

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION
(A COMPONENT UNIT OF THE FEDERATED STATES OF
MICRONESIA NATIONAL GOVERNMENT)**

**FINANCIAL STATEMENTS AND
ADDITIONAL INFORMATION AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED DECEMBER 31, 2006 AND 2005

**FEDERATED STATES OF MICRONESIA SOCIAL SECURITY ADMINISTRATION
(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA
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Years Ended December 31, 2006 and 2005
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INDEPENDENT AUDITORS' REPORT

Board of Trustees
FSM Social Security Administration:

We have audited the accompanying statements of net assets of the Federated States of Micronesia Social Security Administration (the Administration), a component unit of the FSM National Government, as of December 31, 2006 and 2005, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of the Administration'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, and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Administration's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinion, such financial statements present fairly, in all material respects, the financial status of the Administration as of December 31, 2006 and 2005, and the changes in financial status for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This information is the responsibility of the Administration's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of the Administration taken as a whole. The accompanying Combining Statement of Net Assets (page 20) and Combining Statement of Changes in Net Assets (page 21) as of and for the year ended December 31, 2006 are presented for purposes of additional analysis and are not a required part of the basic financial statements of the Administration. These statements are the responsibility of the Administration's management. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 27, 2007, on our consideration of the Administration's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte + Touche LLP

April 27, 2007

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Management's Discussion and Analysis
Years Ended December 31, 2006 and 2005

Program Description

The FSM Social Security Administration (FSMSSA) is one of the successor systems from the former Trust Territory Social Security System that closed down operation on March 31, 1988. The FSMSSA began its full operation on January 1, 1988 and is administered by a six-member Board of Trustees. Five members of the Board are nominated by the President and confirmed by the Congress of the FSM while the FSMSSA Administrator serves as an ex-officio member. The FSMSSA Board of Trustees is comprised of the following individuals:

Lt. Governor Jack E. Yakana	Chairman of the Board and representing Pohnpei State;
Nahoy G. Selifis	Vice-Chairman, representing the National Government;
Charles L. Chieng	Member from the State of Yap;
Bernes O. Reselap	Member from the State of Chuuk;
Nena Ned	Member from the State of Kosrae; and
Alexander R. Narruhn	Administrator serves as the ex-officio member.

In April 2007, the FSM Congress has confirmed Garrison Irons as the new Member from the State of Chuuk. He replaced Bernes Reselap, whose term expired in March 2006. As of this writing, the vacancy for Kosrae State has not yet been filled after Nena Ned's term expired in September 2006.

The FSMSSA Board of Trustees operates the Social Security Program authorized under the FSM Code title 53. Their nominations to the Board should take into account the need to have adequate geographical representation and to have representatives from public and private sector employers and employees. The members of the Board serve a 3-year term, and they shall provide for its own organization and procedure. Should there be any vacancies on the Board, it shall be filled for the unexpired term only. Where a vacancy is 1 year or less, it shall be filled by appointment by the President; otherwise vacancies shall be filled by nomination by the President and confirmation by the Congress. Members of the Board who are not State or National Government employees shall be paid at the rate of \$30 per day and necessary travel expenses when actually attending meetings of the Board.

The FSMSSA was established by the Federated States of Micronesia Public Law 2-74 enacted February 2, 1983 to provide retirement, disability and survivor benefits for the citizens of the Federated States of Micronesia.

The FSM Social Security system is financed by employer/employee contributions at a rate of 6% each, or a combined tax rate of 12% payable to the system every quarter. State and national governments and all private employers incorporated or doing business in the FSM are subject to social security tax. At present, the maximum taxable wages per employee for each quarter is \$5,000, which was effectuated in the fourth quarter of 2003, and to be increased by \$1,000 every 5 years until year 2028 for a maximum of \$10,000.

