

**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, 2007 AND 2006

**FEDERATED STATES OF MICRONESIA SOCIAL SECURITY ADMINISTRATION
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Years Ended December 31, 2007 and 2006
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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, 2007 and 2006, 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.

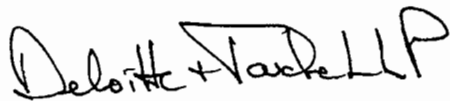
We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan 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, 2007 and 2006, 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 8 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 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 21) and Combining Statement of Changes in Net Assets (page 22) as of and for the year ended December 31, 2007 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 May 28, 2008, on our consideration of the Administration's internal control over financial reporting and on 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 considered in assessing the results of our audit.

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

May 28, 2008

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Management's Discussion and Analysis
Years Ended December 31, 2007 and 2006

The following discussion and analysis provides an understanding of the FSM Social Security Administration's (FSMSSA) financial performance for fiscal year ended December 31, 2007. This section has been prepared by the management and should be read in conjunction with the FSMSSA's financial statements and accompanying notes.

Administration

The FSMSSA is a successor System of the former Trust Territory Social Security System. It was established by the Federated States of Micronesia Public Law 2-74 and began its full operation on January 1, 1988. The FSMSSA provides retirement, disability and survivor benefits to the citizens of the Federated States of Micronesia.

Under Title 53 of the FSM Code, the authority to administer the FSMSSA is vested to a six-member Board of Trustees, five of whom are nominated by the President and confirmed by the Congress of the FSM. The nominations to the Board take into account the need to have adequate geographical representation and to have representatives from public and private sector employers and employees. The Board is duly represented by the following individuals:

Jack E. Yakana	State of Pohnpei	Chairman of the Board
Nahoy G. Selifis	National Government	Vice Chairman
Charles L. Chieng	State of Yap	Member
Garrison Irons	State of Chuuk	Member
Yosiwo George	State of Kosrae	Member
Alexander R. Narruhn	Administrator	Member, Ex officio

The Administrator, who is selected by the Board, is responsible for daily operation as well as supervision of branch managers from each of the four State of the FSM.

Funding

The FSM Social Security system is financed by employer/employee contributions at a rate of 6% each, or a combined tax rate of 12% paid to the system every quarter. The National and State governments, as well as all private employers incorporated or doing business in the FSM, are subject to social security tax. Beginning January 1, 2008, the maximum quarterly taxable wage of \$5,000 is subject to an increment of \$1,000 and every 5 years thereafter for a maximum of \$10,000 until January 1, 2028.

Additional revenues are derived from interest and penalties charged to delinquent taxpayers, and other miscellaneous fees.

Budget

The FSM Public Law 5-120 mandates the FSMSSA to present an annual budget not exceeding 11% of its projected income for the ensuing fiscal year. The budget ceiling for fiscal year 2007 based on projected income of \$12 million was \$1.32 million. However, as part of management's cost cutting measures, the budget was streamlined at \$1.04 million, which is 8.7% of the projected income.

Significant Events

Effective January 1, 2007, the provisions of Public Law No. 14-86 were fully implemented. These are:

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- Raise to 55 years of age the limit on wage earners adopting children so children adopted after December 1, 2006 by wage earners who are 55 years or more would not be eligible for survivor benefits;
- To be eligible, the minimum contribution of \$2,500 is required for a retiree or individual who dies after December 31, 2006 and the minimum contribution of \$1,500 for an individual who becomes disabled after December 31, 2006;
- Raise the minimum monthly benefit from \$50 to \$75;
- FSM citizens working abroad may participate in the Program through voluntary contributions of 12% of \$5,000 wages per year; and
- Lump sum equal to employee's share shall be paid to non-citizens of the USA, Palau and Marshall Islands when they decide to leave the FSM permanently.
- On November 2007, the FSMSSA participated in the annual network of the Freely Associated Social Security Administrators from the Republic of Marshall Islands and the Republic of Palau. The conference/workshop focused on performance updates on investments, accounting, tax collections, claims and benefits, enhancements to the database software, and other challenges faced by the three Social Security Administrations.
- The FSMSSA continues to manage the Prior Service Benefits Program for FSM citizens, which is funded by the U.S. Department of the Interior, Office of the Insular Affairs. For FY 2007, total funds received from the Prior Service Trust Fund Administration (PSTFA) amounted to \$344,514 while benefits paid and administrative expenses totaled \$313,995 and \$68,957 respectively.

