federal agencies to pay their bills on time or an interest penalty must be paid to vendors. In FY 2012, the Department paid timely over 98 percent of the 548,636 payments subject to prompt payment act regulations. The chart below reflects the timeliness of the Department's payments from FY 2010 through FY 2012. During FY 2012, the Department paid $209 thousand in interest penalties, compared to $251 thousand in FY 2011, a 17 percent decrease.

Timeliness of DOS Payments
FY 2010 – FY 2012



Electronic Payments

The payments made through Electronic Funds Transfer (EFT) were over 96 percent of the total payments made for domestic and overseas payments. Domestic operations accomplished over 98 percent of its payments with EFT this year. Overseas operations have a lower EFT 95 percentage than domestic operations due to the complexities of banking operations in some foreign countries. Each year, the Department disburses over 4 million separate payments.

Improper Payments Information Act, as Amended by IPERA

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. During FY 2010, the President signed into law the Improper Payments Elimination and Recovery Act (IPERA, Public Law No. 111-204), which amends the Improper Payments Information Act of 2002, and repeals the Recovery Auditing Act (Section 831 of the FY 2002 Defense Authorization Act, Public Law No. 107-107). IPERA significantly increases agency payment recapture efforts – by expanding the types of payments that can be reviewed and lowering the threshold of annual outlays that requires agencies to conduct payment recapture audit programs. OMB Circular A-123 Appendix C, *Requirements for Effective Management and Remediation of Improper Payments*, defines significant improper payments as annual improper payments in a program that exceed both 2.5 percent of program annual payments and $10 million, or that exceed $100 million, regardless of the error rate. Once those highly susceptible programs and activities are identified, agencies are required to estimate and report the annual amount of improper payments. Generally, an improper payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, and administrative or other legally applicable requirement.

IPIA, AS AMENDED BY IPERA, REPORTING DETAILS

Based on a series of internal control review techniques, the Department determined that none of its programs are risk-susceptible for making significant improper payments at or above the threshold levels set by OMB. These reviews were conducted in addition to audits under the Single Audit Act, the CFO Act, GAO reviews, and reviews by the Department's Office of Inspector General. The Department conducted a risk assessment of programs in FY 2011. Risk assessments over all programs are done every three years. In the interim years, risk assessments evaluating programs that experience any significant legislative changes and/or significant increase in funding will be done to determine if the Department continues to be at low risk for making significant improper payments at or above the threshold levels set by OMB. During FY 2012 the Department revised its methodology for conducting risk assessments, integrating results from reviews conducted to meet compliance requirements with OMB Circular A-123 Appendix A, as well as with our FMFIA program.

RECAPTURE OF IMPROPER PAYMENTS REPORTING

A number of improper payment activities, both preventative and recovery, exist domestically and overseas at the Department, Bureau, post, and program levels to support IPERA efforts and ensure the integrity and accuracy of Department payments. The CGFS has established a two-tiered erroneous payment monitoring and review program that supplements the formal accounts receivable process. The CGFS, Office of Claims, has integrated erroneous payment identification and collection as key functions of the accounts payable process and the paying office's operations. The claims office has established an internal debt management unit, whose primary mission is the identification and collection of erroneous payments, coordinating with the Accounts Receivable Division (ARD) as necessary. This activity historically represented the Department's recapture results,

OVERPAYMENTS RECAPTURED OUTSIDE OF PAYMENT RECAPTURE AUDITS						
Agency Source	**Amount Identified (CY)**	**Amount Recovered (CY)**	**Amount Identified (PYs)**	**Amount Recovered (PYs)**	**Cumulative Amount Identified (CY+PYs)**	**Cumulative Amount Recovered (CY+PYs)**
CGFS Office of Claims	$11.1 million	$11.6 million	$15.6 million	$14.4 million	$26.7 million	$26.0 million
OIG	$8.3 million	$8.3 million	$19.4 million	$19.4 million	$27.7 million	$27.7 million
CY=FY 2012, PYs=FY 2005 - 2011						

but starting in FY 2011 it is classified as overpayments recaptured outside of recapture payment audits activity based on the revised IPERA guidance. In FY 2012, this effort identified and validated transactions totaling $11.1 million of actual duplicate/erroneous payments, of which we collected, or recovered, $10.9 million during FY 2012. Of the prior year identified balance of $15.6 million, we collected $647 thousand during FY 2012. Thus, total amounts recovered in the current year were $11.6 million. The Department has collected all but $175 thousand of the current year identified amount and $552 of the prior year identified amount, resulting in the cumulative outstanding balance of $727 thousand. These results are presented in the table above entitled Overpayments Recaptured Outside of Payment Recapture Audits.

Additionally, the Office of Inspector General conducted investigations spanning a breadth of content, including fraud, embezzlement, bribery and kickbacks, false statements, and employee misconduct. Recoveries obtained as a result of OIG investigations are also presented in the table above.

The CGFS Office of Oversight Management and Analysis conducts a monthly query of all domestic payments, including the largest portion of Department payments subject to IPERA recapture audit requirements, focusing on identifying potential erroneous and duplicate payments. Currently, these payments are reviewed on a monthly basis using IDEA – Data Analysis Software. An automated analysis is executed to run matches of vendor invoice numbers and payment amounts against current payment

PAYMENT RECAPTURE AUDIT REPORTING								
Type of Payment	**Amount Subject to Review for Reporting (CY)**	**Actual Amount Reviewed and Reported (CY)**	**Amount Identified for Recovery (CY)**	**Amount Recovered (CY)**	**% of Amount Recovered out of Amount Identified (CY)**	**Amount Outstanding (CY)**	**% of Amount Outstanding out of Amount Identified (CY)**	**Amount Determined Not to be Collectable (CY)**
Contracts	$11.0 billion	$11.0 billion	$35,357	$35,141	99.4%	$216	.6%	$0

PAYMENT RECAPTURE AUDIT REPORTING *(continued)*							
Type of Payment	**% of Amount Determined Not to be Collectable out of Amount Identified (CY)**	**Amounts Identified for Recovery (PYs)**	**Amounts Recovered (PYs)**	**Cumulative Amounts Identified for Recovery (CY + PYs)**	**Cumulative Amounts Recovered (CY + PYs)**	**Cumulative Amounts Outstanding (CY+PYs)**	**Cumulative Amounts Determined Not to be Collectable (CY+PYs)**
Contracts *(continued)*	0%	$41.1 million	$41.1 million	$41.1 million	$41.1 million	$216	$0
CY=FY 2012, PYs=FY 2005 - 2011							

PAYMENT RECAPTURE AUDIT TARGETS						
Type of Payment	**CY Amount Identified**	**CY Amount Recovered**	**CY Recovery Rate (Amount Recovered / Amount Identified)**	**CY + 1 Recovery Rate Target**	**CY + 2 Recovery Rate Target**	**CY + 3 Recovery Rate Target**
Contracts	$35,357	$35,141	99.4%	90%	90%	90%

DISPOSITION OF RECAPTURED FUNDS						
Type of Payment	**Agency Expenses to Administer the Program**	**Payment Recapture Auditor Fees**	**Financial Management Improvement Activities**	**Original Purpose**	**Office of Inspector General**	**Returned to Treasury**
Contracts	$0	$0	$0	$35,141	$0	$0

AGING OF OUTSTANDING OVERPAYMENTS			
Type of Payment	**CY Amount Outstanding (0-6 months)**	**CY Amount Outstanding (6 months to 1 year)**	**CY Amount Outstanding (over 1 year)**
Contracts	$0	$216	$0

data and payments dating back to 2007. The CGFS approach has incorporated various manual and automated data analysis techniques and processes to identify, validate and collect erroneous payments, including use of data mining software, manual sampling of internal payment records, U.S. Treasury taxpayer identification number matching, and sampling of vendors. Beginning in FY 2011, this activity represents the Department's recapture results, pursuant to newly released OMB guidance as the Department concluded only this internal activity that fits the definitions and purpose of the IPERA Recapture Audit program requirements. These results are presented in the table entitled Payment Recapture Audit Reporting.

In FY 2012, this effort identified and validated 6 transactions totaling $35,035 of actual duplicate/erroneous payments from a review of 120,820 payments, totaling $11.0 billion, in addition to 5 erroneous transactions totaling $322 carried over from FY 2011. The Department has collected, or recovered, all but $216 of the current year identified amount, resulting in a recovery rate of virtually 100 percent, in addition to recovering the prior year outstanding balance of $322. Since the recaptured funds were not expired, they were returned to the originating appropriation. The Department performs analysis to determine the cause of improper payments and has determined the primary reasons are linked to vendor billing issues and initial approval for payment. Increased quality control processes in both the payment generation and internal post-payment review processes have contributed to lower recapture audit amounts. The majority of improper payments identified through recapture audits had already been identified by the Office of Claims and, as such, are reported in the Overpayments Recaptured Outside of Payment Recapture Audits table.

The CGFS duplicate or erroneous payment program using the domestic payment file for recapture audit analysis has proven to be a cost effective tool. The file presently includes the majority of payments subject to IPERA requirements, such as domestic vendor payments and grant payments. In 2005 and 2006, the Department contracted with an external firm to perform recapture audit activities. After 2006, however, the contracted firm determined it was not cost-effective to continue this function. CGFS realizes that additional recapture audit opportunities may exist and will continue to collectively assess areas of greater risk of improper and erroneous payments and implement recapture audit measures deemed cost-effective.

SENSITIVE PAYMENTS

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

Although the Department does not have programs determined risk-susceptible for making significant improper payments at or above the threshold levels set by OMB, the Department performed elective procedures in FY 2012 to determine if improper payments were made in association with two areas of sensitive payments: premium class travel, and payments made from funding received for the American Recovery and Reinvestment Act (ARRA).

The Department has identified areas of sensitive payments for review, some annually and some on a rotating schedule depending on the level of risk and sensitivity. They include: Executive Compensation, Premium Class Travel, Representation Costs, Speaking Honoraria and Gifts, Executive Perquisites, and the American Recovery and Reinvestment Act payments.

Premium Class Travel Reviews

The Department's mission is conducted throughout the world and requires extensive travel, sometimes of a significant duration. Because of the high volume of travel, the Department has made concerted efforts to monitor if official travel has adhered to government-wide and Department regulations for premium class travel.

Beginning with FY 2006, the Department has annually selected a random sample and supporting documentation was reviewed. There have been no instances where evidence was found that a business class travel payment was unapproved and needed to be recovered, or where the travelers flying business class were found to be ineligible. However, there have been instances where proper supporting documentation was not readily available. Those errors represent an error rate of 6 percent ($34,867) in FY 2012, and 10 percent ($36,645) in FY 2011. During FY 2013, the Department will undertake efforts to correct the deficiencies noted during the FY 2012 review.

OMB requires agencies to report improper payment errors based on three categories of errors: documentation and administrative errors, authentication and medical necessity errors, and verification errors. All Department errors found each year were attributable to documentation and administrative errors.

American Recovery and Reinvestment Act (ARRA) Reviews

The Department received $564 million in funding from the American Recovery and Reinvestment Act. The Department has placed emphasis during FY 2009 and FY 2010 in obligating and during fiscal years 2010 - 2012 in expending the monies as quickly as possible to positively contribute to the facilitation of the country's recovery from the current recession. A random sample of ARRA expenses was selected and supporting documentation was reviewed. In all instances the expenses were found to be appropriate, in compliance with the Department's policies regarding ARRA activity, and supported by adequate documentation.

Schedule of Spending

The Schedule of Spending (SOS) is a new requirement by the Office of Management and Budget this year. The SOS presents an overview of how much money is available to spend and how or on what that money was spent. The data used to prepare this report is the same underlying data used to prepare the Statement of Budgetary Resources (SBR). The SOS presents total budgetary resources, gross outlays or total spending, and fiscal year obligations or amounts agreed to be spent, for the reporting entity. The term "spend", as used in this report, means paid out or used. It does not equate to expenses as reported in the Statement of Net Cost.

The Department's total resources for the year ended September 30, 2012, were $57.5 billion. During Fiscal Year 2012, the Department spent $38.4 billion of these resources as summarized below *(dollars in millions)*.

SCHEDULE OF SPENDING
For the Year Ended September 30, 2012 *(dollars in millions)*

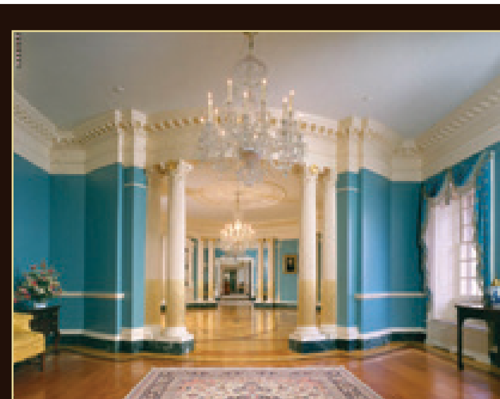
	Administration of Foreign Affairs	International Organizations	International Commissions	Foreign Assistance	Other	Total
What Money is Available to Spend?						
Total Resources	$ 31,987	$ 3,659	$ 211	$ 3,032	$ 18,644	$ 57,533
Less Amount Available but Not Agreed to be Spent	8,236	64	86	1,352	7,002	16,740
Less Amount Not Available to be Spent	373	—	5	95	268	741
Total Amounts Agreed to be Spent	$ 23,378	$ 3,595	$ 120	$ 1,585	$ 11,374	$ 40,052
How was the Money Spent?						
Personnel Compensation & Benefits	$ 6,801	$ —	$ 25	$ 8	$ 251	$ 7,085
Contractual Services & Supplies	10,646	—	86	795	2,191	13,718
Acquisition of Assets	2,185	—	1	19	231	2,436
Grants and Fixed Charges	1,478	3,568	38	660	7,425	13,169
Other	247	2	—	25	1,766	2,040
Total Spending	21,357	3,570	150	1,507	11,864	38,448
Amounts Remaining to be Spent	2,021	25	(30)	78	(490)	1,604
Total Amounts Agreed to be Spent	$ 23,378	$ 3,595	$ 120	$ 1,585	$ 11,374	$ 40,052

Heritage Assets

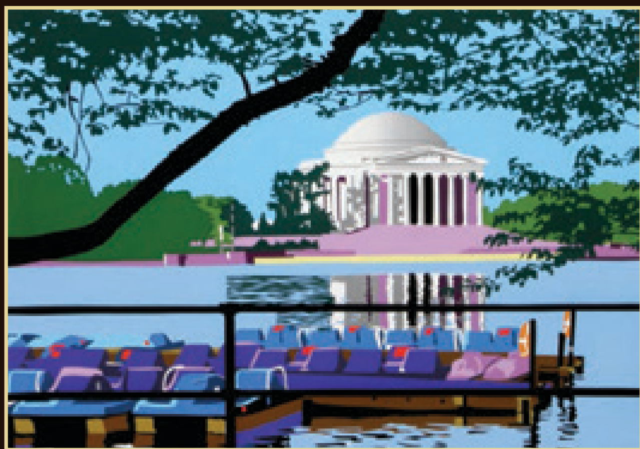
The Department has collections of art objects, furnishings, books, and buildings that are considered heritage or multi-use heritage assets. These collections are housed in the Diplomatic Reception Rooms, senior staff offices in the Secretary's suite, offices, reception areas, conference rooms, the cafeteria and related areas, and embassies throughout the world. The items have been acquired as donations, are on loan from the owners, or were purchased using gift and appropriated funds. The assets are classified into eight categories: the Diplomatic Reception Rooms, Art Bank, Art in Embassies, Cultural Heritage Program, Library Rare & Special Book Collection, the Secretary of State's Register of Culturally Significant Property, the U.S. Diplomacy Center, and the Blair House. Items in the Register of Culturally Significant Property category are classified as multi-use heritage assets due to their use in general government operations.