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Significant Events

- Public Law No. 14-86 was signed into law in October 23, 2006 and was fully implemented in January 1, 2007. The new law includes among other things: definition of "fully insured" which require a minimum # of quarters and a minimum amount of contributions; definition of adopted children which gives the System a discretion not to recognize any adoption on or after the wage earner turn 55; voluntary contributions of 12% of \$5,000.00 wages per year from citizens working abroad which now allow them to participate in the Program on a voluntary basis; and, lump sum payments to certain non-citizens equal to 100% of their contributions when these non-citizens decide to leave the FSM permanently.
- The FSMSSA hosted the 3rd Freely Associated Social Security Administrators (FASSA) annual meeting in Pohnpei from July 19-22, 2006. Attended by Administrators and key staff from the three participating SS Systems: FSM, Republic of Palau and the Republic of the Marshall Islands, the conference was a huge success. Among the topics discussed during the conference included the new database software recently installed and the totalization agreement. Further enhancements to the computer system were introduced and discussed by the Systems' Software Specialist who was also invited to attend the meeting. The Totalization Agreement would allow a member to combine his or her earnings from the three countries to determine eligibility and to receive social security benefits from each country on a pro rata basis. To date, the agreement had already been ratified in the FSM and Palau. During the conference, the three Social Security Systems conducted presentations on each SS Divisions in terms of staffing, general responsibilities, performances and challenges in order to bridge collaboration between the FASSA systems.
- In October 2006, the FSMSSA successfully completed the computerization upgrade of the 3 other branch offices in Chuuk, Kosrae, and Yap. The new system includes an automated cash receipts system, which is currently working well in all four branches including the Pohnpei Branch.
- The FSMSSA continued to build staff capacity, knowledge, skills and abilities through participation of its key personnel in the APIPA conference held in Pohnpei in July. The FSMSSA also had its bi-annual employees' conference in February 2006 at the Headquarters, which was attended by all staff from the HQ and branch offices. The conference focused mainly on the newly upgraded system where HQ staff led to train all other branch employees. The new system has significantly improved the processing of information, which is a key step towards better service to the growing number of recipients, employers and members.
- The FSMSSA assumed the responsibility of the administration of the Prior Service Trust Fund for FSM effective April 1, 2006. As of February 2007, total funds received for this purpose amounted to \$375,993 while benefits paid from April 2006 to February 2007 totaled \$296,136. Fees equivalent to 20% of amount transferred go to FSMSSA as income for administering the funds. Monthly benefits payment will resume when new funding is received from the U.S. Department of the Interior, Office of Insular Affairs.

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Management's Discussion and Analysis
Years Ended December 31, 2006 and 2005

Financial Highlights

- FSMSSA's net assets increased by 6.5% from \$42,657,062 as of December 31, 2005 to \$45,407,637 as of December 31, 2006. This increase was primarily due to the investment's net gain which was approximately 12.8% higher than the previous year. Included in the net asset increase was the Prior Service Trust Fund net assets as of the end of 2006 amounting to \$32,416.

Net investment gain comprises the following:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Interest and dividends earned	\$ 891,671	\$ 837,883	\$ 901,714
Realized gains on sale	2,346,126	1,221,389	1,925,027
Unrealized gains on market value	5,457,012	4,882,324	3,748,234
Realized losses on sale	(428,968)	(261,160)	(214,276)
Unrealized losses on Market Value	(3,808,514)	(2,768,249)	(3,769,275)
Investment fees	<u>(315,102)</u>	<u>(263,189)</u>	<u>(239,484)</u>
Net Investment gain	\$ <u>4,142,225</u>	\$ <u>3,648,998</u>	\$ <u>2,351,940</u>

The investment's market value as of December 31, 2006 reached \$42,622,090, which includes automated cash management fund of \$815,815. During 2006, \$1,250,000 was redeemed from the investment portfolio to supplement current funds to meet benefits payment.

- Tax collections in 2006 declined by 0.7% at \$12,049,988 compared to \$12,129,796 collected in 2005. Of the 2006 collections, \$957,806 was collected from delinquent employers. About \$200,000 of this was attributed to the new Public Law 14-37 which gave delinquent employers the chance to have interest waived if they pay their accounts in full. Additionally, in April 2006, the System received Prior Service allocations amounting to \$341,017.

Other income during the year included prior service reimbursements of \$68,203 and miscellaneous collections of \$35,163 from Social Security cards and other fees.