Financial Highlights

Net assets of the retirement fund (non-inclusive of the Prior Service Fund) increased by \$1.95 million or 4% from fiscal year 2006. The increase is mainly due to positive performance of investments.

Statement of Net Assets
(Retirement Fund)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Assets:			
Cash and equivalents	\$ 4,298,083	\$ 1,417,209	\$ 2,873,476
Investments	39,618,679	41,806,275	37,809,060
Other current assets	3,468,620	2,220,018	1,970,466
Fixed assets, net	<u>85,352</u>	<u>71,988</u>	<u>79,944</u>
Total	47,470,734	45,515,490	42,732,946
Liabilities	<u>149,227</u>	<u>140,269</u>	<u>75,884</u>
Net assets:			
Held in trust for retirement, disability and survivors' benefit	\$ <u>47,321,507</u>	\$ <u>45,375,221</u>	\$ <u>42,657,062</u>

- Investment income absorbed the impact of the 2007 operating deficit of \$1.78 million as a result of lower contributions against benefit payments and administrative expenses.

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Management's Discussion and Analysis
Years Ended December 31, 2007 and 2006

Statement of Changes in Net Assets
(Retirement Fund)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Contributions	\$ 12,783,551	\$ 12,049,988	\$ 12,129,796
Benefit payments	(13,663,880)	(12,586,560)	(12,006,929)
Admin expenses	(969,030)	(968,012)	(940,444)
Other	<u>72,212</u>	<u>80,518</u>	<u>43,804</u>
Operating deficit	(1,777,147)	(1,424,066)	(773,773)
Investment income, net	<u>3,723,433</u>	<u>4,142,225</u>	<u>3,648,998</u>
Change in net assets	1,946,286	2,718,159	2,875,225
Net assets at beginning of year	<u>45,375,221</u>	<u>42,657,062</u>	<u>39,781,837</u>
Net assets at end of year	\$ <u>47,321,507</u>	\$ <u>45,375,221</u>	\$ <u>42,657,062</u>

- The investment portfolio increased by \$734,088 or 1.7% from the previous year's balance of \$42,622,090. Net investment income decreased by 10% due to global volatile market and drawdown of \$2.9 million to fund benefit payments and administrative expenses.

<u>Retirement Fund</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Investment*	\$ 43,356,178	\$ 42,622,090	\$ 39,675,318
Investment income, net	\$ 3,723,433	\$ 4,142,225	\$ 3,648,998
Investment withdrawals	\$ 2,900,000	\$ 1,250,000	\$ -

*includes cash management fund

- Total delinquent taxes collected for FY 2007, excluding \$1.2 million from the Chuuk State Government, amounted to \$1.9 million.

<u>Contributions</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Government	\$ 6,992,581	\$ 6,388,593	\$ 6,292,337
Private	5,575,799	5,398,825	5,662,080
Judgment	16,226	63,990	16,320
Penalties and interest	<u>198,945</u>	<u>198,580</u>	<u>159,059</u>
Total	\$ <u>12,783,551</u>	\$ <u>12,049,988</u>	\$ <u>12,129,796</u>

- Benefit payments were 9% higher due to increased number of beneficiaries that averaged 6,429 monthly compared to 6,363 for FY 2006.

