

Independent Auditor's Report

**Foreign Service Retirement
and Disability Fund
Financial Statements**

September 30, 2007, 2006, and 2005

AUD/FM-08-26, June 2008

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INDEPENDENT AUDITOR'S REPORT

To the Assistant Secretary for Resource Management and Chief Financial Officer and the Director General of the Foreign Service and Director of Human Resources of the U.S. Department of State:

We have audited the Foreign Service Retirement and Disability Fund's (FSRDF) Statements of Projected Plan Benefits and Net Assets Available for Benefits and the Statements of Changes in Projected Plan Benefits and Net Assets Available for Benefits (annual financial statements) as of and for the years ended September 30, 2007, 2006, and 2005. We have considered internal control over financial reporting in place as of September 30, 2007, and for the year then ended, and we tested compliance with selected laws and regulations.

In our opinion, FSRDF's 2007, 2006, and 2005 annual financial statements are presented fairly in all material respects. We found:

- no material weakness in internal control over financial reporting and
- no reportable noncompliance with laws and regulations we tested.

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

ANNUAL FINANCIAL STATEMENTS

In our opinion, FSRDF's annual financial statements, including the notes thereto, present fairly, in all material respects, FSRDF's financial position as of September 30, 2007, 2006, and 2005, and the changes in projected plan benefits and net assets available for benefits for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

INTERNAL CONTROL

In planning and performing our audits of FSRDF's annual financial statements as of, and for the years ended, September 30, 2007, 2006, and 2005, in accordance with auditing standards generally accepted in the United States of America, we considered FSRDF's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the annual financial statements but not for the purpose of expressing an opinion on the effectiveness of FSRDF's internal control. Accordingly, we do not express an opinion on the effectiveness of FSRDF's internal control. We limited our consideration of internal control to those controls necessary to achieve the objectives described in Office of Management and Budget (OMB) Bulletin 07-04, *Audit Requirements for Federal Financial Statements*. We did not consider all internal controls relevant to operating objectives as broadly defined by the Federal Managers Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

The purpose of internal control is to provide management with reasonable, but not absolute, assurance that the following objectives are met:

- transactions are properly recorded and accounted for to permit the preparation of reliable financial reports and to maintain accountability over assets;
- funds, property, and other assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and
- transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements and other laws and regulations that OMB, FSRDF management, or the Office of Inspector General has identified as being significant and for which compliance can be objectively measured and evaluated.

Our consideration of internal control over financial reporting would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency 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 misstatements on a timely basis. Under standards issued by the American Institute of Certified Public Accountants, a significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote

likelihood that a misstatement of the entity's financial statements that is more than consequential will not be prevented or detected.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in a more than remote likelihood that a material misstatement of the financial statements will not be prevented or detected. We noted no matters involving internal control that we considered to be material weaknesses as defined herein.

However, we noted an internal control issue that we have reported to FSRDF's management in a separate letter dated March 25, 2008.

COMPLIANCE WITH LAWS AND REGULATIONS

FSRDF management is responsible for complying with laws and regulations applicable to FSRDF. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of FSRDF'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 07-04. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to FSRDF. The objective of our audit of the annual financial statements, including our tests of compliance with selected provisions of applicable laws and regulations, was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

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

The results of our tests of compliance with the laws and regulations described above did not disclose instances of noncompliance with the laws and regulations that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin 07-04.

We noted an instance of noncompliance that we have reported to FSRDF's management in a separate letter dated March 25, 2008.

RESPONSIBILITIES AND METHODOLOGY

FSRDF management is responsible for:

- preparing the annual financial statements and required supplementary information and other accompanying information in conformity with accounting principles generally accepted in the United States of America,

- establishing and maintaining effective internal control, and
- complying with applicable laws and regulations.

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

To fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts on the financial statements and related disclosures;
- assessed the accounting principles used and significant estimates made by management;
- evaluated overall presentation of the annual financial statements;
- obtained an understanding of the internal controls over financial reporting by obtaining an understanding of FSRDF's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls;
- tested compliance with selected provisions of laws and regulations that may have a direct and material effect on the financial statements;
- obtained written representations from management; and
- performed other procedures as we considered necessary under the circumstances.

Our audit was conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin 07-04. We believe that our audit provided a reasonable basis for our opinion.

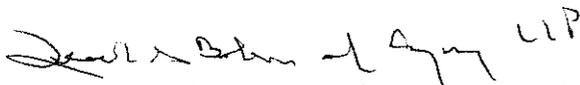
Our audit was conducted for the purpose of forming an opinion on the annual financial statements taken as a whole. The Combining Statement of Projected Plan Benefits and

Net Assets Available for Benefits is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the annual financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

The Overview and Supplemental Financial and Management Information sections are presented for purposes of additional analyses and are not required parts of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the annual financial statements, and accordingly, we express no opinion on them.

This report is intended solely for the information and use of FSRDF management, the Inspector General of the U.S. Department of State and Broadcasting Board of Governors, OMB, and Congress and is not intended to be, and should not be, used by anyone other than those specified parties. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Comments by the Bureau of Resource Management on this report are presented as an appendix.


Leonard G. Birnbaum and Company, LLP

Alexandria, Virginia
March 25, 2008



United States Department of State

Deputy Chief Financial Officer

Washington, D.C. 20520

May 27, 2008

MEMORANDUM

TO: OIG/AUD – Mr. Mark W. Duda
FROM: RM/DCFO – Christopher Flaggs *Christopher H. Flaggs*
SUBJECT: Draft Independent Auditor's Report (Report) on the Foreign Service Retirement and Disability Fund's 2007, 2006, and 2005 Financial Statements and Management Letter

We have reviewed the subject draft Report and Management Letter, and have no substantive comments. We are pleased to receive an unqualified opinion on the FSRDF's financial statements which comprise about one-third of the Department's \$45 billion in assets and three-fourths of the Department's \$20 billion in liabilities. In regards to the Management Letter, we will work with our actuary to implement the Independent Auditor's observations and suggestions on improving the FSRDF's actuarial report.

We thank you for the opportunity to comment on the draft Report and extend our appreciation for the professional manner in which Leonard G. Birnbaum and Company and your office conducted the FY 2007 audit.

CC: Mr. Bradford R. Higgins
Mr. James L. Millette
Mr. Phil Schlatter
Ms. Gayle Voshell