- Benefits payment increased by nearly 7% due to increases in lump sum, retirement, and surviving spouse claims. Total benefits paid in 2006 were \$12,828,256. Of this amount, \$241,696 was paid to Prior Service recipients. Benefits paid in 2005 totaled \$12,006,929. At the end of 2006, the total number of beneficiaries of FSMSSA declined to 6,363 compared to 6,404 at the end of 2005.

Breakdown of benefits according to entitlement follows:

	<u>2006</u> <u>FSMSSA</u>	<u>2006</u> <u>Prior Service</u>	<u>2005</u> <u>FSMSSA</u>	<u>2004</u> <u>FSMSSA</u>
Retirement	\$ 7,251,790	\$ 116,973	\$ 6,870,291	\$ 6,550,765
Survivor	4,339,471	124,723	4,269,263	4,025,827
Disability	841,012	-	830,813	710,668
Lump Sum	154,287	-	36,562	33,088
Prior year credits	<u>-</u>	<u>-</u>	<u>-</u>	<u>(10,540)</u>
Total	\$ <u>12,586,560</u>	\$ <u>241,696</u>	\$ <u>12,006,929</u>	\$ <u>11,309,808</u>

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- In our efforts to cut costs, 2006's total administrative expenses were lower by 10.2% compared with 2005. FSMSSA successfully managed to reduce quite a number of expense items, travel expenses in particular, which declined by as much as 26%. Although some of the expense items have increased dramatically including utilities due to escalating prices, these expenses were still under the budget limit.

Fixed asset acquisitions during the year amounted to \$18,102 comprised mostly of computer hardware and software.

As in the past years, total administrative costs were lower than the approved budget by 7% in 2006 and lower by 29.4% when compared to the budget ceiling provided in the Social Security Act. In March 2007, the Board approved a \$1,039,581 budget for fiscal year 2007. This amount is 3.19% higher than the budget approved for fiscal year 2006.

Statement of Net Assets

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cash and cash equivalents	\$ 1,556,975	\$ 2,873,476	\$ 1,789,785
Investments	41,806,275	37,809,060	35,855,045
Other current assets	2,220,018	1,970,466	2,156,189
Fixed assets, net	<u>71,988</u>	<u>79,944</u>	<u>91,221</u>
	<u>45,655,256</u>	<u>42,732,946</u>	<u>39,892,240</u>
Liabilities	<u>247,619</u>	<u>75,884</u>	<u>110,403</u>
Net assets:			
Held in trust for retirement, disability and survivors' benefit	<u>\$ 45,407,637</u>	<u>\$ 42,657,062</u>	<u>\$ 39,781,837</u>

Statement of Changes in Net Assets

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Revenues	\$ 16,638,881	\$ 15,844,718	\$ 14,679,843
Expenses	<u>13,888,306</u>	<u>12,969,493</u>	<u>12,244,908</u>
Changes in net assets	2,750,575	2,875,225	2,434,935
Net assets at beginning of year	<u>42,657,062</u>	<u>39,781,837</u>	<u>37,346,902</u>
Net assets at end of year	<u>\$ 45,407,637</u>	<u>\$ 42,657,062</u>	<u>\$ 39,781,837</u>

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Conclusion

In 2006, FSMSSA was able to pay \$12.8 million in total benefits and still left with a \$2.7 million increase in net assets. Thanks to the good performance of the investment portfolio which generated 10% net return during the year. However, tax collection level in 2006 remained unchanged compared to the past 2 years resulting in an operational deficit of \$1.4 million this year. To cover the deficit, management was prompted to redeem part of the investment portfolio in order to meet benefit payments.

With benefits increasing at an average yearly rate of 5%, we have yet to find other resources to supplement Social Security tax contributions for the growing benefits and administrative expenses. We hope that with the new amendments to the Social Security Act which gave the Administrator the power to waive interest on delinquent taxes, we would be able to increase our tax collections from delinquent employers. Also, we believe that our continued efforts in auditing as well as controlling administrative expenses will help maintain the balance in our operations.

Overall, during fiscal years 2006 and 2005, FSMSSA generated a net increase in net assets of \$2,718,159 (excluding the Prior Service Trust Fund) and \$2,875,225, respectively.