<u>Benefit Payments</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Retirement	\$ 7,885,913	\$ 7,251,790	\$ 6,870,291
Survivors	4,563,095	4,339,471	4,269,263
Disability	947,870	841,012	830,813
Lump Sum	<u>267,002</u>	<u>154,287</u>	<u>36,562</u>
Total	\$ <u>13,663,880</u>	\$ <u>12,586,560</u>	\$ <u>12,006,929</u>

- Actual administrative expenses were 7% lower than the approved budget and 27% less than the budget ceiling.

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<u>Budget</u>	<u>Approved</u>	<u>Actual</u>	<u>Surplus</u>	<u>%</u>
2007	\$ 1,039,581	\$ 969,030	\$ 70,551	7%
2006	\$ 1,007,412	\$ 968,012	\$ 39,400	4%

- For additional information on FSMSSA's fixed assets, please refer to the note 2F to the financial statements.
- As of FY 2007, the Prior Service Fund has net a deficiency of \$4,291. Reimbursements increased by 1% while benefit payments increased by 30%. The Prior Service Fund commenced in April 2006, hence lower disbursements occurred in FY 2006.

Statements of Net Assets
(Prior Service Fund)

	<u>2007</u>	<u>2006</u>	<u>Inc (dec)</u>	<u>%</u>
Assets	\$ 30,378	\$ 139,766	\$ (109,388)	-78%
Liabilities	(34,669)	(107,350)	(72,681)	-68%
Net assets (deficiency)	\$ <u>(4,291)</u>	\$ <u>32,416</u>	\$ <u>(36,707)</u>	-113%

Statements of Changes in Net Assets
(Prior Service Fund)

	<u>2007</u>	<u>2006</u>	<u>Inc (dec)</u>	<u>%</u>
PSTFA reimbursements	\$ 344,513	\$ 341,017	\$ 3,496	1%
Benefit payments	(313,995)	(241,696)	72,299	30%
Admin expenses	(68,957)	(68,241)	716	1%
Other income	<u>1,732</u>	<u>1,336</u>	396	30%
Change in net assets	(36,707)	32,416		
Net assets at beginning of year	<u>32,416</u>	<u>-</u>		
Net assets at end of year	\$ <u>(4,291)</u>	\$ <u>32,416</u>	\$ <u>(36,707)</u>	-113%

Management's Discussion and Analysis for the year ended September 30, 2006 is set forth in the report on the audit of FSMSSA's financial statements, which is dated April 27, 2007. That Discussion and Analysis explains the major factors impacting the 2006 financial statements.

Conclusion

The FSMSSA retirement fund posted a net asset increase of \$1.95 million and \$2.7 million for fiscal years 2007 and 2006, respectively. However, management was prompted to redeem \$2.9 million and \$1.25 million from the investment portfolio during fiscal years 2007 and 2006, respectively, to sustain lower tax collections against increasing benefit payments and administrative expenses.

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With increased benefit payments of 9% and 5%, respectively, for fiscal years 2007 and 2006, and given the unfunded accrued liability of \$219.5 million (as of Jan 1, 2006), management endeavors to improve its operations through the following:

1. Collection of delinquent taxes;
2. Initiate further tax audits;
3. Conduct periodic eligibility survey of current beneficiaries;
4. Monitor investment performance; and
5. Control administrative expenses.

Significantly, management continues to lobby legislation for proposed amendments to the Social Security Act. Public hearings are ongoing for Congressional Bill No. 15-52 that propose the following:

1. Clarify the definition of "employer" whether it is an individual, a partnership, a corporation, a municipal or state organization or agency thereof, or any other type of business or non-business organization and its responsibilities as far as social security taxes are concerned.
2. Individuals who attain age 60 or die after December 31, 2007, must earn at least 50 quarters of coverage and have contributed at least \$2,500 to the Social Security System to be fully insured for death or old age benefits.
3. Individuals who become disabled on or after January 1, 2008, must earn at least 45 quarters of coverage and have contributed at least \$1,500 to the Social Security System to be fully insured for disability benefits.
4. Individuals who become disabled on or after January 1, 2008, must also meet the definition of currently insured to qualify for a disability benefit.
5. Violations, penalties and interest, attorney's fees and costs
 - Impose criminal penalties on an employer for failure to pay taxes.
 - Identify the chief financial officer of a state or municipal government or any agency thereof as the individual liable to the program.
6. Lien for taxes: all taxes, including penalties and interest accrued thereon, imposed or authorized under this subtitle and owed by a state or municipal government, or any agency thereof, shall be subject to a writ of garnishment of all moneys owed by the FSM National Government to any state or municipal government or any agency thereof, and such writ of garnishment shall have priority over any claim for such moneys in any manner by the particular state or municipal government or agency thereof.
7. Limit surviving child's benefit to age 20 for students.
8. Retirement benefits that begin on or after January 1, 2008, that are paid to individuals aged 60 to 64 are reduced by 50% until the retiree attains age 65, at which time the benefit will automatically be adjusted to what it would have been prior to the 50% reduction. Reduced payments are not subject to the earnings test. In other words, a retiree aged 60 to 64 will receive 50% of his/her calculated retirement benefit while still working full-time.

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9. Fully insured individuals, who are also citizens of the Federated States of Micronesia, may elect to receive a lump sum payment equal to all amounts contributed by him or her at the time of application for this lump sum, which will be paid when the individual attains age 60. Upon election of the lump sum, the individual shall forfeit credit for all quarters of coverage earned up to the date of application. If the lump sum is greater than \$5,000, the payment will be divided into 6 month payments. If the lump sum is greater than \$10,000, the lump sum payment will be divided into 12 month payments.
10. For retirement benefit payments that begin or continue after January 1, 2008, the Administration will pay a retirement benefit as calculated in section 804 until the sum of retirement benefits paid to the retiree exceeds the total of amounts received by the Administration under sections 901 and 902 on behalf of the retiree. In the calendar year following this event, the retiree's monthly retirement benefit shall be reduced by 30%. This reduction will not apply to any disability benefits as calculated in section 804 and paid under section 803A nor will it apply to any survivor benefits paid under section 806.
11. Increase the tax rate paid by employees and employers to 7% each on October 1, 2008, and then to 7.5% each on October 1, 2012.
12. To enable the FSMSSA to invest in BBB investment grade bonds.
13. To allow for investments in the international market but only with those who exchange their currency in American Depository Receipts.
14. Concerning preferred and common stocks in the investment act:
 - To increase the market value of the fund that may be invested in the stock of any one corporation from five to ten percent.
 - To increase the market value of the fund that may be invested in any one industry group from ten to twenty-five percent.
 - To create a security measure so that shares are invested and actively traded only on a recognized national or regional stock exchange. (To be expanded to allow for investments in the local economy.)
15. To establish an FSM Social Security Credit Union, which could then invest locally by making loans and taking deposits. The establishment of such a credit union can be accomplished by Board action and through the issuance of regulations.

This MD&A is designed to provide our citizens, taxpayers, creditors and other interested parties with a general overview of the FSMSSA's finances and to demonstrate its accountability to funding agencies. Questions concerning any of the information provided in this discussion or requests for information should be addressed to the Administrator, FSM Social Security Administration at P. O. Box L Kolonia, Pohnpei, FSM 96941.

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Statements of Net Assets
December 31, 2007 and 2006

	2007	2006
<u>ASSETS</u>		
Cash and cash equivalents	\$ 4,328,461	\$ 1,556,975
Receivables, net:		
Contributions	3,284,107	1,969,335
Accrued interest	151,056	115,170
Prior Service Trust Fund	2,497	71,954
Other	19,652	42,399
Total receivables, net	3,457,312	2,198,858
Prepayments	11,308	21,160
Investments:		
Fixed income	14,056,831	13,504,675
Stocks	25,561,848	28,301,600
Total investments	39,618,679	41,806,275
Fixed assets, net	85,352	71,988
Total assets	47,501,112	45,655,256

LIABILITIES

Accounts payable	144,915	101,841
Other liabilities and accruals	24,699	21,634
Accrued management fees	14,282	124,144
Total liabilities	183,896	247,619

Contingencies

NET ASSETS

Held in trust for retirement, disability and survivors' benefits	\$ 47,317,216	\$ 45,407,637
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See accompanying notes to financial statements.