Diplomatic Reception Rooms

In 1961, the State Department's Office of Fine Arts began the privately-funded Americana Project to remodel and redecorate the 42 Diplomatic Reception Rooms - including the offices of the Secretary of State - on the seventh and eighth floors of the Harry S. Truman Building. The Secretary of State, the President and Senior Government Officials use the rooms for official functions promoting American values through diplomacy. The rooms reflect American art and architecture from the time of our country's founding and its formative years, 1740 - 1840. The rooms also contain one of the most important collections of early Americana in the nation, with over 5,000 objects, including museum-quality furniture, rugs, paintings, and silver. These items have been acquired through donations or purchases funded through gifts from private citizens, foundations, and corporations. No tax dollars have been used to acquire or maintain the collection. There are three public tours each day.



Top left: State Luncheon for the President of the Republic of the Philippines Benigno S. Aquino III.
Top right: The Treaty Room Suite in the Harry S. Truman Building, 7th Floor.
Right: The John Quincy Adams State Drawing Room of the Diplomatic Reception Rooms, Harry S. Truman Building, 8th Floor.
Department of State



Art Bank works include "Jefferson Memorial" (2003) Joseph Craig English, silkscreen (left) and "Bulbous" (2011) Mark Brosseau, mixed media (right).

Art Bank

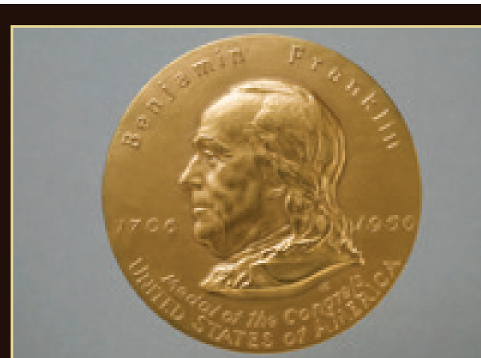
The Art Bank was established in 1984 to acquire artworks that could be displayed throughout the Department's offices and annexes. The works of art are displayed in staff offices, reception areas, conference rooms, the cafeteria, and related public areas. The collection consists of original works on paper (watercolors and pastels) as well as limited edition prints, such as lithographs, woodcuts, intaglios, and silk-screens. These items are acquired through purchases funded by contributions from each participating bureau.

Rare & Special Book Collection

In recent years, the Library has identified books that require special care or preservation. Many of these publications have been placed in the Rare Books and Special Collections Room, which is located adjacent to the Reading Room. Among the treasures is a copy of the Nuremberg Chronicles, which was printed in 1493; volumes signed by Thomas Jefferson; and books written by Foreign Service authors.

Cultural Heritage Program

The Cultural Heritage Program, which is managed by the Bureau of Overseas Buildings Operations, Office of Residential Design and Cultural Heritage, is responsible for identifying and maintaining cultural objects owned by the Department in its properties abroad. The collections are identified based upon their historic importance, antiquity, or intrinsic value.



Benjamin Franklin Medal of the Congress, 1956. Struck in honor of the 250th anniversary of Franklin's birth, and distributed to organizations which are part of Franklin's legacy. Collections of the U.S. Diplomacy Center.

Art in Embassies

The Art in Embassies Program was established in 1964 to promote national pride and the distinct cultural identity of America's arts and its artists. The program, which is managed by the Bureau of Overseas Buildings Operations, provides original U.S. works of art for the representational rooms of United States ambassadorial residences worldwide. The works of art were purchased or are on loan from individuals, organizations, or museums.

Secretary of State's Register of Culturally Significant Property

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

New Delhi Chancery, built in the 1950s, was the first major embassy building project approved in the Eisenhower years. The Chancery was designed by master architect Edward Durell Stone, who captured history and fantasy in a memorable symbol of the United States' commitment to India after its independence. The Chancery expresses the characteristic American preference for efficiency and straightforwardness.

Department of State/OBO

Hôtel Rothschild, the official residence of the U.S. Ambassador to France and Monaco was constructed between 1852 and 1855. It measures over 7,000 square meters and occupies a 1.2 hectare site at 41 Rue du Faubourg Saint-Honoré in Paris, a short distance from the U.S. Embassy and the home and offices of the French President, the Elysée Palace.

Department of State/OBO

Diplomacy Center

The U.S. Diplomacy Center will be a unique education and exhibition venue at the Department of State that will explore the history, practice and challenges of U.S. diplomacy. It will be a place that fosters a greater understanding of the role of U.S. diplomacy, past, present and future, and will be an educational resource for students and teachers in the United States and around the globe. Exhibitions and programs will inspire visitors to make diplomacy a part of their lives. The Diplomacy Center is situated within the Bureau of Public Affairs, and actively collects artifacts for exhibitions.

Blair House

Composed of four historic landmark buildings owned by GSA, Blair House, the President's Guest House, operates under the stewardship of the Department of State's Office of the Chief of Protocol and has accommodated official guests of the President of the United States since 1942. Its many elegant rooms are furnished with collections of predominantly American and English fine and decorative arts, historical artifacts, other cultural objects, rare books, and archival materials documenting the Blair family and buildings history from 1824 to the present. Objects are acquired via purchase, donation or transfer through the private non-profit Blair House Restoration Fund; transfers may also be received through the State Department's Office of Fine Arts and Office of the Chief of Protocol. Collections are managed by the Office of the Curator at Blair House, which operates under the Office of Fine Arts.

Hand-painted Chinese wallpaper ca. 1760, a gift of President John F. Kennedy's Treasury Secretary C. Douglas Dillon in 1964, provides a striking background for official welcoming ceremonies in the Lee Drawing Room of Blair House.

Department of State

Used as an office by President Harry S. Truman while in residence at Blair House 1948-1952, the Truman Study today provides a quiet retreat for visiting officials. Original portraits of the Blair family by Thomas Sully and a Charles McKim-designed fireplace mantel from Teddy Roosevelt's White House ornament the room.

Department of State

Inspector General's Assessment of Management and Performance Challenges

The Reports Consolidation Act of 2000[1] requires that the Department's Performance and Accountability Report include a statement by the Inspector General that summarizes the most serious management and performance challenges facing the Department and briefly assesses the progress in addressing them. The Office of Inspector General (OIG) considers the most serious management and performance challenges for the Department to be in the following areas:

Deputy Inspector General, Harold W. Geisel

1. Protection of People and Facilities
2. Contract and Procurement Management
3. Information Security and Information Management
4. Financial Management
5. Military to Civilian-Led Transitions—Iraq and Afghanistan
6. Foreign Assistance Coordination and Oversight
7. Diplomacy with Fewer Resources
8. Public Diplomacy
9. Effective Embassy Leadership
10. Consular Operations

1 Protection of People and Facilities

Protecting people, facilities, and information is a Department priority. Regional Security Officers (RSO) assigned overseas are entrusted with managing programs and individuals providing this security. The Department has recognized the need to improve RSO management skills and recently mandated leadership training for all of its supervisors and managers.[2] OIG is also focusing more on management and oversight of security programs to include Deputy Chief of Mission oversight of RSOs.

Protecting people, facilities, and information in areas of armed conflict and at missions rated critical for terrorist threats is a particular challenge. At some of these missions, the host government sponsors or turns a blind eye to the harassment and intimidation of mission personnel, both American and local national.[3] At one mission, the host government slowed visa issuance to security personnel to a trickle. At another, the host government interfered with incoming classified and unclassified diplomatic pouches. These actions severely hampered the mission's security operations. The Department is challenged to foster better cooperation with the host nation and effectively manage its security programs under these conditions.

The Bureau of Diplomatic Security (DS) established physical security standards for the Department's domestic facilities a few years ago in response to an executive order.[4] In recent domestic inspections, OIG found required upgrades have not occurred because of a lack of funding. DS, responsible for compliance with security standards, designs security features for upgrades and coordinates funding with Department bureaus that request security upgrades.[5] However, resources available for domestic offices have been strained as overseas requirements increase.[6]

[1] Public Law No. 106-531, 114 Stat. 2537 (2000).

[2] FY 2014 Bureau Resource Request, Bureau of Diplomatic Security.

[3] *Embassy Sanaa, Yemen* (ISP-I-10-63A, June 2010) and ISP-S-12-28A.

[4] Standards were patterned after the security standards issued by the Interagency Security Committee, under the Department of Homeland Security, as authorized by Executive Order 12977.

[5] 1 FAM 262.1-1(B), "Facilities Security Division."

[6] FY 2014 Bureau Resource Request, Bureau of Diplomatic Security.

2 CONTRACT AND PROCUREMENT MANAGEMENT

The Department continues to face challenges managing contracts and procurements, including grants and cooperative agreements. Although Departmental contracting activities have significantly increased from $1.8 billion in 2001 to $8.8 billion in 2011,[7] the Department has not met this considerable growth with a corresponding increase in contracting personnel to handle the workload.[8] To meet the burgeoning demands for its services, the Department's Bureau of Administration increased its procurement staff from 109 contracting professionals in FY 2009 to 146 in FY 2011.[9] However, the Department has not fully assessed whether the increased workforce is sufficient to meet workload requirements and to provide effective oversight.[10] Further, the anticipated cost of the Department's multi-year plan to upgrade or build new overseas facilities is over $1.5 billion annually,[11] and the Department must ensure that contractors are properly chosen, work is properly conducted and monitored, and costs are effectively contained.

In addition to increased expenditures, the Department has undertaken unprecedented responsibilities in the Middle East and has relied heavily on contractors and Department of Defense procurement support for some critical goods and services.[12] In Iraq and Pakistan, OIG identified instances in which poor contract monitoring resulted in increased costs and poor performance. In Iraq, OIG determined that the contracting officer's representatives for Embassy Baghdad's operations and maintenance contract had not verified contractor invoices against appropriate supporting documentation or the contract terms and conditions, resulting in erroneous payments to the contractor.[13]

Proper oversight and accountability of grants, contracts, and cooperative and interagency agreements are also ongoing challenges. During inspections of the Bureau of Counterterrorism[14] and the Bureau of Diplomatic Security's Office of Antiterrorism Assistance,[15] which jointly manage antiterrorism assistance totaling about $200 million, OIG found that several program managers lacked program monitoring and evaluation training. In Beirut,[16] the mission did not document the results of site visits to grantee locations, creating uncertainty on whether $3.9 million in grants and cooperative agreements were fulfilling intended purposes. The Bureau of Near Eastern Affairs (NEA) had difficulty determining the origin and progress of some of its grants for capacity-building because of insufficient training, pressure to award grants quickly, and turnover in the Bureau and at Embassy Baghdad.

OIG audits found a pressing need for improved management and monitoring of grantees. In Iraq, one grantee received eight grants, totaling about $130 million, to carry out local democracy-building programs. These eight grants exceeded their respective award budgets by a total of approximately $4.6 million because the Department did not adequately monitor program performance and did not detect questionable charges. For example, security costs were not competed, and, as a result, the $64.3 million in security costs exceeded the $49.5 million in direct costs to carry out the Iraqi democracy-building programs. Additionally, the grants officer did not provide prior approval to purchase vehicles valued at $700,000.[17] In another audit, OIG found that a Department

[7] FY 2014 Bureau Resource Request, Bureau of Administration, May 31, 2012.

[8] *State and DOD Should Ensure Interagency Acquisitions Are Effectively Managed and Comply with Fiscal Law* (GAO-12-750, August 2012).

[9] FY 2014 Bureau Resource Request, Bureau of Administration, May 31, 2012.

[10] GAO-12-750.

[11] FY 2014 Bureau Resource Request, Bureau of Overseas Buildings Operations, June 19, 2012.

[12] GAO-12-750.

[13] *Evaluation of Invoices and Payments for the Embassy Baghdad Operations and Maintenance Contract* (AUD-MERO-12-43, August 2012).

[14] *Inspection of the Bureau of Counterterrorism* (ISP-I-12-32A, June 2012).

[15] *Inspection of the Bureau of Diplomatic Security, Office of Antiterrorism Assistance* (ISP-I-12-31, June 2012).

[16] *Inspection of Embassy Beirut, Lebanon* (ISP-I-12-10A, February 2012).

[17] *Review of Costs Charged to Iraq Democracy-Building Grants Awarded to the International Republican Institute During FYs 2004–2010* (AUD-CG-12-35, June 2012).

bureau did not always follow policy guidance on managing and monitoring over $200 million in climate change grants and interagency acquisition agreements. In one instance, the Department cannot account for $600,000 in related Economic Support Funds transferred to another Federal agency.[18]

3 Information Security and Information Management

The Department continues its efforts to meet the requirements of the Federal Information Security Management Act of 2002 (FISMA), but the Department still faces challenges in implementing a fully effective information security management program. The internal control weaknesses identified during the FY 2011 FISMA evaluation, reported collectively by OIG, represent a significant deficiency.[19] The Department's Management Control Steering Committee voted to establish a reportable condition[20] under the Federal Managers Financial Integrity Act of 1982.[21] During the FY 2012 FISMA audit, OIG determined that the Department had made some progress toward improving the posture of information security. However, the Department had not documented policy and procedures to identify baseline controls in support of information technology systems. Specifically, the Department had not effectively implemented the National Institute for Standards and Technology (NIST) requirements for account management and remote access or the FISMA and Office of Management and Budget (OMB) requirements for a Plan of Actions and Milestones process.

Additionally, OIG found that overall progress had been made toward the implementation of effective logical access controls for major applications but noted that challenges remained. OIG reported[22] that logical access processes and procedures around major applications pertaining to account authorization, periodic account revalidation, concept of least privilege,[23] separation of duties, audit log monitoring, and database vulnerability assessments were deficient.