Management's Discussion and Analysis for the year ended December 31, 2005 is set forth in FSMSSA's report on the audit of financial statements, which is dated March 31, 2006. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmpublicauditor.fm.

Teresita B. Dayao
Comptroller

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Statements of Net Assets
December 31, 2006 and 2005

	2006	2005
<u>ASSETS</u>		
Cash and cash equivalents	\$ 1,556,975	\$ 2,873,476
Receivables, net:		
Contributions	1,969,335	1,798,521
Accrued interest	115,170	144,007
Prior Service Trust Fund	71,954	10,727
Other	42,399	13,611
Total receivables, net	2,198,858	1,966,866
Prepayments	21,160	3,600
Investments:		
Fixed income	13,504,675	13,346,830
Stocks	28,301,600	24,462,230
Total investments	41,806,275	37,809,060
Fixed assets, net	71,988	79,944
Total assets	45,655,256	42,732,946

LIABILITIES

Accounts payable	101,841	42,569
Other liabilities and accruals	21,634	19,604
Accrued management fees	124,144	13,711
Total liabilities	247,619	75,884

Contingencies

NET ASSETS

Held in trust for retirement, disability and survivors' benefits	\$ 45,407,637	\$ 42,657,062
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See accompanying notes to financial statements.

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Statements of Changes in Net Assets
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Additions:		
Contributions	\$ 12,049,988	\$ 12,129,796
Investment income:		
Net increase in the fair value of investments	3,565,656	3,074,304
Interest and dividends	<u>893,007</u>	<u>837,883</u>
Total investment income	4,458,663	3,912,187
Less investment expense:		
Investment management and custodial fees	<u>315,102</u>	<u>263,189</u>
Net investment income	<u>4,143,561</u>	<u>3,648,998</u>
Other	<u>445,332</u>	<u>65,924</u>
Total additions	<u>16,638,881</u>	<u>15,844,718</u>
Deductions:		
Benefit payments:		
Retirement	7,368,763	6,870,291
Survivors	4,464,194	4,269,263
Disability	841,012	830,813
Lump sum	<u>154,287</u>	<u>36,562</u>
Total benefit payments	12,828,256	12,006,929
Refunds	23,797	22,120
Administrative	<u>1,036,253</u>	<u>940,444</u>
Total deductions	<u>13,888,306</u>	<u>12,969,493</u>
Change in net assets	2,750,575	2,875,225
Net assets at beginning of year	<u>42,657,062</u>	<u>39,781,837</u>
Net assets at end of year	<u>\$ 45,407,637</u>	<u>\$ 42,657,062</u>

See accompanying notes to financial statements.

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Notes to Financial Statements
December 31, 2006 and 2005

(1) Organization

The Social Security Administration of the Federated States of Micronesia National Government was established by Public Law 2-74, passed on February 8, 1983, and began operations on October 1, 1987, for the purpose of providing retirement, disability and death benefits to qualified individuals and their survivors. The Administration is administered under the authority of a six-member board, five of whom are appointed by the President of the Federated States of Micronesia. The Administrator, who is selected by the board, serves as an ex-officio member. Additionally, the Administrator is responsible for processing, monitoring and distributing benefit claims under the Prior Service Benefits Program (see note 6). Accordingly, the Administrator established the Prior Service Fund to account for activities under this program.

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

The Federated States of Micronesia (FSM) Social Security Administration (the Administration) is accounted for as a Fiduciary Fund Type - Private Purpose Trust Fund and is a component unit of the FSM National Government. The Administration prepares its financial statements using the accrual basis of accounting. It recognizes employee and employer contributions as revenues in the quarter employee earnings are paid. Retirement benefits are recognized as expenses when payable. Expenses are recorded when the corresponding liabilities are incurred regardless of when payment is made.

Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus* and modified by Statement No. 38, *Certain Financial Statement Disclosures*. These statements establish financial reporting standards for governmental entities, which includes the requirement for the Administration to present Management's Discussion and Analysis (MD&A). The MD&A is considered to be required supplementary information and precedes the financial statements. In addition, these statements require that resources be classified for accounting and reporting purposes as held in trust for retirement, disability and survivors' benefits. Management of the Administration has determined that per its enabling legislation, all net assets of the Administration are held in trust for retirement, disability and survivors' benefits.