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Statements of Changes in Net Assets
Years Ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Additions:		
Contributions	<u>12,783,551</u>	<u>\$ 12,049,988</u>
Investment income:		
Net increase in the fair value of investments	2,927,650	3,565,656
Interest and dividends	<u>1,060,147</u>	<u>893,007</u>
Total investment income	3,987,797	4,458,663
Less investment expense:		
Investment management and custodial fees	<u>262,632</u>	<u>315,102</u>
Net investment income	<u>3,725,165</u>	<u>4,143,561</u>
Other	<u>436,813</u>	<u>445,332</u>
Total additions	<u>16,945,529</u>	<u>16,638,881</u>
Deductions:		
Benefit payments:		
Retirement	8,029,590	7,368,763
Survivors	4,733,089	4,464,194
Disability	948,194	841,012
Lump sum	<u>267,002</u>	<u>154,287</u>
Total benefit payments	13,977,875	12,828,256
Refunds	20,088	23,797
Administrative	<u>1,037,987</u>	<u>1,036,253</u>
Total deductions	<u>15,035,950</u>	<u>13,888,306</u>
Change in net assets	1,909,579	2,750,575
Net assets at beginning of year	<u>45,407,637</u>	<u>42,657,062</u>
Net assets at end of year	<u>\$ 47,317,216</u>	<u>\$ 45,407,637</u>

See accompanying notes to financial statements.

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Notes to Financial Statements
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(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 Note 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. Cash and Cash Equivalents

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 in money market funds with a maturity date within three months of the date acquired.

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Notes to Financial Statements
December 31, 2007 and 2006

(2) Summary of Significant Accounting Policies, Continued

D. 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.

E. Deposits and Investments

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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Notes to Financial Statements
December 31, 2007 and 2006

(2) Summary of Significant Accounting Policies, Continued

E. 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, 2007 and 2006, the carrying amount of the Administration's total cash and cash equivalents was \$4,328,461 and \$1,556,975, respectively, and the corresponding bank balances were \$4,536,656 and \$1,937,614, respectively. As of December 31, 2007 and 2006, bank deposits in the amount of \$799,157 and \$1,121,679, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2007 and 2006, bank deposits in the amount of \$200,000 were FDIC insured. The Administration does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. The remaining amounts of \$3,737,499 and \$815,935, respectively, represent short-term investments held and administered by the Administration's trustees in accordance with various trust agreements. 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, 2007 and 2006.

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

E. Deposits and Investments, Continued

Investments:

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, 2007 and 2006, investments at fair value are as follows:

	<u>2007</u>	<u>2006</u>
Fixed income securities:		
Domestic fixed income	\$ 13,612,005	\$ 13,455,724
International fixed income	<u>444,826</u>	<u>48,951</u>
	14,056,831	13,504,675
Other investments:		
Domestic equities	<u>25,561,848</u>	<u>28,301,600</u>
	<u>\$ 39,618,679</u>	<u>\$ 41,806,275</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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December 31, 2007 and 2006

(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Investments, Continued:

As of December 31, 2007, 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	\$ -	\$ 3,028,492	\$ 1,105,481	\$ 1,017,075	\$ 5,151,048
Mortgage and asset-backed securities	-	-	-	4,494,154	4,494,154
U.S. Government agencies	307,191	880,053	510,261	95,074	1,792,579
Corporate notes	-	1,151,837	919,374	523,761	2,594,972
Municipal bonds	-	-	-	24,078	24,078
	<u>\$ 307,191</u>	<u>\$ 5,060,382</u>	<u>\$ 2,535,116</u>	<u>\$ 6,154,142</u>	<u>\$ 14,056,831</u>