During recent inspections, OIG also identified information systems security shortcomings that leave embassies vulnerable to cyber security attacks. Information systems staff often lack appropriate security training.[24] At a number of posts, Information Systems Security Officers are not performing required duties[25] primarily because of competing priorities, inadequate guidance, or a lack of planning. To strengthen security measures and facilitate security checks, OIG has recommended that domestic bureaus consolidate classified materials and processing equipment in interior, enclosed, secure offices rather than scattering classified resources in several locations.[26]

Information technology (IT) contingency planning is critical to ensure that Department data is protected and that the Department can quickly resume operations after unforeseen incidents, such as power outages, equipment failures, or natural disasters. In December 2011, OIG noted that in 20 of 50 (40 percent) recent inspections, IT contingency planning shortcomings were identified.[27] OIG recommended

[18] *Audit of Bureau of Oceans and International Environmental and Scientific Affairs Administration and Oversight of Funds Dedicated To Address Global Climate Change* (AUD-CG-12-40, July 2012).

[19] *Evaluation of Department of State Information Security Program* (AUD/IT-12-14, November 2011).

[20] A reportable condition is defined as a control deficiency, or combination of control deficiencies, that in management's judgment, should be communicated because it represents significant weaknesses in the design or operation of internal control that could adversely affect the organization's ability to meet its internal control objectives. A reportable condition, if not addressed, could ultimately rise to the level of a material weakness if corrective actions are not taken. Reportable conditions are not reported externally.

[21] Public Law No. 97-255, 96 Stat. 814 (1982).

[22] *Audit of Department of State Access Controls for Major Applications* (AUD/IT-12-44, August 2012).

[23] The concept of least privilege is the security objective of granting users only those accesses needed to perform official duties.

[24] *Inspection of Embassy Algiers, Algeria* (ISP-I-12-06A, January 2012); *Inspection of the American Institute in Taiwan* (ISP-I-12-12A, February 2012).

[25] ISP-I-12-06A. *Inspection of Embassy Port-au-Prince, Haiti* (ISP-I-12-24A, May 2012); *Inspection of Embassy Beirut, Lebanon* (ISP-I-12-10A, February 2012).

[26] *Inspection of the Bureau of Consular Affairs, Directorate of Overseas Citizens Services, Office of Children's Issues, Office of Policy Review and Interagency Liaison, and the Planning, Programs, and Systems Liaison Division* (ISP-I-12-21, May 2012).

[27] Memorandum Report–Improvements Needed in Information Technology Contingency Planning (ISP-I-12-04, December 15, 2011).

that the Bureau of Information Resource Management (IRM) track bureau and post compliance with IT contingency planning requirements, incorporate contingency planning in Department-wide IT risk scoring methodology, and consider adherence to contingency planning requirements in performance appraisals of responsible systems owners and IRM personnel.

Cloud computing is a new challenge likely to continue into the future. Although cloud computing is the Department's second highest information technology goal,[28] key decisions and standards related to its implementation have yet to be promulgated. For example, the Department has not yet announced whether it plans to build and maintain a "private cloud," purchase services from an external provider in the "public cloud," or adopt some combination of both. A lack of guidance on this subject has led to problems and delays in development. For example, IRM's Systems and Integration Office (SIO) sought to develop private cloud technology in a way that OIG found was inconsistent with the IRM Strategic Planning Office's strategy or with the federally-mandated Cloud First Policy. Additionally, SIO's version of the cloud does not meet standards defined by NIST.

The Department continues to struggle with systems development, as noted in the inspection of the Bureau of Consular Affairs Consular Shared Tables.[29] Often domestic bureaus and offices do not follow mandated systems development life cycle requirements. In the Bureau of Educational and Cultural Affairs,[30] insufficient stakeholder involvement resulted in a system that did not meet user needs, and many offices developed separate systems to fill the gaps. The Office of Global Publishing Solutions[31] similarly developed a print management system without formally studying user requirements. OIG has also found insufficient documentation supporting system changes and inadequate security and vulnerability testing. There is no Department-mandated methodology for documenting compliance with systems development life cycle requirements, the absence of which contributes to these shortcomings.[32]

4 Financial Management

Financial management continues to be a significant management challenge for the Department. During the audit of the FY 2011 financial statements, an independent auditor identified potentially material amounts related to after-employment benefits provided to locally employed overseas staff that had not been previously reported on the Department's financial statements, which impacted the FY 2011 and 2010 financial statements. The independent auditor also identified significant internal control deficiencies related to financial reporting, property and equipment, budgetary accounting, unliquidated obligations, accounts payable accruals, and information technology.[33] In FY 2011, the Department made progress toward improving controls over financial management. For instance, the Department took actions to address certain aspects of the deficiency related to after-employment benefits. However, the Department acknowledged that the deficiencies identified in the financial statement audit report would require more attention and improvement.[34]

Another financial management issue identified during the year related to the Department's identification and recovery of improper payments. OIG reported[35] that the Department had taken steps to comply with the Improper Payments Information Act of 2002,[36] which had been amended in 2010 by the Improper Payments Elimination and Recovery Act[37] (IPERA). However, the Department's improper payments risk assessment methodology was insufficient, recapture audit activities were not performed for all types of improper

[28] Department of State IT Strategic Plan, Fiscal Years 2011–2013.

[29] *Inspection of the Bureau of Consular Affairs, Office of Consular Systems and Technology* (ISP-I-11-51, May 2011).

[30] *Inspection of the Bureau of Educational and Cultural Affairs* (ISP-I-12-15, February 2012).

[31] *Inspection of the Bureau of Administration, Global Information Services, Global Publishing Solutions* (ISP-I-12-07, January 2012).

[32] *Inspection of the Bureau of Information Resource Management, Systems and Integration Office* (ISP-I-12-30, June 2012).

[33] *Independent Auditor's Report on the U.S. Department of State 2011 and 2010 Financial Statements* (AUD/FM-12-05, November 2011).

[34] Ibid.

[35] *Audit of Department of State Compliance With the Improper Payments Information Act* (AUD/FM-12-31, March 2012).

[36] Improper Payments Information Act of 2002, Public Law No. 107-300, 116 Stat. 2350 (2002).

[37] Improper Payments Elimination and Recovery Act of 2010, Public Law No. 111-204, 124 Stat. 2224 (2010).

payments or all payments, and some improper payment disclosures required to be included in the Agency Financial Report were omitted or were inaccurate.[38] Although the Department agreed that improvements were needed, the Department indicated that it did not have any programs deemed susceptible to significant improper payments. As such, the Department stated that incorporating the efforts would be a multi-phased process and does not intend to perform a full risk assessment of programs and activities again until FY 2014. To be in compliance with IPERA during FY 2012 and 2013, the Department stated that it would determine whether any programs or activities experience a significant change in legislation or a significant funding increase and would conduct a full risk assessment for any programs or activities that meet those criteria.[39] Nevertheless, because of the deficiencies OIG found in the Department's risk assessment methodology, OIG recommended the Department implement the new risk assessment methodology for FY 2012 to ensure that the results of the Department's initial risk assessment were valid.[40]

Currently, the Department's Border Security Program, which supports activities related to consular relations, security, information resource management, and training, relies on funding from certain consular-related fees and surcharges. During an audit of how consular fees collected by the Department were used, OIG found that the Department's Border Security Program did not have a centralized program management structure.[41] For example, OIG found that program-related roles and responsibilities were not clearly defined, funding decisions were not based on prioritization factors, and overall accomplishments were not being tracked. The Department also did not have sufficient guidance on the use of the funds and did not have an adequate process in place to monitor Border Security Program expenditures. The Department revamped the budget formulation process for this program.[42]

5 MILITARY TO CIVILIAN-LED TRANSITIONS–IRAQ AND AFGHANISTAN

The United States completed its transition from a military-led to a civilian-led presence in Iraq in December 2011 and continues to plan for a similar transition in Afghanistan in 2014. In Iraq, the Department continues to react to mission priorities and a continually evolving relationship between the United States and the Government of Iraq (GOI). In Afghanistan, the Department must leverage lessons learned throughout the Iraq transition to meet a similar mission goal in Afghanistan, which is to assist Afghanistan in efforts to become a secure, stable, and self-reliant country as efficiently and effectively as possible.

On January 1, 2012, the Department became solely responsible for the U.S. Mission–Iraq (USM–I) and the associated foreign policy goals that aim to orient the GOI and the Iraqi economy towards self-sustainability and a strengthened democracy.[43] Although the United States has completed the transition from a military-led to a civilian-led presence with some measures of success, the nature and extent of the U.S. foreign policy goals and the attainment of those goals remain unclear amidst environmental and political uncertainty and lack of precedent for such a mission. The sustainment of the transition includes efforts to (1) establish a long-term diplomatic presence leading to normalizing the bilateral relationship in economics, culture, diplomacy, and security; the internal stability of Iraq; and increased stability in the region, and (2) provide the infrastructure necessary for the Department's long-term diplomatic mission including staffing, building, and supporting sites throughout Iraq.[44]

[38] AUD/FM-12-31.

[39] Comptroller Memorandum, dated April 30, 2012.

[40] OIG Memorandum, dated July 17, 2012.

[41] *Audit of Department of State Use of Consular Fees Collected in Support of the Border Security Program* (AUD/FM-12-39, August 2012).

[42] Ibid.

[43] These goals were laid out in two accords between the United States and the Government of Iraq: *Agreement on the Withdrawal of United States Forces from Iraq and the Organization of Their Activities during Their Temporary Presence in Iraq*, U.S.-Iraq, art. 24, par. 1, November 17, 2008, Temp. State Department No. 09-6; *Strategic Framework Agreement for a Relationship of Friendship and Cooperation*, U.S.-Iraq, sec. III, November 17, 2008, Temp. State Department No. 09-7.

[44] Staff of S. Comm. on Foreign Relations, 112th Congress, Iraq: The Transition from a Military Mission to a Civilian Led Effort (Comm. Print 2011).

Embassy Baghdad, NEA, and the Bureau of the Comptroller and Global Financial Services have made substantial progress establishing consulates and other support facilities and sustaining programs and operations. For example, the Department was able to assume responsibility for a multitude of support services that were previously provided by or procured by the Department of Defense, including security, air transportation, medical care, and some construction projects. In addition, in January 2012, OIG reported that Embassy Baghdad's emergency action plan was adequately resourced and tested, which is key to the embassy's ability to respond in emergency situations.[45]

Despite these achievements, the Department continues to experience challenges sustaining and rightsizing the USM–I as security throughout Iraq remains volatile and the GOI commitment to the U.S. presence and its programs remains unclear. The tradeoff between security and cost considerations when rightsizing a mission is made clear in recent analyses and estimates of the portion of costs that account for the security and support of programs in Iraq. In June 2012, GAO reported that the Departments of State and Defense allocated approximately $4 billion toward the U.S. diplomatic presence in Iraq, 93 percent of which was designated solely for security and support costs.[46] The Special Inspector General for Iraq Reconstruction (SIGIR) reported a similar analysis of the portion of support costs focused on the Police Development Program (PDP) in Iraq—a program to assist the GOI in strengthening rule of law. In July 2012, SIGIR reported that 94 percent of the PDP's projected FY 2013 budget would be dedicated to support and security activities.[47] SIGIR also questioned PDP's viability due in part to limited GOI support for the program, citing that they had repeatedly reported on the importance of obtaining host country buy-in to proposed programs for the long-term success and sustainment of relief and reconstruction activities.[48] The Department continues to work with GOI to define and facilitate a much smaller PDP than was originally envisioned.

In February 2012, the Department announced a formal effort to rightsize the U.S. mission in Iraq as it evaluates both the achievement of its policy goals and the political and security environment.[49] A number of facility changes are planned, including transferring the Baghdad Police College Annex to the Iraqis by the end of 2012 and moving the Office of Security Cooperation–Iraq from the Embassy Military Attaché and Security Assistance Annex onto the embassy complex by mid-2013, reducing or potentially ending its presence at another Baghdad site, Embassy Annex Prosperity. Such closures and reductions will likely have significant impacts on the staffing levels of other agencies involved in the mission and have implications on the overall mission infrastructure and security requirements. As the Department continues the effort to rightsize its operations in Iraq, it is important that mission priorities, security, and cost considerations are synchronized.

In its inspection of the NEA,[50] OIG recommended that the bureau document lessons learned from Iraq about military to civilian transition and provincial reconstruction teams.[51] NEA has taken steps toward, but has not yet documented, lessons learned related to provincial reconstruction teams and stabilization efforts.

The Department continues to face challenges in supporting and sustaining the civilian presence in Afghanistan as the U.S. military withdraws. Because the foreign policy goals are similar to those in Iraq, there are many opportunities for lessons learned in the planning, execution, and sustainment of Afghanistan transition efforts. U.S. officials have emphasized

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[45] *Evaluation of Emergency Action Plans for Embassy Baghdad and Consulates General Basrah and Erbil* (AUD/MERO-12-18, January 2012).

[46] *Assessment of the Transition from a Military to a Civilian-Led Mission in Iraq: Hearing Before the Subcomm. on Nat'l Sec., Homeland Def. and Foreign Operations of the H. Comm. on Oversight and Gov't Reform*, 112th Congress (2012) (statement of Michael J. Courts, Acting Director, International Affairs and Trade, Government Accountability Office).

[47] *Iraq Police Development Program: Lack of Iraqi Support and Security Problems Raise Questions about the Continued Viability of the Program* (SIGIR 12-020, June 2012).

[48] SIGIR, *Hard Lessons: The Iraq Reconstruction Experience*, Government Printing Office, Washington, 2009.

[49] U.S. Embassy Baghdad, Special Briefing by Thomas Nides, Deputy Secretary of State for Management and Resources, "Rightsizing U.S. Mission Iraq," February 8, 2012.

[50] *Inspection of the Bureau of Near Eastern Affairs* (ISP-I-11-49A, May 2011).

[51] NEA compliance correspondence (12 MDA 23430).

that Afghanistan has a much greater dependence upon foreign assistance because it has limited revenue-generating resources, more widespread energy infrastructure challenges, and a high illiteracy rate.[52] These environmental and historical factors create impediments toward maintaining adequate security while developing and training the Afghan security forces, overcoming Afghan governance and development issues, executing counternarcotics programs, and implementing rule of law and anti-corruption initiatives. Accomplishing and sustaining both short- and long-term objectives in these strategic areas is critical to achieving Department, U.S., and Afghan strategic goals central to the transition.[53]

In September 2011 and May 2012, OIG and the Special Inspector General for Afghanistan Reconstruction (SIGAR) reported on challenges the Department faced in conjunction with an increased civilian presence in Afghanistan related to the accounting, management, and reporting of costs.[54] These challenges included increased costs associated with the assumption of Department of Defense security duties, costs of opening new consulates, and need for housing and office space for the increased civilian personnel. Establishment of additional facilities increases costs as the Department becomes responsible for supplies and all service provisions, including food, motor pools, vehicle repair, air traffic control at the airport, crash and rescue, medical evacuation, and hospital services, among others.