B. Future Liabilities and Contributions

No recognition is given in the accompanying financial statements to the present value of the liabilities of prospective benefit payments or the present value of future contributions required from employees or employers.

C. Deposits and Investments

For the purposes of the statement of net assets, cash and cash equivalents include cash on hand, and cash in checking and savings accounts as well as short-term investments with original maturities of three months or less from the date acquired. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statements of net assets.

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(2) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The deposit and investment policies of the Administration are governed by its enabling legislation. The Board is required to engage one or more fund custodians to assume responsibility for the physical possession of the Administration's investments. Legally authorized investments are as follows:

- (i) Government obligations - Obligations issued or guaranteed as to principal and interest by the FSM National Government and/or State governments of the Federated States of Micronesia or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.
- (ii) Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the Federated States of Micronesia or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or pass through and other mortgage-backed securities provided that the obligation is issued by an agency of the United States Government, the FSM National Government, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the Fund or ten percent of the outstanding value of the issue at the time of purchase.
- (iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the Administration's investment advisor at the time of purchase, that not more than five percent of the market value of the Fund shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of the Fund shall be invested in any one industry group.
- (iv) Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments of the Fund.

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(2) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

Deposits:

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by the Administration or its agent in the Administration's name;
- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Administration's name; or
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Administration's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Administration's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Administration does not have a deposit policy for custodial credit risk.

As of December 31, 2006 and 2005, the carrying amount of the Administration's total cash and cash equivalents was \$1,556,975 and \$2,873,476, respectively, and the corresponding bank balances were \$601,394 and \$1,007,218, respectively. These bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC). As of December 31, 2006 and 2005, bank deposits in the amount of \$300,000 were FDIC insured. Accordingly, these deposits are exposed to custodial credit risk. The Administration does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. The remaining amounts of \$815,815 and \$1,866,258, respectively, represent short-term investments held and administered by Smith Barney Citigroup and Pacific Century Trust, respectively, in accordance with a fiduciary trust agreement. Based on negotiated trust and custody contracts, all of these investments were held in the Administration's name by Smith Barney Citigroup and Pacific Century Trust, respectively, at December 31, 2006 and 2005.

Investments:

Investments and related investment earnings are recorded at fair value. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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(2) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

Investments, Continued:

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by the Administration or its agent in the Administration's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the Administration's name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Administration's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of December 31, 2006 and 2005, investments at fair value are as follows:

	<u>2006</u>	<u>2005</u>
Fixed income securities:		
Domestic fixed income	\$ 13,455,724	\$ 13,346,830
International fixed income	<u>48,951</u>	<u>-</u>
	13,504,675	13,346,830
Other investments:		
Domestic equities	<u>28,301,600</u>	<u>24,462,230</u>
	<u>\$ 41,806,275</u>	<u>\$ 37,809,060</u>

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Administrator does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

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Notes to Financial Statements
December 31, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

Investments, Continued:

As of December 31, 2006, the Administration's investments in debt securities were as follows:

	<u>Investment Maturities (In Years)</u>				<u>Fair Value</u>
	<u>Less Than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	<u>Greater Than 10</u>	
U.S. Treasury obligations	\$ -	\$ 4,814,991	\$ 1,761,879	\$ 2,315,501	\$ 8,892,371
Mortgage and asset-backed securities	-	570,222	83,096	2,049,462	2,702,780
U.S. Government agencies	818,511	-	-	867,608	1,686,119
Corporate notes	-	223,405	-	-	223,405
	<u>\$ 818,511</u>	<u>\$ 5,608,618</u>	<u>\$ 1,844,975</u>	<u>\$ 5,232,571</u>	<u>\$ 13,504,675</u>

As of December 31, 2005, the Administration's investments in debt securities were as follows:

	<u>Investment Maturities (In Years)</u>				<u>Fair Value</u>
	<u>Less Than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	<u>Greater Than 10</u>	
U.S. Treasury obligations	\$ -	\$ 7,347,364	\$ 4,586,383	\$ 842,460	\$ 12,776,207
U.S. Government agencies	-	-	31,869	538,754	570,623
	<u>\$ -</u>	<u>\$ 7,347,364</u>	<u>\$ 4,618,252</u>	<u>\$ 1,381,214</u>	<u>\$ 13,346,830</u>

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligation.