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>

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, 2007, was as follows:

<u>Standard and Poors' Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
AAA	\$ 11,607,610	\$ 11,487,870	\$ 119,740
AA	376,437	376,437	-
AA-	450,331	372,092	78,239
A+	480,380	440,774	39,606
A	580,173	459,220	120,952
A-	401,312	315,022	86,289
BBB+	<u>160,590</u>	<u>160,590</u>	-
	<u>\$ 14,056,831</u>	<u>\$ 13,612,005</u>	<u>\$ 444,826</u>

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Notes to Financial Statements
December 31, 2007 and 2006

(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Investments, Continued:

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>

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, 2007 and 2006. The Administration's agent is not affiliated with or related to investment brokers. Accordingly, these investments are not exposed to custodial credit risk.

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. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. There was no concentration of credit risk for investments as of December 31, 2007 and 2006.

F. 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>	<u>January 1, 2007</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31, 2007</u>
Motor vehicles	5 years	\$ 127,385	\$ 13,168	\$ (9,950)	\$ 130,603
Computer software and hardware	5 years	106,194	24,347	(21,059)	109,482
Office furniture, fixtures and equipment	5 years	105,922	5,692	(814)	110,800
Home furnishings	5 years	<u>3,377</u>	<u>1,064</u>	<u>(1,595)</u>	<u>2,846</u>
		342,878	44,271	(33,418)	353,731
Less accumulated depreciation		<u>(270,890)</u>	<u>(30,907)</u>	<u>(33,418)</u>	<u>(268,379)</u>
		<u>\$ 71,988</u>	<u>\$ 13,364</u>	<u>\$ -</u>	<u>\$ 85,352</u>

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Notes to Financial Statements
December 31, 2007 and 2006

(2) Summary of Significant Accounting Policies, Continued

F. Fixed Assets, Continued

	<u>Estimated Useful Lives</u>	<u>January 1, 2006</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31, 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>

G. 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, 2007 and 2006 are comprised of the following:

	<u>2007</u>	<u>2006</u>
Government employment	\$ 6,992,581	\$ 6,388,593
Private employment	5,575,799	5,398,825
Judgment	16,226	63,990
Penalties and interest	<u>198,945</u>	<u>198,580</u>
	\$ <u>12,783,551</u>	\$ <u>12,049,988</u>

H. 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.

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Notes to Financial Statements
December 31, 2007 and 2006

(2) Summary of Significant Accounting Policies, Continued

H. Benefit Obligations, Continued

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, 2.0% of any earnings in excess of \$40,000, and 1.0% of any earnings in excess of \$302,500. As of December 31, 2007 and 2006, the minimum monthly benefit payment is \$75 and \$50, respectively.

I. New Accounting Standards

In fiscal year 2007, the Administration implemented GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit 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 this pronouncement did not have a material effect on the financial statements of the Administration.

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, 2006. 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, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. 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.

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Notes to Financial Statements
December 31, 2007 and 2006

(2) Summary of Significant Accounting Policies, Continued

I. New Accounting Standards, Continued

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. 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 May 2007, GASB issued Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. The provisions of this statement are effective for periods beginning after June 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 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

J. 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.

K. 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.

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(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 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 December 31, 2007, the Administration recorded total fund equity of \$47,321,507 in the Retirement Fund, as funds available to fund future benefit obligations. These conditions indicate that the Administration should not increase future or current benefits until a long-term trend of decreasing the unfunded accrued liability is realized.