OIG and SIGAR have also reported that security remains a primary challenge in Afghanistan.[55] Low literacy levels and the lack of basic vocational skills have hindered the training and development of the Afghan National Security Forces (ANSF). The Department also continues to face significant costs and security issues related to convoy protection and movement security needs, such as recovering killed and wounded personnel, retrieving damaged vehicles and downed aircraft, and monitoring private security contractors. Most Afghanistan Infrastructure Fund projects are experiencing acquisition and funding delays and subsequent interruptions in project execution schedules. The uncertainty of the size and composition of the ANSF over the next few years could result in inefficient and costly procurements if not closely managed.[56]

6 Foreign Assistance Coordination and Oversight

In FY 2011, U.S. foreign assistance totaled $32 billion,[57] much of which was devoted to peace and security programs in Iraq, Afghanistan, and Pakistan and global HIV/AIDS prevention and democracy promotion activities. Foreign assistance coordination among agencies and Department bureaus remains inadequate.[58] OIG has found duplication among agency programs and staffing. In the Quadrennial Diplomacy and Development Review (QDDR), the Department and the United States Agency for International Development (USAID) recognized the need to better coordinate programs and established a goal of empowering the Chief of Mission to better oversee all agency activities. Consistent with this goal, the Foreign Service Institute expanded coverage of development and foreign assistance management in its economic and political courses, including a new course on development and diplomacy.

[52] *Withdrawal from Afghanistan: Historical Lessons: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Armed Services*, 112th Congress (2012) (statement of Olga Oliker, Director, International and Security Policy Department, RAND Corporation).

[53] *Afghan National Police Training Program: Lessons Learned During the Transition of Contract Administration* (AUD/CG-11-42, August 2011); Ike Skelton National Defense Authorization Act for Fiscal Year 2011, Public Law No. 111-383, § 1235, 124 Stat. 4398 (2011).

[54] *The U.S. Civilian Uplift in Afghanistan Has Cost Nearly $2 Billion, and State Should Continue to Strengthen Its Management and Oversight of the Funds Transferred to Other Agencies* (AUD/SI-11-45, September 2011); *Limited-Scope Audit of Department of State Management of the Afghanistan Civilian Uplift* (AUD/SI-12-36, May 2012).

[55] Ibid.

[56] *Joint Strategic Oversight Plan for Afghanistan Reconstruction FY 13* (July 2012). Inspectors General of the Department of State, Department of Defense, United States Agency for International Development, and Special Inspectors General for Afghanistan Reconstruction form the Joint Strategic Planning Subgroup for Oversight of Afghanistan Reconstruction.

[57] FY 2011 Congressional Budget Justification for Foreign Operations.

[58] *Inspection of Embassy Nairobi, Kenya* (ISP-I-12-38A, August 2012); *Inspection of Embassy Pretoria, South Africa, and Constituent Posts* (ISP-I-11-42A, June 2011); *Compliance Followup Review of Embassy Islamabad and Constituent Posts, Pakistan* (ISP-C-12-28A, May 2012); *Compliance Follow-up Review of Embassy Kabul, Afghanistan* (ISP-C-11-53A, June 2011).

Given rapidly changing relationships and events in frontline states and at other missions, the need exists to regularly evaluate programs. At Embassy Beirut,[59] OIG noted that the mission had successfully increased and recalibrated assistance programs totaling $238 million to strengthen Lebanese civil society and institutions after Syrian troops withdrew in 2005. At Embassy Islamabad,[60] OIG highlighted the mission's challenge in executing extensive assistance programs. Most programs were envisioned as part of a 2009 grant engagement strategy. Changes in the bilateral relationship between the United States and Pakistan coupled with pervasive corruption and a lack of absorptive capacity in many levels of government, a daunting security environment, and a shortage of secure office space and staffing had contributed to a large pipeline of unspent assistance funding. OIG recommended the Department review all staffing plans, requests, and construction projects with an eye to scaling them back. The mission completed a rightsizing review and reduced its projected 5-year staffing numbers by 200 positions, required project-based or time-specified positions to be re-evaluated in a timely manner, and identified problems that would jeopardize the viability of current and proposed construction projects if changes in the scale of foreign assistance to Pakistan occur.[61]

Consistent with QDDR goals, the Department recently added program evaluation guidance to the *Foreign Affairs Manual*[62] (FAM) to strengthen the way the Department measures performance. Additionally, to improve security and justice sector assistance, the Department plans to evaluate all programs over $25 million at least once during the program's life cycle.

7 Diplomacy with Fewer Resources

In its FY 2014 budget guidance,[63] OMB directed all Federal agencies to cut waste, set program priorities, and make targeted investments in critical priorities. OMB also asked agencies to reduce overall requests by 5 percent below the net discretionary total of their FY 2013 budgets. The Department's QDDR also stresses the importance of working smarter and better prioritizing objectives.

The Government Accountability Office (GAO) recently reported that while the Department's Office of Rightsizing's reviews of overseas staffing levels were more consistent, the Department does not follow up on its recommendations included in those reviews. Often bureaus and missions do not use the reviews to determine appropriate staffing levels. Additionally, the Office of Rightsizing has difficulty estimating the correct number of programmatic positions and relies on other agencies to determine their own staffing needs. In light of these shortcomings, OIG continues to review overseas staffing numbers as well as the cost of maintaining U.S. staff overseas—some $570,000 per overseas officer position.[64]

In 2012, OIG recommended reducing overseas direct hire and locally employed staff positions.[65] At Consulate General Hong Kong and the American Institute in Taiwan, consular officer visa workload declined significantly without commensurate staffing adjustments. OIG also found functions performed at overseas locations that could be performed more cost effectively from a lower cost mission or from domestic locations.[66] In Vienna, OIG recommended that the Bureau of Population, Refugees and Migration move a regional facility servicing refugees from Europe and the countries in the former Soviet Union to a lower cost location. In San Jose, OIG found voucher processing costs were roughly double the costs of outsourcing the function

[59] ISP-I-12-10A.

[60] ISP-C-12-28A.

[61] Embassy Islamabad compliance correspondence (12 MDA 25018).

[62] 18 FAM 300, "Program Evaluation Policy."

[63] OMB Memorandum M-12-13, "Fiscal Year 2014 Budget Guidance."

[64] Overseas Rightsizing: State Has Improved the Consistency of Its Approach, but Does Not Follow Up on Its Recommendations (GAO-12-799, July 2012).

[65] *Inspection of: Embassy Vienna, Austria* (ISP-I-12-16A, March 2012); *Inspection of Embassy San José, Costa Rica* (ISP-I-12-23A, May 2012); *Inspection of Embassy Nassau, The Bahamas* (ISP-I-12-08A, January 2012); *Inspection of the Tri-Mission Vienna Joint Management Office* (ISP-I-12-19A, March 2012); *Compliance Followup Review of Consulate General Hong Kong, China* (ISP-C-12-29A, May 2012); and ISP-I-12-12A.

[66] ISP-I-12-10A; ISP-I-12-16A; and ISP-I-12-23A.

to the Department's Post Support Unit based in Charleston, South Carolina.

OIG has also identified countries where the Department can carry out its mission with a smaller footprint. OIG has recommended that the Department consider closing or downsizing consulates.[67] While the Department has downsized a number of consulates, none have been closed.

The Department has achieved limited success in eliminating redundant management platforms and services. Despite progress at many posts, redundancies remain in basic service areas, e.g. furniture and furnishings, motor transportation, administrative procurement, and locally employed staff recruiting.[68] The QDDR underscores the Department's commitment to continue consolidating Department and USAID administrative platforms.[69] While the Department focuses on duplicative services maintained by USAID, OIG recommends it also review other sources of redundancy, particularly at posts with Narcotics Affairs sections[70] and Centers for Disease Control offices.

8 Public Diplomacy

Several public diplomacy challenges from last year remain, including planning strategically in an era of reduced budgets, managing person-to-person outreach in a tight security environment, and effectively employing social media. As noted in the most recent inspection of the Bureau of Educational and Cultural Affairs, the Department must improve oversight of exchange visitor programs, a new challenge of concern. The Department's Management Control Steering Committee identified the Summer Work Travel program as a "material weakness" and developed a corrective action plan to monitor reforms. The Bureau has capped the number of Summer Work Travel participants in 2012, imposed a moratorium on new sponsor designations, removed several sponsor organizations, established a pilot fee-transparency program, and expanded the number of onsite reviews it conducts as additional staff is added to the Office of Private Sector Exchange.

In a recent cable to public diplomacy officers,[71] the Under Secretary of Public Diplomacy and Public Affairs noted that it was not a universal practice for public affairs officers to use annual strategic planning sessions to focus on resources and improve the impact of public diplomacy, and, consequently, OIG found a lack of public diplomacy planning on several recent inspections.[72]

Over the past decade, many embassies moved from city centers to more secure compounds in less-accessible locations. Some posts responded by closing embassy-based information resource centers and creating alternative venues like American Corners, which are hosted and staffed by local institutions. Some American Corners sites have worked well; others have not.[73] Public diplomacy officers must continue to explore innovative ways to engage critical audiences where they are, rather than relying on the audience to seek out U.S. personnel within embassy grounds.

Some public affairs sections have done an extraordinary job employing social media.[74] Others have set up Facebook, YouTube, Twitter, and Flickr sites without determining whether they have the time, resources, or appropriately trained staff to maintain fresh, interesting, and up-to-date content on sites. Missions must go beyond simply counting the number of online friends or "likes," and personnel must thoughtfully examine the messages conveyed and the extent to which they

[67] *Inspection of Embassy Berlin, Germany* (ISP-I-11-65A, September 2011); *Embassy Athens, Greece* (ISP-I-11-15A, February 2011); and ISP-I-11-42A.

[68] ISP-I-12-24A.

[69] The Department recently established a Joint Management Board with the U.S. Agency for International Development.

[70] *Compliance Follow-up Review of Embassy Bogotá, Columbia* (ISP-C-09-08A, December 2008); *Embassy La Paz, Bolivia* (ISP-I-08-56A, September 2008).

[71] "Message from Under Secretary Tara Sonenshine to All Public Diplomacy Officers and Staff," State 84040, August 15, 2012.

[72] *Inspection of Embassy Caracas, Venezuela* (ISP-I-12-09A, February 2012); *Inspection of the U.S. Mission to United Nations Educational, Scientific, and Cultural Organization, Paris, France* (ISP-I-12-26, May 2012); and ISP-I-12-16A.

[73] *Inspection of Embassy Singapore* (ISP-I-12-36A, June 2012); *Inspection of Embassy Bucharest, Romania* (ISP-I-12-45A, August 2012); *Inspection of Embassy Ljubljana, Slovenia* (ISP-I-12-46A, August 2012); and *Inspection of Embassy Hanoi and Consulate General Ho Chi Minh City, Vietnam* (ISP-I-12-11A, February 2012).

[74] ISP-I-12-12A.

support policy objectives.[75] Additionally, numerous missions, regional bureaus, and functional bureaus use social media to discuss the same issue or event. OIG has raised concerns about duplication, cost-effectiveness, and policy coordination that are not yet fully resolved.[76]

9 Effective Embassy Leadership

Ensuring that leaders and managers with appropriate skills lead our missions remains a challenge. OIG continues to find deficiencies in senior leadership at some overseas locations. While most leaders of missions abroad are performing very well, especially in areas such as advocating U.S. policies and actively engaging in public diplomacy, some are falling short in managing their missions. This has resulted in reduced productivity and effectiveness, low morale, and costly personnel curtailments.

Some leaders have demonstrated a lack of discipline in deploying personnel and financial resources. Some Chiefs of Mission have tasked their staff with numerous personally generated initiatives, which take time and resources away from work that is more central to advancing high-priority policy objectives. Some leaders fall short in developing and motivating staff, and some treat staff poorly. A very few have been insufficiently attentive to required security procedures.

All Chiefs of Mission and Deputy Chiefs of Mission, no matter how successful, could improve their performance based on feedback from their staff and their colleagues in the Department and other government agencies. For this reason, in 2010, OIG recommended that the Department institute a system to regularly assess the performance of leaders overseas and in the United States and to take remedial actions when necessary, including training, counseling, and, if necessary, reassignment.[77] While the Department's QDDR process has focused attention on strengthening leadership of overseas missions, there has been little progress on this issue during the past year. OIG continues to provide advice to the Department based on its inspections.

10 Consular Operations

Consular officers are the first line of defense in border security, and technology is at the core of their operations. The Department's refocused technology platform, Consular One, is being designed to help posts efficiently maintain security and manage large consular workloads. In the meantime, existing infrastructure and software do not always keep up with demands. On several recent inspections, including those in Caracas[78] and Singapore,[79] OIG found that inadequate bandwidth and other systems' problems slowed down visa processing times to unacceptable levels. Reducing visa processing times is a priority of the Department and the Administration,[80] given the positive impact international visitors have on our travel and tourism industries.

Physical facilities for consular operations present particular challenges, including the difficulty in projecting consular workload 10 years into the future, lengthy timelines for new construction, and mandates for secure facilities. At several missions, including Caracas[81] and Port-au-Prince,[82] OIG found consular section design did not meet requirements regarding space, security, privacy, and accessibility. The Bureau of Overseas Buildings Operations and the Bureau of Consular Affairs have been working to develop adequate designs but challenges remain.

[75] *Inspection of Embassy Lusaka, Zambia* (ISP-I-12-41A, August 2012); ISP-I-12-45A; ISP-I-12-46A; ISP-I-12-11A; and ISP-I-12-38A.

[76] ISP-I-11-49A and ISP-I-11-42A.

[77] Memorandum Report—Implementation of a Process to Assess and Improve Leadership and Management of Department of State Posts and Bureaus (ISP-I-10-68, June 29, 2010).

[78] ISP-I-12-09A.

[79] ISP-I-12-36A.

[80] Executive Order No. 13597, Establishing Visa and Foreign Visitor Processing Goals and the Task Force on Travel and Competitiveness, signed January 19, 2012.

[81] ISP-I-12-09A.

[82] ISP-I-12-24A.

Management Challenges Response

In FY 2012, the Department of State's Office of Inspector General (OIG) identified challenges in the areas of: protection of people and facilities; contract and procurement management; information security and information management; financial management; military to civilian-led transitions in Iraq and Afghanistan; foreign assistance coordination and oversight; diplomacy with fewer resources; public diplomacy; effective embassy leadership; and consular operations. The Department promptly takes corrective actions in response to OIG findings and recommendations. Highlights are summarized below.