The Administration's exposure to credit risk at December 31, 2006, was as follows:

<u>Standard and Poors' Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
AAA	\$ 13,281,270	\$ 13,281,270	\$ -
AA	15,680	-	15,680
AA-	62,405	62,405	-
A+	83,813	83,813	-
A	<u>61,507</u>	<u>28,236</u>	<u>33,271</u>
	<u>\$ 13,504,675</u>	<u>\$ 13,455,724</u>	<u>\$ 48,951</u>

The Administration's exposure to credit risk at December 31, 2005, was as follows:

<u>Standard and Poors' Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
AAA	\$ 13,346,830	\$ 13,346,830	\$ -

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Notes to Financial Statements
December 31, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

Investments, Continued:

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Administration will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Administration's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the Administration's name by the Administration's custodial financial institutions at December 31, 2006 and 2005.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Administration. There was no concentration of credit risk for investments as of December 31, 2006 and 2005.

D. Fixed Assets

The cost of fixed assets, if greater than \$250, is capitalized at the time of acquisition. Depreciation is provided using the straight-line basis over the estimated useful lives of the respective assets.

	<u>Estimated Useful Lives</u>	January 1, <u>2006</u>	<u>Additions</u>	<u>Retirements</u>	December 31, <u>2006</u>
Motor vehicles	5 years	\$ 124,695	\$ 2,690	\$ -	\$ 127,385
Computer software and hardware	5 years	135,889	10,648	(40,343)	106,194
Office furniture, fixtures and equipment	5 years	114,631	4,764	(13,473)	105,922
Home furnishings	5 years	<u>3,377</u>	<u>-</u>	<u>-</u>	<u>3,377</u>
		378,592	18,102	(53,816)	342,878
Less accumulated depreciation		<u>(298,648)</u>	<u>(26,058)</u>	<u>53,816</u>	<u>(270,890)</u>
		<u>\$ 79,944</u>	<u>\$ (7,956)</u>	<u>\$ -</u>	<u>\$ 71,988</u>
	<u>Estimated Useful Lives</u>	January 1, <u>2005</u>	<u>Additions</u>	<u>Retirements</u>	December 31, <u>2005</u>
Motor vehicles	5 years	\$ 112,688	\$ 12,007	\$ -	\$ 124,695
Computer software and hardware	5 years	144,458	2,870	(11,439)	135,889
Office furniture, fixtures and equipment	5 years	110,535	6,198	(2,102)	114,631
Home furnishings	5 years	<u>2,649</u>	<u>2,957</u>	<u>(2,229)</u>	<u>3,377</u>
		370,330	24,032	(15,770)	378,592
Less accumulated depreciation		<u>(279,109)</u>	<u>(34,711)</u>	<u>15,172</u>	<u>(298,648)</u>
		<u>\$ 91,221</u>	<u>\$ (10,679)</u>	<u>\$ (598)</u>	<u>\$ 79,944</u>

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Notes to Financial Statements
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(2) Summary of Significant Accounting Policies, Continued

E. Contributions

Contributions to the Fund are governed by the Federated States of Micronesia Social Security Act of 1983 which imposes a tax on the quarterly income of every employee not currently subject to the United States Social Security Administration or any other recognized social security system. There is imposed on the income of every applicable employee a tax equal to six percent of wages received.

Maximum quarterly taxable wages are currently \$5,000. Every employer is required to contribute an amount equal to that contributed by employees.

Contribution revenues received during the years ended December 31, 2006 and 2005, are comprised of the following:

	<u>2006</u>	<u>2005</u>
Government employment	\$ 6,293,327	\$ 6,450,475
Private employment	5,320,880	5,662,080
SS Tax contributions	173,211	(158,138)
Judgment	63,990	16,320
Penalties and interest	198,580	159,059
Prior service allocation	<u>341,017</u>	<u>-</u>
	<u>\$ 12,391,005</u>	<u>\$ 12,129,796</u>

F. Benefit Obligations

Retirement benefits are paid to every person who is a fully insured individual as defined by the Federated States of Micronesia Social Security Act, has attained sixty years of age, and has filed an application for old age insurance benefits. Benefits are also paid to surviving spouses of deceased workers, subject to eligibility requirements, as long as they do not remarry or work. Eligible children who are not married or are not working may also receive benefits until age eighteen (18) or up to age twenty-two (22) if in school.