(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 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 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 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 Administration assumed administrative functions and as of December 31, 2007 and 2006, had received an allocation of \$344,513 and \$341,017, respectively, from PSTFA of which \$313,995 and \$241,696 were paid as benefits during the years ended December 31, 2007 and 2006, respectively. However, while the Administration accepts the liability for any amounts received, the Administration does not accept the obligation to pay future benefits unless additional funds are received from PSTFA. As of December 31, 2007 and 2006, the amount available for future benefit payments under the Prior Service Benefits Program amounted to \$(4,291) and \$32,416, respectively.

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Combining Statement of Net Assets
December 31, 2007

	<u>Retirement Fund</u>	<u>Prior Service Fund</u>	<u>Total</u>
<u>ASSETS</u>			
Cash and cash equivalents	\$ 4,298,083	\$ 30,378	\$ 4,328,461
Receivables, net:			
Contributions	3,284,107	-	3,284,107
Accrued interest	151,056	-	151,056
Prior Service Trust Fund	2,497	-	2,497
Other	19,652	-	19,652
Total receivables, net	<u>3,457,312</u>	<u>-</u>	<u>3,457,312</u>
Prepayments	<u>11,308</u>	<u>-</u>	<u>11,308</u>
Investments:			
Fixed income	14,056,831	-	14,056,831
Stocks	25,561,848	-	25,561,848
Total investments	<u>39,618,679</u>	<u>-</u>	<u>39,618,679</u>
Fixed assets, net	<u>85,352</u>	<u>-</u>	<u>85,352</u>
Total assets	<u>47,470,734</u>	<u>30,378</u>	<u>47,501,112</u>
<u>LIABILITIES</u>			
Accounts payable	110,246	34,669	144,915
Other liabilities and accruals	24,699	-	24,699
Accrued management fees	14,282	-	14,282
Total liabilities	<u>149,227</u>	<u>34,669</u>	<u>183,896</u>
<u>NET ASSETS</u>			
Held in trust for retirement, disability and survivors' benefits	<u>\$ 47,321,507</u>	<u>\$ (4,291)</u>	<u>\$ 47,317,216</u>

See Accompanying Independent Auditors' Report.

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Combining Statement of Changes in Net Assets
Year Ended December 31, 2007

	<u>Retirement Fund</u>	<u>Prior Service Fund</u>	<u>Total</u>
Additions:			
Contributions	\$ 12,783,551	\$ -	\$ 12,783,551
Investment income:			
Net increase in the fair value of investments	2,927,650	-	2,927,650
Interest and dividends	1,058,415	1,732	1,060,147
Total investment income	3,986,065	1,732	3,987,797
Less investment expense:			
Investment management and custodial fees	262,632	-	262,632
Net investment income	3,723,433	1,732	3,725,165
Other	92,300	344,513	436,813
Total additions	<u>16,599,284</u>	<u>346,245</u>	<u>16,945,529</u>
Deductions:			
Benefit payments:			
Retirement	7,885,913	143,677	8,029,590
Survivors	4,563,095	169,994	4,733,089
Disability	947,870	324	948,194
Lump sum	267,002	-	267,002
Total benefit payments	13,663,880	313,995	13,977,875
Refunds	20,088	-	20,088
Administrative	969,030	68,957	1,037,987
Total deductions	<u>14,652,998</u>	<u>382,952</u>	<u>15,035,950</u>
Change in net assets	1,946,286	(36,707)	1,909,579
Net assets at beginning of year	45,375,221	32,416	45,407,637
Net assets at end of year	<u>\$ 47,321,507</u>	<u>\$ (4,291)</u>	<u>\$ 47,317,216</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, 2007, and have issued our report thereon dated May 28, 2008. 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 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 inconsequential will not be prevented or detected by the entity'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 entity's internal control.

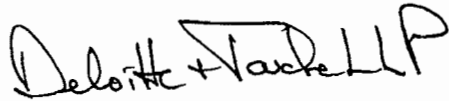
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies 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 Administration's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters 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 May 28, 2008.

This report is intended for the information of the Board of Trustees, management, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

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

May 28, 2008