PROTECTION OF PEOPLE AND FACILITIES	
Challenge	**Regional Security Officer (RSO) Management and Leadership Training:** The Department has recognized the benefit of enhancing RSO management skills and remains a proponent of mandated leadership training for all of its supervisors and managers. OIG is also focusing more on management and oversight of security programs to include Deputy Chief of Mission oversight of RSOs.
Actions Taken	The Bureau of Diplomatic Security (DS) uses the Post Security Program Review (PSPR) as a management oversight tool to ensure Regional Security Offices are carrying out security program responsibilities with full mission support and participation. An important component of the PSPR is RSO Leadership, Outreach, and Liaison. Regional Directors in DS International Programs were asked to pay particular attention to the relationship between the RSO and DCM and Principal Officer during the PSPR. In August 2012, DS distributed 10 Leadership Tenets to all personnel critical to DS's success in providing a safe and secure environment for the conduct of U.S. foreign policy. The tenets have been defined as expectations at every level within the Bureau. Office Directors, Field Office Special Agents-in-Charge (SACs), and Regional Security Officers (RSOs) are directed to engage their employees to formally introduce, discuss, and garner feedback about the tenets. DS has also expanded use of SharePoint technology to create and manage policy and reporting documents. Included is the requirement for the Deputy Chief of Mission (DCM) to formally register clearance/approval of these documents. To meet this requirement, the DCM or other appropriate post manager is provided access to the DS SharePoint system.
Actions Remaining	DS will solicit feedback from personnel to refine the leadership tenets and incorporate them into the DS Training Center training courses and curriculum codifying and reinforcing them at every level of the organization. Additional steps to institutionalize the tenets will follow.
Challenge	**Protecting People, Facilities, and Information in Conflict Zones:** Protecting people, facilities, and information in areas of armed conflict and at missions rated critical for terrorist threats is a particular challenge. For example, some host governments sponsored or turned a blind eye to the harassment and intimidation of mission personnel; slowed visa issuance to security personnel to a trickle; and interfered with incoming classified and unclassified diplomatic pouches. The Department is challenged to foster better cooperation with the host nation and effectively manage its security programs under these conditions.
Actions Taken	Missions experiencing such issues engage regularly with the host government at all levels and use the visits of senior U.S. Government officials to emphasize the need for better cooperation. Embassy Sanaa coordinated outreach within the mission to obtain customs clearance and registration for numerous armored vehicles, some of which had been in the port for months. In addition, post and the Diplomatic Courier Service have coordinated the use of a variety of transportation options for the delivery of classified pouches, but challenges remain. The Department also works closely through its Office of Foreign Missions (OFM) to leverage post-specific reciprocity issues whenever possible. Also, issues of harassment of U.S. Government employees are regularly addressed at all levels in the Department and most recently by the Secretary on September 21, 2012.
Actions Remaining	The Department will continue to provide high level Departmental support to address this issue.

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PROTECTION OF PEOPLE AND FACILITIES *(continued)*	
Challenge	**Funding for Physical Security Standards for the Department's Domestic Facilities:** DS established physical security standards for the Department's domestic facilities a few years ago. In recent domestic inspections, the OIG found required upgrades have not occurred because of a lack of domestic bureau funding. DS is responsible for compliance with security standards and designs security features for upgrades.
Actions Taken	DS works with Department bureaus to ensure new construction and major renovations are in compliance with DS *Physical Standards for Department of State Domestic Occupied Space*. Where deficiencies are found through the Physical Security Survey process, funding for corrections and mitigation are the responsibility of the other bureaus which can be challenging in the current budget environment. DS works with other bureaus to leverage cost efficiencies for compliance and recommends mitigations to achieve the same level of protection. After deficiencies are identified through the survey process, DS reviews the corrections to ensure compliance with standards to the maximum extent feasible.
Actions Remaining	DS will continue to work with domestic bureaus to leverage cost efficiencies for compliance or recommend mitigation to achieve the same level of protection.
CONTRACT AND PROCUREMENT MANAGEMENT	
Challenge	**Managing Contracts and Procurements:** The Department continues to face challenges managing contracts and procurements, including grants and cooperative agreements. Although Departmental contracting activities have significantly increased, the Department has not met this considerable growth with a corresponding increase in contracting personnel to handle the workload. The Department's primary acquisition organization, the Bureau of Administration's Office of Acquisitions Management (AQM), has experienced an increase in the number of procurement transactions processed and an increase in the dollar value of procurement actions issued without a corresponding increase in contracting personnel to handle the workload. During fiscal year 2011, AQM completed 27,133 contract actions valued at $8.6 billion, $955 million more than in the previous year, an increase of 12 percent.
Actions Taken	AQM hired over 76 direct-hire employees and 41 contract staff since 2008 in contract officer/procurement-related positions. In FY 2012 AQM has requested to add 40 direct hire employees to assist with the workload. In addition to staffing, the Bureau of Administration's Office of Logistics Management (A/LM) has successfully integrated and deployed the Integrated Logistics Management System (ILMS). ILMS is the Department's platform for global logistics, integrating post logistics operations with Washington headquarters and Regional Centers. Now fully deployed domestically and overseas at 260+ posts, ILMS is critical to ensuring diplomatic personnel around the world can provide the goods and services that are essential to support the Department's mission.
Actions Remaining	AQM will continue to assess its workforce, training, and tools. The OIG conducted an entrance conference with A Bureau offices in July 2012, to specifically address the Department's application of the Working Capital Fund (WCF) to achieve key Procurement Shared Services goals, including workforce capacity. AQM will continue to adjust staffing to meet the Department's procurement needs.
Challenge	**Construction of New Overseas Facilities and Selection of Contractors:** The anticipated cost of the Department's multi-year plan to upgrade or build new overseas facilities is over $1 billion annually, and the Department must ensure that contractors are properly chosen, work is properly conducted and monitored, and costs are effectively contained.
Actions Taken	The Department ensures every contractor selection is done in accordance with Federal Acquisition Regulations (FAR), Department of State Acquisition Regulations (DOSAR) and Foreign Affairs Manual (FAM) acquisitions regulations and procedures, and applicable law. Work performance is monitored by the Contracting Officer and the Contracting Officer's Representative assigned in the field. Furthermore, the Bureau of Overseas Buildings Operations (OBO) minimizes duration and cost growth allowing OBO to accomplish its key goal of strengthening consular and management capabilities by moving more people into secure, safer, and functional facilities quickly and efficiently. This is done through a robust data collection and monthly reporting process. Project managers and supervisors use these data to identify concerns on individual projects and mitigate the risk of budget and schedule overruns. In FY 2012, OBO effectively achieved an average cost growth for capital construction projects of 2.8 percent.
Actions Remaining	The Department will continue to ensure that contractors are properly chosen, work is properly conducted and monitored, and costs are effectively contained.

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CONTRACT AND PROCUREMENT MANAGEMENT *(continued)*	
Challenge	**Contract Monitoring in Iraq and Pakistan:** In addition to increased expenditures, the Department has undertaken unprecedented responsibilities in the Middle East and has relied heavily on contractors and Department of Defense procurement support for some critical goods and services. In Iraq and Pakistan, the OIG identified instances in which poor contract monitoring resulted in increased costs and poor performance. In Iraq, the OIG determined that the contracting officer's representatives for Embassy Baghdad's operations and maintenance contract had not verified contractor invoices against appropriate supporting documentation or the contract terms and conditions, resulting in erroneous payments to the contractor.
Actions Taken	The OIG inspected the Operation and Maintenance contract for the Embassy Compound in Baghdad and found that even though the contract required that items shipped to Iraq should be at the Contractor's expense, the Contractor was reimbursed for its transportation costs. The Department views this as a mistake in drafting the contract, as it was never the intent of the parties to require the Contractor to pay for transportation; such costs were very unpredictable in wartime Iraq and could not have been reasonably included in the price offered by the Contractor.
Actions Remaining	The Contractor and the Government are now in negotiations to resolve the issue. Contract oversight is a special focus of AQM in all existing and upcoming contracts in Iraq to assure that contract terms are properly set and enforced. The Department will work to ensure that the applicable contracts have been suitably amended to ensure a fair method of identifying and paying appropriately for transportation costs is included in the applicable contract.
Challenge	**Providing Proper Oversight of Interagency Agreements:** Proper oversight and accountability of grants, contracts, and cooperative and interagency agreements are also ongoing challenges. During inspections of the Bureau of Counterterrorism (CT) and the Bureau of Diplomatic Security's (DS) Office of Antiterrorism Assistance, which jointly manage antiterrorism assistance totaling about $200 million, the OIG cited the need for improved monitoring procedures of contractor performance, and the timely review and processing of invoices.
Actions Taken	On June 8, 2012, DS issued Office Policy Directive 07-FY 2012, which provides guidance on required coordination between DS program managers and regional security offices to ensure adequate oversight of contractual services in the deliverance of training conducted abroad. This will facilitate a prompt review of all related invoices and supporting documentation. To address program managers' lack of program monitoring and evaluation training, CT required CT program implementers to attend the Overview of Federal Assistance Management course (PP425). As of September 27, 2012 three employees out of 35 have completed the course and two others are registered.
Actions Remaining	CT will ensure that all 35 employees complete the training.
Challenge	**Managing Grants and Cooperative Agreements:** In Beirut, the mission did not document the results of site visits to grantee locations, creating uncertainty on whether $3.9 million in grants and cooperative agreements were fulfilling intended purposes. The Bureau of Near Eastern Affairs (NEA) had difficulty determining the origin and progress of some of its grants for capacity-building because of insufficient training, pressure to award grants quickly, and turnover in the Bureau and at Embassy Baghdad.
Actions Taken	NEA clarified with Embassy Beirut that this OIG recommendation was specific to the Embassy Small Grants Program. Post's Middle East Partnership Initiative (MEPI) staff remains in full compliance with all MEPI regulations based on the last MEPI grant review conducted by visiting Tunis MEPI Director in May 2012. Embassy Beirut established a standard procedure for the project officers who monitor the Embassy Beirut Small Grants Program to include: 1) project officer training as a requirement; 2) supervisors will add narrative on grants management duties to project officers' work requirements against which they will be rated ; and 3) project officers will use the site visit reporting forms in post's Standard Operating Procedure.
Actions Remaining	NEA and Embassy Beirut will implement additional corrective action as needed.

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CONTRACT AND PROCUREMENT MANAGEMENT *(continued)*	
Challenge	**Management and Monitoring of Grantees:** In Iraq, one grantee received eight grants, totaling about $130 million, to carry out local democracy-building programs. These eight grants exceeded their respective award budgets by a total of approximately $4.6 million because the Department did not adequately monitor program performance and did not detect questionable charges. For example, security costs were not competed, and, as a result, the $64.3 million in security costs exceeded the $49.5 million in direct costs to carry out the Iraqi democracy-building programs. Additionally, the grants officer did not provide prior approval to purchase vehicles valued at $700,000.
Actions Taken	In FY 2011, the NEA/Iraq Grant Team carried out the following activities: 1) provided Grant Officer Representative (GOR) Training for approximately 30 personnel involved in grants management; 2) worked with a third party contractor on an assessment of two major programs: the Quick Response Fund and the Targeted Development Fund ; and 3) contracted for technical support to assist GORs with regular monitoring and evaluation of all NEA/Iraq grants by the Monitoring and Evaluation Team (M&E Team). This contract is an Indefinite Delivery, Indefinite Quantity (IDIQ) and is open for use through individual Task Orders for other bureaus and sections with programs in Iraq. In FY 2012, the NEA/Iraq Grant Team carried out the following activities: 1) conducted GOR training in Baghdad for approximately 35 grants management personnel; 2) conducted in-depth training for the new M&E Team in Iraq; and 3) worked with post to establish Standard Operating Procedures to manage the Ambassador's Funds.
Actions Remaining	In October 2012, NEA will hold the first of regularly scheduled annual GOR training sessions in Baghdad for approximately 40 Embassy personnel. The training will include aspects of pre-award competition in addition to the post-award management curriculum. In December 2012, Embassy Baghdad will hold the first of regularly scheduled annual M&E training sessions at post.
Challenge	**Managing and Monitoring Climate Change Grants and Interagency Agreements:** The Department needs to abide by policy guidance on managing and monitoring over $200 million in climate change grants and interagency acquisition agreements. In one instance, the Department cannot account for $600,000 in related Economic Supports Funds transferred to another Federal agency.
Actions Taken	Funding was transferred to USAID via an interagency agreement and programmed for a Development Credit Authority guarantee of a commercial loan in India. The Bureau of Oceans and International Environmental and Scientific Affairs (OES) considers the activity attempted in good faith and pursuant to the terms of the agreement, though the loan fell through at the end of the fiscal year and the funding expired (these funds then reverted back to the U.S. Treasury). To date, OES and the Office of U.S. Foreign Assistance Resources worked to properly account for the $600,000 in Economic Support Funds transferred to USAID, including issuance of a formal inquiry to USAID. This requires USAID to reconcile their internal accounts, an ongoing process that has been the source of the current delay.
Actions Remaining	Actions remaining include follow-up with USAID before a determination of any further actions can be made. More broadly, the audit process has assisted OES in its pursuit to continually strengthen operating procedures and programmatic oversight, and has prompted the Bureau of Administration to develop a new Departmental policy on interagency agreements, a process in which OES has been actively engaged.
INFORMATION SECURITY AND INFORMATION MANAGEMENT	
Challenge	**Implementing a Fully Effective Information Security Management Program:** The Department needs to effectively implement the National Institute for Standards and Technology (NIST) guidance for account management and remote access and Office of Management and Budget (OMB) requirements for a Plan of Actions and Milestones (POA&M) process.
Actions Taken	The Department has implemented an effective and cost efficient risk management-based information security program. Necessary improvements have brought POA&M processes in compliance with requirements and applicable guidance. Remote administrative access is appropriately evaluated, granted and monitored.
Actions Remaining	The Department will address other user account management issues, e.g., unused and "stale" accounts will be monitored and scored in iPost.