Eligible children who become disabled before age twenty-two (22) will continue to receive benefits for the duration of the disability. Disability benefits are paid to qualified workers for the duration of the disability or until retirement or death at which time retirement or survivor benefits become available.

Benefits are paid monthly and are computed on an annual basis of 16.5% of the first \$10,000 of cumulative covered earnings, plus 3.0% of the next \$30,000, and 2.0% of any earnings in excess of \$40,000. The minimum benefit payment is \$50 per month.

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Notes to Financial Statements
December 31, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

G. New Accounting Standards

In fiscal year 2006, the Administration implemented the following pronouncements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*, which improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination of Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

The implementation of these pronouncements did not have a material impact on the accompanying financial statements.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

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Notes to Financial Statements
December 31, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

G. New Accounting Standards, Continued

In October 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. GASB Statement No. 48 establishes uniform financial reporting for these types of revenues. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

H. Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect the reported amounts of net assets and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

I. Risk Management

The Administration is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Administration has elected to purchase automobile insurance from independent third parties for the risks of loss to which it is exposed. The Administration is substantially self-insured for all other risks. Settled claims have not exceeded commercial coverage in any of the past three years.

(3) Net Assets Held in Trust

Net assets are held in trust to comply with the Social Security Act of 1983. All net assets of the Administration are to be used for retirement, disability and survivors' benefits.

(4) Contingencies

The Administration is aware of liabilities of the fund related to retroactive benefit payments for wages not posted to the system due to an unmatched social security number or name provided by the employer, as well as a liability related to overpayment of contributions. Management is unable to determine a reasonable estimate of the abovementioned liabilities at this time; however management is of the opinion that the amount is not material to the financial statements taken as a whole.

In October 2006, the FSM Social Security Administration obtained an actuarial valuation of the Retirement Fund as of January 1, 2006. The valuation reported actuarial accrued liabilities for the Retirement Fund of \$262,187,000. As of January 1, 2006, the FSM Social Security Administration recorded a total fund equity of \$42,657,000 in the Retirement Fund, as funds available to fund future benefit obligations; these figures resulted in an accrued unfunded liability of \$219,530,000. The report indicates that the Administration should not increase future or current benefits until a long-term trend of decreasing the unfunded accrued liability is realized.

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(5) Contributions Receivable

The Administration is of the opinion that there are outstanding contributions due to the fund; however, a reasonable estimate of this amount cannot be made due primarily to noncompliance by employers.

(6) Prior Service Claims

Under the terms of a Prior Service Claim Adjudication Service Agreement between Social Security Administration of the Federated States of Micronesia and the Trust Territory Prior Service Trust Fund, the FSM Social Security Administration is to provide for the processing of benefit claims and to assist in the monitoring of continuing eligibility under the Prior Service Program. The Prior Service Trust Fund Administration (PSTFA) will reimburse the FSM Social Security Administration \$8,000 per annum plus an amount equal to eight percent of the total amount of automated and manual benefit payments. Any cost for the FSM Social Security Administration personnel who assist in searching and locating prior service documents in cooperation with the Prior Service Administration will be reimbursed on a dollar for dollar basis.

On September 15, 2005, an agreement was entered into between the PSTFA Board and the U.S. Department of the Interior to delegate the Board's obligations and responsibility for the enrollees eligible for Prior Service Benefits Program to the Social Security Systems of the Republic of the Marshall Islands, the Republic of Palau, the Federated States of Micronesia and the Retirement Fund of the Commonwealth of the Northern Mariana Islands. Based on the agreement, the Social Security Administration (SSA) of each Government shall be entitled to an administrative fee not to exceed 20% of the share of allocated funds.