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INFORMATION SECURITY AND INFORMATION MANAGEMENT *(continued)*	
Challenge	**Implementation of Effective Logical Access Controls for Major Applications:** The OIG reported that logical access processes and procedures around major applications pertaining to account authorization, periodic account revalidation, concept of least privilege, separation of duties, audit log monitoring, and database vulnerability assessments were deficient.
Actions Taken	The Department works with bureaus to bring about adherence to certification and accreditation procedures, including implementing scanning and vulnerability database assessments, as appropriate. For example, recently the Bureau of Diplomatic Security has begun the process of evaluating and selecting appropriate scanning tools for its systems.
Actions Remaining	The Department will continue to work with bureaus to achieve compliance with logical access processes and procedures around major applications, and will promulgate audit log management procedures for account processes and procedures.
Challenge	**Lack of Security Training for Information Systems Staff:** The OIG report that Information Systems staff often lack appropriate security training. At a number of posts, Information Systems Security Officers are not performing required duties primarily because of competing priorities, inadequate guidance, or a lack of planning.
Actions Taken	The Department has developed and implemented a role-based Information Assurance (IA) training program that meets the Federal requirements and guidance associated with the Federal Information Security Management Act of 2002 (FISMA) and Office of Personnel Management (OPM) regulations. Information Systems Security Officers (ISSO) receives appropriate guidance and training within one year of appointment. The ISSO course is a 40 hour instructor-led training course.
Actions Remaining	IRM will continue to work with DS to develop role based training for IT professionals who have elevated account (administrative) privileges. This training program is expected to be completed this calendar year.
Challenge	**IT Contingency Planning Requirements:** The Department needs to put in place a tracking methodology to ensure bureaus and posts comply with information technology contingency planning requirements.
Actions Taken	Local conditions vary so markedly that contingency planning at each mission is necessarily unique to post and to local civil and environmental conditions. Post's IT contingency plan is required to be incorporated into its emergency action plan. As noted by 12 FAH-1 H-231 the emergency action committee (EAC), as designated by the chief of mission is responsible for full mission participation in the completion of emergency preparedness activities and the Department looks to the EAC to rate effectiveness of local contingency strategies as measured against the context of local conditions. The Department is working on additions to 12 FAH-1, Emergency Planning Handbook that will allow IT contingency planning to be incorporated into the overall emergency action planning and automated tracking process.
Actions Remaining	Action will be completed after additions to 12 FAH-1 that will allow IT contingency planning to be incorporated into the overall emergency action planning and automated tracking process.
Challenge	**Implementation of Cloud Computing:** The challenge is to implement the cloud strategy in a way that provides genuine operational and customer benefits across the Department. Transitioning existing, traditionally acquired, infrastructure to the cloud is a lengthy and complex process that involves policy, security, performance, budget, acquisition, and human resources. To achieve lasting benefits, it requires an incremental approach, establishing an internal private IaaS (Infrastructure as a Service) cloud offering consistent with NIST guidelines.
Actions Taken	As a key Departmental strategic priority goal, the Department has implemented a tailored cloud computing program, which calls for a hybrid approach to cloud computing. This approach has two primary elements. The first, is the use of the public cloud for low security risk "open" systems; to date, five systems have been migrated to the public cloud. The second, is the transition from traditionally acquired infrastructure to a cloud computing model, which is a longer term and more complex transition process. In addition, the Department has established the Cloud Computing Clearinghouse to coordinate cloud initiative across the Department and to leverage best practices across industry and government.
Actions Remaining	The Department will continue to transition existing infrastructure toward an internal private IaaS cloud model leveraging the Working Capital Fund (WCF) and developing capabilities consistent with NIST guidelines.

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INFORMATION SECURITY AND INFORMATION MANAGEMENT *(continued)*	
Challenge	**Systems Development:** Collection and interpretation of customer requirements is a key factor to the success of application development when following the System Development Life Cycle (SDLC) process, and in some cases, this is not working. Collection of requirements should also include determining if another solution already exists.
Actions Taken	Project planning training and certification is available for SDLC including requirements. The *Managing State Projects* (MSP) course is required for all project managers, and OMB requires that major projects be managed by government managers who are Project Management Professional (PMP) certified. Under Project One Voice, the applications working group identified one finding for systems developers, particularly those developing systems where Post are primary users, to engage the user community to gather and help validate requirements. In addition, a working group was established to define best practices for systems analysis and collection of customer requirements, which will be published in an update to MSP methodology focusing on IT projects (MSP-IT) that includes gate reviews by Enterprise Architecture (EA) to mitigate duplicative initiatives.
Actions Remaining	IRM will finalize the MSP-IT methodology, which will include gate reviews prior to any systems development, Bureaus should consult with the eGov PMO (including EA) to determine if a similar system is in development, or has been developed.
FINANCIAL MANAGEMENT	
Challenge	**Improving Internal Controls over Financial Management:** During the audit of the FY 2011 financial statements, an independent auditor identified potentially material amounts related to after-employment benefits provided to locally employed overseas staff that had not been previously reported on the Department's financial statements, which impacted the FY 2011 and 2010 financial statements. The independent auditor (IA) also identified significant internal control deficiencies related to financial reporting, property and equipment, budgetary accounting, unliquidated obligations, accounts payable accruals, and information technology.
Actions Taken	For the four FY 2011 principal financial statements, the Department received an unqualified ("clean") opinion for the Statement of Budgetary Resources and the Consolidated Statement of Net Cost. However, late in FY 2011, the independent auditor (IA) identified issues with the Department's reporting of after-employment (i.e., retirement) benefits for the Foreign Service Nationals (FSNs) employed around the world. Consequently, the IA issued a qualified opinion for the Consolidated Balance Sheet and Statement of Changes in Net Position. The Department has put in considerable effort this year to address the priority concerns highlighted in the FY 2011 Report of Independent Auditors. In particular, the Department worked methodically with the IA and others to: (1) establish a comprehensive inventory of after-employment benefits; (2) determine the correct accounting standards to use for reporting FSN after-employment benefits'; and (3) establish the methods to calculate the projected liabilities for these after-employment benefits. In addition, the Bureau of the Comptroller and Global Financial Services (CGFS) continues to work with all Bureaus and posts to make improvements in other areas identified as significant deficiencies, such as our management of property and equipment, unliquidated obligations and the accounts payable accruals process.
Actions Remaining	CGFS is in the final stages of completing the methods for calculating the projected liabilities for the after-employment benefits in order to address this deficiency for the FY 2012 Financial Statements. In FY 2013, the Department will establish a new global defined contributions after-employment plan for posts to participate in that will provide a uniform and standard after-employment benefit option.

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FINANCIAL MANAGEMENT *(continued)*	
Challenge	**Recovery of Improper Payments:** The OIG reported that the Department had taken steps to comply with the Improper Payments Information Act of 2002, which had been amended in 2010 by the Improper Payments Elimination and Recovery Act (IPERA). However, the Department's improper payments risk assessment methodology was insufficient, recapture audit activities were not performed for all types of improper payments or all payments, and some improper payment disclosures required to be included in the Agency Financial Report were omitted or were inaccurate.
Actions Taken	The Bureau of the Comptroller and Global Financial Services (CGFS) concurred with many of the IPERA audit review findings. Specifically, we agreed that stronger policies and procedures for our risk assessment activities, recapturing activities, and reporting activities should be developed and documented, but did not agree that the risk assessment methodology was insufficient. During FY 2012, we have documented Standard Operating Procedures, and prepared updates to the FAM and FAH for the impact of IPERA. We have also worked to bolster our IPERA risk assessment process where appropriate and developed a multi-year transition plan. As required by *Public Law No. 111-204, Improper Payments Elimination and Recovery Act of 2010*, agencies are required to review programs and activities to identify those that may be susceptible to significant improper payments in the year after enactment (i.e., 2011) and at least once every three fiscal years thereafter for programs deemed not risk susceptible. For FY 2011, based on a risk assessment performed in FY 2011, the Department reported that it did not have any programs deemed susceptible to significant improper payments. As such, the Department is not required to perform the next full risk assessment of programs and activities until FY 2014. During FY 2012 and FY 2013, we will conduct a full risk assessment for any programs or activities that experience a significant change in legislation or significant funding increase. Also, in FY 2013, we will begin our efforts to perform a full risk assessment that would incorporate those changes made to bolster our process (e.g., including changes and results of our Do Not Pay efforts) with the objective of completing the full risk assessment required by mid-FY 2014.
Actions Remaining	Incorporating these new efforts will be a multi-phased process. As noted above, the Department does not intend to perform the next full risk assessment of programs and activities until FY 2014. For FY 2013, the Department will determine whether any programs or activities experience a significant change in legislation or significant funding increase, and conduct a full risk assessment for any programs or activities that meet those criteria. If any programs are determined to be high risk, the Department will also pilot additional recapture auditing activities to explore the inclusion of additional payment types, audit activities for higher-risk programs, analytics, and a documented cost-benefit analysis into our current recapture audit process. These specific requirements will be evaluated and implemented to the extent they are cost-effective and a beneficial use of government funds.
Challenge	**Border Security Program:** Currently, the Department's Border Security Program (BSP), which supports activities related to consular relations, security, information resource management, and training, relies on funding from certain consular-related fees and surcharges. However, a number of clarifications are needed to the existing guidance on the use of the funds and for monitoring Border Security Program expenditures.
Actions Taken	The Bureau of Consular Affairs (CA) is in the process of updating 1 FAM 250 to formalize its authority as the overall program management office for the Border Security Program. In addition, CA is developing Service Level Agreements (SLAs) with Department bureaus that receive consularfee funding, in order to formalize the roles and responsibilities for all parties involved in the BSP. CA will continue to use the annual budget formulation process, along with the new SLAs, to formalize the process for prioritizing BSP funding requests.
Actions Remaining	CA intends to work with its BSP-partner bureaus to design a process for developing goals, indicators, and performance measurements, and to use that process to develop an overarching goal and performance management structure for the BSP. As part of the new SLAs, CA will monitor the use of BSP funds by performing quarterly reviews of Bureau expenditures. In addition, CA plans to evaluate whether overseas posts are spending border security funds in accordance with Department guidelines, as part of the Bureau-wide internal review program.

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MILITARY TO CIVILIAN-LED PRESENCE: IRAQ	
Challenge	**Sustainment of Transition and Achieving Foreign Policy Goals in Iraq:** On January 1, 2012, the Department became solely responsible for the U.S. Mission-Iraq (USM-I). Although the United States has completed the transition from a military-led to a civilian-led presence with some measures of success, attaining the goals of aiming to orient the Government of Iraq (GOI) and the Iraqi economy towards self-sustainability and a strengthened democracy remains unclear amidst environmental and political uncertainty and lack of precedent for such a mission. The sustainment of the transition includes efforts to: establish a long-term diplomatic presence leading to normalizing the bilateral relationship in economics, culture, diplomacy, and security; the internal stability of Iraq; and increased stability in the region; and provide the infrastructure necessary for the Department's long-term diplomatic mission including staffing, building, and supporting sites throughout Iraq.
Actions Taken	Efforts to promote Iraq's democratic development include strengthening Iraq's democratic institutions, specifically provincial elections in 2013 and national elections in 2014. Staff at the Embassy meets regularly with President Talabani, Prime Minister Maliki, cabinet ministers, parliamentarians, and civil society leaders throughout Iraq. Our civilian presence as planned will continue to permit significant engagement and outreach activities fully supported by our Regional Security Office. In the past year, Iraq has made strides to improve relations with regional and international actors. It hosted a successful Arab League Summit with twenty-one delegations, including nine heads of state/government. Iraq also hosted the P5+1 talks on Iran's nuclear enrichment program. Iraq faces challenges addressing the crisis in Syria, and aspects of its relations with Turkey and GCC countries, but there is open dialog and signs of movement, including complex relations with Kuwait. The Department is providing substantial diplomatic support to Iraq's efforts to re-establish itself in the Arab world through strong, responsible relations with its neighbors, and with the international community. Under the Strategic Framework Agreement, the Governments of Iraq and the United States continue to work together at the most senior levels on a wide range of issues through eight Joint Coordination Committees (JCC), including defense and security, education and cultural affairs, energy, law enforcement and judicial cooperation, politics and diplomacy, services, and trade and finance. In recent months, we have hosted Iraq's Education and Defense Ministers, Deputy Prime Minister Shahristani, Deputy National Security Advisor, and Chief Justice of the Supreme Court Medhat for the latest round of JCC meetings on education, defense, energy, and judicial issues. The Department of State has assumed lead for logistic operations in Iraq in January 2012. The principal vehicle remains the Logistic Civil Augmentation Program (LOGCAP) contract, which State oversees, with assistance from personnel by the Defense Contract Management Agency (DCMA), the Defense Contract Audit Agency (DCAA), and the Defense Logistics Agency (DLA). State has awarded a new contract for facilities maintenance which will replace similar LOGCAP functions at State sites on a rolling basis throughout Iraq in FY 2013.
Actions Remaining	State's own logistic contract, the Baghdad Life Support Service (BLiSS), will be competed in FY 2013 and is scheduled to replace remaining LOGCAP functions at this site by 2014. The Department is enhancing its contract oversight capacities in Iraq; whether further assistance will be requested by the Department of Defense contract oversight organizations in FY 2014 is not yet decided. State Department work on infrastructure construction will concentrate on work require for further facility consolidation, with a permanent New Consulate Compound (NCC) in Erbil slated for completion in 2017. The Department's Bureau of International Narcotics and Law Enforcement Affairs (INL) operates Embassy Air Iraq, with a fixed and rotary wing fleet, which will be phased out as reliable, safe commercial alternatives become available.

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MILITARY TO CIVILIAN-LED PRESENCE: IRAQ *(continued)*	
Challenge	**Rightsizing:** In February 2012, the Department announced a formal effort to rightsize the U.S. mission in Iraq as it evaluates both the achievement of its policy goals and the political and security environment. A number of facility changes are planned, including transferring the Baghdad Police College Annex to the Iraqis by the end of 2012 and moving the Office of Security Cooperation–Iraq from the Embassy Military Attaché and Security Assistance Annex onto the embassy complex by mid-2013, reducing or potentially ending its presence at another Baghdad site, Embassy Annex (EMASAA) Prosperity. Such closures and reductions will likely have significant impacts on the staffing levels of other agencies involved in the mission and have implications on the overall mission infrastructure and security requirements. As the Department continues the effort to rightsize its operations in Iraq, it is important that mission priorities, security, and cost considerations are synchronized.
Actions Taken	Embassy rightsizing is not driven by facility closures; facility closures occur as mission-driven rightsizing steps are taken, along with whatever security and support downsizing as permitted by increased normalization of conditions in Iraq. The goal is the most effective Mission structure to achieve our highest priority strategic goals, while keeping our people safe and supported. The closure of Baghdad Police College Annex (BPAX), for example, did not prompt the design of the new Police Development Program (PDP), but reflected decisions by INL made about PDP, in consultations with the Government of Iraq on the evolving requirements of the program. The closure of Office of Security Cooperation (OSC)-I base Kirkuk reflected the decision to shift specific Foreign Military Sales (FMS) cases to other locations; State programs in Kirkuk continue from a temporary location in Erbil, but no final decision has been made about whether to reopen Consulate Kirkuk at a later time. That decision will be made based on mission, security, and cost-effectiveness. Similarly, the projected closure of EMASAA and Embassy Annex Prosperity by the end of calendar year 2013 were based on decisions about the structure of OSC-I and the projected support requirements of the Chancery, respectively, and were made in full consultation with affected agency and by the Chief of Mission, in accordance with responsibilities laid out in National Security Decision Directive (NSDD)-38 and the President's Letter of Instruction.
Actions Remaining	The Department will continue to rightsize operations in Iraq as increased normalization conditions in Iraq permit. Mission priorities, security and cost considerations will continue to be taken into consideration as the effort proceeds.
MILITARY TO CIVILIAN-LED PRESENCE: AFGHANISTAN	
Challenge	**Supporting and Sustaining the Civilian Presence in Afghanistan:** The Department continues to face challenges in supporting and sustaining the civilian presence in Afghanistan as the U.S. military withdraws. Because the foreign policy goals are similar to those in Iraq, there are many opportunities for lessons learned in the planning, execution, and sustainment of Afghanistan transition efforts. U.S. officials have emphasized that Afghanistan has a much greater dependence upon foreign assistance because it has limited revenue-generating resources, more widespread energy infrastructure challenges, and a high illiteracy rate.
Actions Taken	The Department recognizes that environmental and historical factors coupled with the internal security threat continues to challenge U.S., ISAF, and Afghan abilities to maintain adequate security while developing and training the Afghan security forces. Alongside these security efforts, our mission has worked hard to overcome Afghan governance and development issues, execute counternarcotics programs, and implement rule of law and anti-corruption initiatives in order to strengthen the Afghan state and ensure stability.
Actions Remaining	The Department will continue to work with its allies and Afghanistan to sustain both short and long-term objectives in the areas critical to achieving Department, U.S., and Afghan strategic goals central to the transition.
Challenge	**Increased Civilian Presence in Afghanistan:** In September 2011 and May 2012, OIG and the Special Inspector General for Afghanistan Reconstruction (SIGAR) reported on challenges the Department faced in conjunction with an increased civilian presence in Afghanistan related to the accounting, management, and reporting of costs. These challenges included increased costs associated with the assumption of Department of Defense security duties, costs of opening new consulates, and need for housing and office space for the increased civilian personnel.
Actions Taken	As our civilian presence consolidates from our presence in over 80 plus military platforms into our enduring presence posts, the Department will continue to minimize operating costs whenever possible, to create an enduring and normalized presence that is consistent with global priorities.
Actions Remaining	The Department will continue to use a "Whole of Government" approach to leverage capabilities across agencies and avoid redundancies. Review of staffing and funding projections will continue with an aim to scale the U.S. enduring presence appropriately in Afghanistan post-2014.

(continued)

MILITARY TO CIVILIAN-LED PRESENCE: AFGHANISTAN *(continued)*	
Challenge	**Security:** OIG and SIGAR have also reported that security remains a primary challenge in Afghanistan. Low literacy levels and the lack of basic vocational skills have hindered the training and development of the Afghan National Security Forces (ANSF).
Actions Taken	This challenge falls largely under the purview of the Department of Defense (DoD). According to DoD, literacy training for the ANSF is a major part of a national transformation in human capital development. So far, more than 150,000 ANA and 118,000 ANP members have received some level of literacy training since November 2009. An average of 5,200 ANA and 4,500 ANP receive training on any given month. Literacy training enables ANSF service members to learn required skills at vocational schools, enhances instruction on human rights and the rule of law, and promotes the long-term sustainability of the force as well as post-service economic opportunity. As focus has shifted from force growth to force development, literacy training efforts have likewise begun shifting to increasing the number of ANSF personnel at the international standard for functional literacy (Level 3). Level 3 literacy is also required for ANSF personnel to attend professional military and branch schools, as it enables students to learn technical information and skills. Increasing the number of ANSF personnel at Level 3 literacy will have a significant positive impact on basic vocational capacity of the ANSF. As members return to civilian life from the ANSF, those benefits spread across the country to society as a whole.
Actions Remaining	The Department of Defense continues to pursue literacy and vocational training within ANSF and civilian institutions. What, how, and if this training will continue post-2014 will largely depend on the enduring presence military footprint.
FOREIGN ASSISTANCE COORDINATION AND OVERSIGHT	
Challenge	**Foreign Assistance Coordination and Oversight:** The Department must establish a project management expertise to manage, monitor and evaluate foreign assistance programs.
Actions Taken	On February 22, 2012, the Deputy Secretary for Management and Resources distributed a revised Department policy on program evaluation. This policy applies to the Department's diplomatic and development programs, projects, and activities and calls for the establishment of a Bureau evaluation plan and coordinator. Evaluation Guidance was released in Spring 2012 outlining planning for evaluations, data collection methods, and roles and responsibilities, and briefings offered to the bureau evaluation coordinators. In addition, the Department awarded a contract for use by the bureaus to obtain contractual support in evaluating diplomatic and development efforts and embarked on high-level data driven reviews of cross-cutting initiatives, such as Economic Statecraft, Global Health, and Global Climate Change.
Actions Remaining	The Office of U.S. Foreign Assistance Resources (F) and the Bureau of Budget and Planning (BP) will continue to collaborate with the Foreign Service Institute to refine and develop specific evaluation and performance management-related modules and training throughout their current course curriculum. F and BP also will continue to advocate for allocating funding specifically to support program evaluations and provide evaluation expertise and knowledge to bureaus and offices.
DIPLOMACY WITH FEWER RESOURCES	
Challenge	**Rightsizing:** The Department is working closely through the Office of Rightsizing and regional bureaus to ensure that staffing at overseas missions and domestic bureaus is appropriate, given the high cost of maintaining U.S. staff overseas.
Actions Taken	The Department takes seriously the mandate to rightsize the U.S. Government presence overseas. All overseas posts are now subject to "rightsizing reviews" approximately every 5 years to monitor staffing changes and develop staffing projections for out-years. As the Department expands to meet global challenges, this process assists the Department and USAID in appropriately allocating positions, adding and decreasing staff to meet changing needs.
Actions Remaining	Chief of Missions, who have clear authority via National Security Decision Directive 38 (NSDD-38) to control staffing levels at posts overseas, will continue to consult with the Department's regional bureaus and the agencies comprising their missions in making decisions about staffing levels.

(continued)

DIPLOMACY WITH FEWER RESOURCES *(continued)*	
Challenge	**Regionalization of Administrative Services:** The Department should expand regionalization of administrative services to achieve economies of scale in administrative support and reduce the average operating costs for posts.
Actions Taken	Regionalization of support services, voucher processing and six other management initiatives make up the "Top 8" target areas for cost reductions identified by the Regional Initiatives Council and spearheaded by M/PRI. The other six include warehousing, expendable supplies, furniture pools, utilities, local transportation and TDY cost containment.
Actions Remaining	The Department will continue to capitalize on opportunities to consolidate administrative support services to better serve medium and small-sized posts.
Challenge	**Redundant Management Services:** The Department has achieved limited success in eliminating redundant management platforms and services. Despite progress at many posts, redundancies remain in basic service areas, e.g. furniture and furnishings, motor transportation, administrative procurement, and locally employed staff recruiting. The QDDR underscores the Department's commitment to continue consolidating Department and USAID administrative platforms. While the Department focuses on duplicative services maintained by USAID, OIG recommends it also review other sources of redundancy, particularly at posts with Narcotics Affairs sections and Center for Disease Control offices.
Actions Taken	In summer 2012, the Department advised all posts with a USAID presence that the State Department and USAID must combine furniture pools. Posts were further advised to establish a furniture pool, if one did not already exist, to encourage other agencies to join and reduce redundancies.
Actions Remaining	In FY 2013, The Department will calculate for all interested agencies an assessment of other agency furniture and the estimated one-time and on-going annual assessment cost for that agency to join each post's furniture pool. Posts must also continue to encourage wider participation.
PUBLIC DIPLOMACY	
Challenge	**Oversight of Exchange Visitor Program:** The Department must improve oversight of exchange visitor programs, and the Department's Management Control Steering Committee identified Summer Work Travel program as a "material weakness" with a need to develop a corrective action plan to monitor reforms.
Actions Taken	The Summer Work Travel (SWT) Program is currently in the midst of the most significant series of reforms in its nearly 50-year history. Beginning with an Interim Final Rule in July 2011, followed by a cap on the SWT program size, a moratorium on new sponsors, a second Interim Final Rule in May 2012, and a major restructuring of the Office of Private Sector Exchange, which includes the creation of a third office, the Department is now poised to publish a final set of reforms in 2013. Additionally, ECA completed an unprecedented SWT national monitoring program during the summer of 2012, visiting 650 work and housing sites in 31 states.
Actions Remaining	ECA believes that the continued rulemaking in early 2013 combined with the 2013 OIG compliance follow-up review and internal administrative reform will address this weakness.
Challenge	**Strategic Framework for Public Diplomacy:** With tighter budgets, the Department needs to think more strategically about how best to improve the impact of public diplomacy and to use resources to engage, inform and influence foreign publics in support of U.S. strategic objectives.
Actions Taken	The Department has undertaken a number of initiatives to better deploy resources in line with current priorities and to improve strategic planning and reporting for public diplomacy. There have been significant shifts of Public Diplomacy resources within bureaus to bring funding levels in line with current priorities, and we have shifted funds among bureaus as needed.
Actions Remaining	FSI's Public Diplomacy Training Division will continue to emphasize and expand strategic planning courses, including the recent launch of an online course which will allow a baseline level of knowledge across the public diplomacy spectrum. The Public Diplomacy Implementation Plan template will be finalized by the end of FY 2013 for piloting in FY 2014. Improvements to the Mission Activity Tracker will continue throughout FY 2013.

(continued)

PUBLIC DIPLOMACY *(continued)*	
Challenge	**Security Issues:** Security considerations have increasingly restricted public access to U.S. embassies and consulates. Finding the right balance between legitimate security concerns and the need to proactively engage foreign publics is a challenge in the execution of effective public diplomacy.
Actions Taken	The Department created a specific office under the Bureau of International Information Programs (IIP) to oversee planning, standards, management and evaluation of American spaces. Clear standards have been developed, which will ensure that the appropriate public diplomacy platform is used for each environment and that sustainability, as well as evaluation metrics, are an integral component. In addition, a pilot program that will allow a public diplomacy section to "go on the road" with their outreach, is being deployed to the field.
Actions Remaining	The Department continues to explore innovative ways to ensure public diplomacy is engaging critical audiences where they are, rather than relying on the audience to seek out U.S. personnel. The Department is attuned to possible impact on participant levels when a Public Affairs Section moves from an off-embassy/consulate location into a more secure embassy/consulate compound. As a pilot project, the Consulate General in Guangzhou is collecting data to observe the effect of increased security on public diplomacy engagement at the new consulate building opening in Spring 2013.
Challenge	**Use of Social Media:** Posts and domestic bureaus are making very effective use of social media at posts, including Facebook, Twitter, and popular local platforms. Social media efforts are loosely coordinated across the Department, with each bureau and mission largely determining for themselves how to apply these new communications technologies to advance their strategic goals. This approach has proved successful thus far, with the Department being widely recognized as a leader in this area amongst other U.S. Government agencies and ministries of foreign affairs. One challenge that the Department faces is ensuring diplomacy keeps pace with non-state actors' use of technological innovations such as new mobile devices and applications, while at the same time ensuring the new devices and applications are adequately supported and do not pose security risks.
Actions Taken	The Office of the Under Secretary for Public Diplomacy and Public Affairs has led efforts across the R-family of bureaus to respond to recommendations made by the OIG in ISP-1-11-10 "Review of the Use of Social Media by the Department of State." As part of this response, the Office of Policy, Planning, and Resources for Public Diplomacy (R/PPR) organized a three-day cross-Department working group (October 1-3, 2012) chaired by R and the Senior Advisor for Innovation on integrating social media as a core function of the Department's external communications. Key stakeholders from across the Department and from overseas missions participated. The working group focused on assessing the current state of social media use at the Department, describing desired future capabilities, and generating actionable recommendations for advancing efforts across the organization. In addition, the Bureau of Public Affairs is in the process of updating the Foreign Affairs Manual (FAM) to provide guidelines for the use of social media by Department personnel, in both their professional and personal capacities.
Actions Remaining	Recommendations made by the Social Media Working Group will be considered by leadership for action, including but not limited to the establishment of appropriate decision-making mechanisms at leadership levels across stakeholder bureaus to address common needs in a strategic, holistic fashion where appropriate and empowering posts and bureaus to continue to innovate and experiment to advance the Department's mission. The Department will find ways for posts within and across regional bureaus to access and utilize innovation at other posts such as sharing app development and social media technical expertise. The Bureau of Public Affairs will finalize the FAM updates via the eFAM process.
EFFECTIVE EMBASSY LEADERSHIP	
Challenge	**Effective Embassy Leadership:** Ensuring that leaders and managers with appropriate skills lead our missions.
Actions Taken	The Department has identified effective leadership of our missions abroad as a priority under the QDDR. Leadership training for Chiefs of Mission (COM) and Deputy Chiefs of Mission (DCM) has been enhanced with attention to leadership of multiagency missions abroad. Performance management training has been developed and instituted for managers at all levels. Interagency leadership experience has been emphasized in the Department's selection processes for COMs and DCMs.
Actions Remaining	The Department will continue to implement OIG recommendations on leadership skills and training and work toward the priorities of the QDDR, contacting other Federal agencies as well as soliciting input internally. The Department is developing a model for worldwide assessment of mission leadership performance based on leadership components identified by the Office of the Inspector General. The assessment will include, as the OIG has recommended, "provision for the appropriate Assistant Secretary to follow up with corrective action where necessary." We expect to vet the model in the coming months in preparation for a possible pilot run in 2013.

(continued)

CONSULAR OPERATIONS	
Challenge	**Consular Operations:** Consular officers are the first line of defense in border security, and technology is at the core of their operations. The Department's refocused technology platform, ConsularOne, is being designed to help posts efficiently maintain security and manage large consular workloads. In the meantime, existing infrastructure and software do not always keep up with demands. On several recent inspections, including those in Caracas and Singapore, the OIG found that inadequate bandwidth and other systems' problems slowed down visa processing times to unacceptable levels. Reducing visa processing times is a priority of the Department and the Administration, given the positive impact international visitors have on our travel and tourism industries.
Actions Taken	In FY 2012, the Bureau of Consular Affairs (CA), Office of Consular Systems and Technology (CA/CST) implemented aspects of a service oriented architecture that serve as the foundation to ConsularOne user-interface development. Meanwhile, this architecture can be leveraged for enhancing legacy systems by sharing common data sets, thus improving overall systems performance.
Actions Remaining	CA/CST is also in the midst of procuring and implementing an enterprise queuing system. This system will provide statistics which will enable CA, over time, to help to identify inefficiencies in the visa process, streamline operations, and ultimately reduce travelers' wait times. CA/CST will continue to work with the Bureau of Information Management (IRM) in optimizing bandwidth in this region.
Challenge	**Physical Facilities for Consular Operations:** Physical facilities for consular operations present particular challenges, including the difficulty in projecting consular workload 10 years into the future, lengthy timelines for new construction, and mandates for secure facilities. At several missions, including Caracas and Port-au-Prince, OIG found consular section design did not meet requirements regarding space, security, privacy, and accessibility. The Bureau of Overseas Buildings Operations (OBO) and the Bureau of Consular Affairs (CA) have developed adequate designs.
Actions Taken	CA and OBO have worked together in the last year on a coordinated approach to consular section physical facilities. CA and OBO meet regularly in working group meetings to discuss the design of consular sections. CA and OBO have begun close collaboration on conducting studies of flow through consular sections to maximize the efficiency of waiting rooms and internal processing. CA and OBO met with the consular chief from Caracas in June 2012 to discuss the current space limitations of the consular section and come up with options to better use their space. CA has been funding reconstruction and expansion projects in China and Brazil and has worked closely with OBO in creating and opening new consulates in Porto Alegre, Belo Horizonte, and Wuhan. In August 2012, CA funded non-construction level renovations to sections around the world to improve physical facilities and increase workflow and efficiencies. CA plans additional funding in FY 2013 for construction level projects, which will require OBO review.
Actions Remaining	CA and OBO will continue to coordinate on ways to develop adequate designs for consular workspace. CA will work with OBO to establish a permanent position within CA/EX to serve as the liaison and help facilitate cooperation between the two bureaus.