The FSM Social Security Administration assumed administrative functions and received an allocation of \$341,017 from PSTFA in April 2006, of which \$241,696 was paid as benefits during the year ended December 31, 2006. However, while the FSM Social Security Administration accepts the liability for any amounts received, the FSM Social Security Administration does not accept the obligation to pay future benefits unless additional funds are received from PSTFA. At December 31, 2006, the amount available for future benefit payments under the Prior Service Benefits Program amounted to \$32,416.

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Combining Statements of Net Assets
December 31, 2006

	<u>Retirement Fund</u>	<u>Prior Service Fund</u>	<u>Total</u>
<u>ASSETS</u>			
Cash and cash equivalents	\$ 1,417,209	\$ 139,766	\$ 1,556,975
Receivables, net:			
Contributions	1,969,335	-	1,969,335
Accrued interest	115,170	-	115,170
Prior Service Trust Fund	71,954	-	71,954
Other	42,399	-	42,399
Total receivables, net	<u>2,198,858</u>	<u>-</u>	<u>2,198,858</u>
Prepayments	<u>21,160</u>	<u>-</u>	<u>21,160</u>
Investments:			
Fixed income	13,504,675	-	13,504,675
Stocks	28,301,600	-	28,301,600
Total investments	<u>41,806,275</u>	<u>-</u>	<u>41,806,275</u>
Fixed assets, net	<u>71,988</u>	<u>-</u>	<u>71,988</u>
Total assets	<u>45,515,490</u>	<u>139,766</u>	<u>45,655,256</u>
<u>LIABILITIES</u>			
Accounts payable	101,841	-	101,841
Other liabilities and accruals	21,634	-	21,634
Accrued management fees	124,144	-	124,144
Total liabilities	<u>247,619</u>	<u>-</u>	<u>247,619</u>
<u>NET ASSETS</u>			
Held in trust for retirement, disability and survivors' benefits	<u>\$ 45,267,871</u>	<u>\$ 139,766</u>	<u>\$ 45,407,637</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
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Combining Statements of Changes in Net Assets
Year Ended December 31, 2006

	<u>Retirement Fund</u>	<u>Prior Service Fund</u>	<u>Total</u>
Additions:			
Contributions	\$ 12,049,988	\$ -	\$ 12,049,988
Investment income:			
Net increase in the fair value of investments	3,565,656	-	3,565,656
Interest and dividends	891,671	1,336	893,007
Total investment income	4,457,327	1,336	4,458,663
Less investment expense:			
Investment management and custodial fees	315,102	-	315,102
Net investment income	4,142,225	1,336	4,143,561
Other	104,315	341,017	445,332
Total additions	16,296,528	342,353	16,638,881
Deductions:			
Benefit payments:			
Retirement	7,251,790	116,973	7,368,763
Survivors	4,339,471	124,723	4,464,194
Disability	841,012	-	841,012
Lump sum	154,287	-	154,287
Total benefit payments	12,586,560	241,696	12,828,256
Refunds	23,797	-	23,797
Administrative	968,012	68,241	1,036,253
Total deductions	13,578,369	309,937	13,888,306
Change in net assets	2,718,159	32,416	2,750,575
Net assets at beginning of year	42,657,062	-	42,657,062
Net assets at end of year	<u>\$ 45,375,221</u>	<u>\$ 32,416</u>	<u>\$ 45,407,637</u>

See Accompanying Independent Auditors' Report.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Trustees
FSM Social Security Administration:

We have audited the financial statements of the FSM Social Security Administration (the Administration), as of and for the year ended December 31, 2006, and have issued our report thereon dated April 27, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Administration's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Administration's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Administration's internal control over financial reporting.

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. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Administration'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 Administration's financial statements that is more than inconsequential will not be prevented or detected by the Administration's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Administration's internal control.

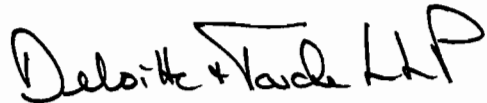
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FSM Social Security Administration's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We noted other matters that we reported to management of the Administration in a separate letter dated April 27, 2007.

This report is intended for the information of the Board of Trustees and management of FSM Social Security Administration, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

April 27, 2007