Ten Things You Should Know About Your State Department

What do the U.S. State Department and the U.S. Agency for International Development (USAID) do for the American people? *With just over one percent of the entire Federal budget*, we have a huge impact on how Americans live and how the rest of the world engages America.

1. **We create American jobs.** We directly support millions of U.S. jobs by promoting new and open markets for U.S. firms, protecting intellectual property, negotiating new U.S. airline routes worldwide, and competing for foreign government and private contracts.

2. **We support American citizens abroad.** Last year, we provided emergency assistance to U.S. citizens in several countries experiencing natural disasters or civil unrest. We also assisted in 9,320 international adoptions. Over 1,300 children were reported abducted from the United States, and more than 660 children were reported returned last year; 361 children were also reported abducted to the United States.

3. **We promote democracy and foster stability around the world.** Stable democracies are less likely to pose a threat to their neighbors or to the United States. In South Sudan, Tunisia, and many other countries we worked through various means to foster democracy and peace.

4. **We help to make the world a safer place.** Our nonproliferation and disarmament programs have destroyed stockpiles of missiles, munitions and material that can be used to make a nuclear weapon. The Treaty between the United States of America and the Russian Federation on Measures for the Further Reduction and Limitation of Strategic Offensive Arms (aka the New START Treaty) when fully implemented will reduce the number of deployed nuclear weapons to levels not seen since the 1950s. In 2011, the State Department invested $142 million in 42 countries for Conventional Weapons Destruction. This included funding for clearance operations, assistance to conflict survivors, education for communities to prevent injuries from unexploded ordnance, and weapons destruction.

5. **We save lives.** Strong bipartisan support for U.S. global health investments has led to worldwide progress against HIV/AIDS, tuberculosis, malaria, smallpox and polio. Better health abroad reduces the risk of instability and enhances our national security.

6. **We help countries feed themselves.** We help other countries plant the right seeds in the right way and get crops to markets to feed more people. Strong agricultural sectors lead to more stable countries.

A worker sews an American flag into each glove made at the Nokona Baseball Glove Company in Nocona, Texas. *©AP Image*

7. **We help in times of crisis.** From earthquakes in Haiti, Japan and Chile to famine in the Horn of Africa, our experienced and dedicated emergency professionals deliver assistance to those who need it most.

8. **We promote the rule of law and protect human dignity.** We help people in other countries find freedom and shape their own destinies. Reflecting U.S. values, we advocate for the release of prisoners of conscience, prevent political activists from suffering abuse, train police officers to combat sex trafficking and equip journalists to hold their governments accountable.

9. **We help Americans see the world.** In 2011, we issued 13 million passports for Americans to travel abroad. We facilitate the lawful travel of international students, tourists and business people to the United States, adding greatly to our economy. We keep Americans apprised of dangers or difficulties abroad through our travel warnings.

10. **We are the face of America overseas.** Our diplomats, development experts, and the programs they implement are the source of American leadership around the world. They are the embodiments of our American values abroad. They are a force for good in the world.

For a very small investment the State Department and USAID yield a large return by advancing U.S. national security, promoting our economic interests, and reaffirming our country's exceptional role in the world.

©iStock Image

Summary of Financial Statement Audit and Management Assurances

As described in this report's section called Departmental Governance, the Department tracks audit material weaknesses as well as other requirements of the Federal Manager's Financial Integrity Act of 1982 (FMFIA). Below is management's summary of these matters as required by OMB Circular A-136, *Financial Reporting Requirements*, revised.

Summary of Financial Statement Audit

Audit Opinion: **Unqualified**

Restatement: **Yes**

MATERIAL WEAKNESSES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
Financial Reporting	1	0	0	0	0	1
FSNAEB	1	0	1	0	0	0
Total Material Weaknesses	**2**	**0**	**1**	**0**	**0**	**1**

Summary of Management Assurances

MATERIAL WEAKNESSES	BEGINNING BALANCE	NEW	RESOLVED	CONSOLIDATED	REASSESSED	ENDING BALANCE
EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING (FMFIA § 2)						
Statement of Assurance:	**Unqualified**					
FSNAEB	1	0	1	0	0	0
Total Material Weaknesses	1	0	1	0	0	0
EFFECTIVENESS OF INTERNAL CONTROL OVER OPERATIONS (FMFIA § 2)						
Statement of Assurance:	**Qualified**					
ECA Summer Work Travel Program	1	0	0	0	0	1
Total Material Weaknesses	1	0	0	0	0	1
CONFORMANCE WITH FINANCIAL MANAGEMENT SYSTEM REQUIREMENTS (FMFIA § 4)						
Statement of Assurance:	**Systems conform to financial system management requirements**					
Total Non-conformances	0	0	0	0	0	0

	AGENCY	AUDITOR
COMPLIANCE WITH FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA)		
Overall Substantial Compliance	Yes	No
1. System Requirements	Yes	No
2. Accounting Standards	Yes	No
3. USSGL at Transaction Level	Yes	No

DEFINITION OF TERMS

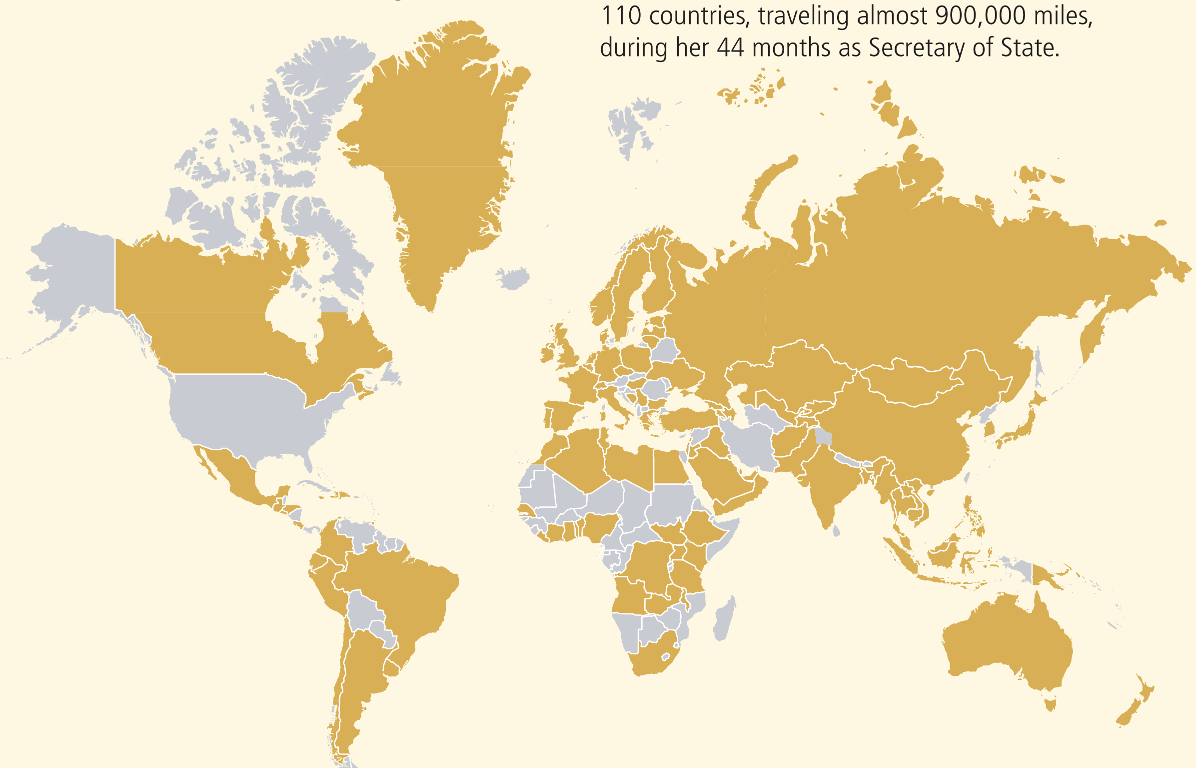
Beginning Balance: The beginning balance will agree with the ending balance of material weaknesses from the prior year.
New: The total number of material weaknesses that have been identified during the current year.
Resolved: The total number of material weaknesses that have dropped below the level of materiality in the current year.
Consolidation: The combining of two or more findings.
Reassessed: The removal of any finding not attributable to corrective actions (e.g., management has re-evaluated and determined a material weakness does not meet the criteria for materiality or is redefined as more correctly classified under another heading (e.g., section 2 to a section 4 and vice versa)).
Ending Balance: The agency's year-end balance.

Appendix
Abbreviations

AFR	Agency Financial Report
AP	Associated Press
Appendix A	(Refers to) OMB Circular A-123, Appendix A
ARRA	American Recovery and Reinvestment Act
BP	Bureau of Budget and Planning (DOS)
CFO	Chief Financial Officer
CGFS	Bureau of the Comptroller and Global Financial Services (DOS)
CSRS	Civil Service Retirement System
DOS	U.S. Department of State
EFT	Electronic Funds Transfer
ESCM	Embassy Security, Construction, Maintenance Appropriation
FASAB	Federal Accounting Standards Advisory Board
FECA	Federal Employees Compensation Act
FEGLIP	Federal Employees Group Life Insurance Program
FEHB	Federal Employees Health Benefits Program
FERS	Federal Employees Retirement System
FFMIA	Federal Financial Management Improvement Act
FISMA	Federal Information Security Management Act
FMFIA	Federal Managers' Financial Integrity Act
FSC	Financial Services Center
FSN	Foreign Service National
FSNAEB	Foreign Service Nationals' After-Employment Benefits
FSNDCF	Foreign Service National Defined Contributions Retirement Fund
FSO	Foreign Service Officer
FSRDF	Foreign Service Retirement and Disability Fund
FSRDS	Foreign Service Retirement and Disability System
FSPS	Foreign Service Pension System
FTE	Full-Time Equivalent
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GFMS	Global Financial Management System
GFS	Global Financial Services
GMRA	Government Management Reform Act
GPRA	Government Performance and Results Act
GPRAMA	GPRA Modernization Act
HHS	The Department of Health and Human Services
HR	Bureau of Human Resources (DOS)
IBWC	International Boundary and Water Commission
ICASS	International Cooperative Administrative Support Services (DOS)
IG	Inspector General
IIP	Bureau of International Information Programs (DOS)
INL	Bureau of International Narcotics and Law Enforcement Affairs (DOS)
IPIA	Improper Payments Information Act
IT	Information Technology
JAMS	Joint Assistance Management System
LE Staff	Locally Employed Staff
LSSS	Local Social Security System
NATO	North Atlantic Treaty Organization
NGO	Non-governmental Organization
OBO	Overseas Buildings Operations (DOS)
OECD	Organization for Economic Cooperation and Development
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
P&F	Program and Financing Schedule
PEPFAR	President's Emergency Plan for AIDS Relief
PMS	Payment Management System (HHS)
PP&E	Property, Plant and Equipment
PSA	Personal Services Agreement
PSC	Personal Services Contractor
PSU	Post Support Unit
QDDR	Quadrennial Diplomacy and Development Review
RM	Bureau of Resource Management (DOS)
RSI	Required Supplementary Information
SAT	Senior Assessment Team (FMFIA)
S/CRS	Office of the Coordinator for Reconstruction and Stabilization (DOS)
SFFAS	Statements of Federal Financial Accounting Standards
UDO	Undelivered Orders
UN	United Nations
UNESCO	United Nations Educational, Scientific and Cultural Organization
USAID	United States Agency for International Development
USG	U.S. Government
WCF	Working Capital Fund

Global Diplomacy Travels

Hillary Rodham Clinton has visited more than 110 countries, traveling almost 900,000 miles, during her 44 months as Secretary of State.



Countries Visited

Afghanistan
Algeria
Angola
Argentina
Armenia
Australia
Azerbaijan
Bahrain
Bangladesh
Barbados
Belgium
Benin
Bosnia and Herzegovina
Brazil
Brunei
Bulgaria
Burma
Cambodia
Canada
Cape Verde
Chile
China
Colombia
Cook Islands
Costa Rica
Côte d'Ivoire
Czech Republic
Democratic Republic of Congo
Denmark
Dominican Republic
Ecuador
Egypt
El Salvador
Estonia
Ethiopia
Finland
France
Georgia
Germany
Ghana
Greece
Greenland
Guatemala
Haiti
Honduras
Hong Kong
Hungary
India
Indonesia
Iraq
Ireland
Israel
Italy
Jamaica
Japan
Jordan
Kazakhstan
Kenya
Kosovo
Kuwait
Kyrgyz Republic
Laos
Latvia
Lebanon
Liberia
Libya
Lithuania
Malawi
Malaysia
Malta
Mexico
Mongolia
Morocco
Netherlands
New Zealand
Nigeria
Norway
Oman
Pakistan
Papua New Guinea
Peru
Philippines
Poland
Portugal
Qatar
Russia
Saudi Arabia
Senegal
Serbia
Singapore
South Africa
South Korea
South Sudan
Spain
Sweden
Switzerland
Tajikistan
Tanzania
Thailand
Timor-Leste
Togo
Trinadad and Tobago
Tunisia
Turkey
Uganda
Ukraine
United Arab Emirates
United Kingdom
Uruguay
Uzbekistan
Vietnam
Yemen
Zambia

DUTIES OF THE SECRETARY OF STATE

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

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

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

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

ACKNOWLEDGMENTS

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Associated Press (AP): *Cover, Inside Cover, Table of Contents, Message from the Secretary, pages 11, 20, 24, 35, 100, 169*
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Table of Contents Image Captions: Images (L) to (R): (1) Secretary of State Clinton meets with Chinese Foreign Minister Yang Jiechi in Beijing, China, September 4, 2012. ©AP Image; (2) Secretary of State Clinton delivers a keynote address during the Gender Equality and Women's Empowerment Policy Dialogue in Siem Reap, Cambodia, July 13, 2012. ©AP Image; (3) Top: Secretary of State Clinton autographs a coffee bean sack while visiting the Timor Coffee Cooperative in Dili, East Timor, September 6, 2012. ©AP Image; (4) Bottom: Secretary of State Clinton meets with South Africa's Foreign Minister Maite Nkoana-Mashabane at the U.S. South Africa Strategic Dialogue in Pretoria, South Africa, August 7, 2012. ©AP Image; and (5) Secretary of State Clinton meets with U.S. Marine Corps Guards at the U.S. Embassy in Yerevan, Armenia, June 4, 2012. Department of State.

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