

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

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

YEARS ENDED DECEMBER 31, 2012 AND 2011

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

Years Ended December 31, 2012 and 2011
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INDEPENDENT AUDITORS' REPORT

Board of Trustees
FSM Social Security Administration:

Report on Financial Statements

We have audited the accompanying financial statements of the Federated States of Micronesia (FSM) Social Security Administration (the Administration), a component unit of the FSM National Government, which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of changes in net position for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 *Government 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the FSM Social Security Administration as of December 31, 2012 and 2011, and the changes in its net position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 1 to the financial statements, during the year ended December 31, 2012, the Administration has implemented the Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, and Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. This supplementary information is the responsibility of the Administration's management. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

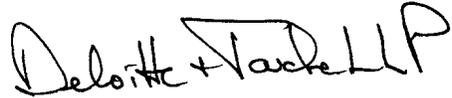
Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Administration's basic financial statements. The supplemental Combining Statement of Net Position as of December 31, 2012 and Combining Statement of Changes in Net Position for the year ended December 31, 2012 on pages 23 and 24 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplemental Combining Statement of Net Position and Combining Statement of Changes in Net Position are the responsibility of the Administration's management and were derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Combining Statement of Net Position and Combining Statement of Changes in Net Position information are fairly stated in all material respects in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 27, 2013 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Administration's internal control over financial reporting and compliance.

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

May 27, 2013

**FEDERATED STATES OF MICRONESIA SOCIAL SECURITY ADMINISTRATION
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Management's Discussion and Analysis
Years Ended December 31, 2012 and 2011

The following discussion and analysis provides an understanding of the Federated States of Micronesia (FSM) Social Security Administration's (FSMSSA) financial performance for fiscal year ended December 31, 2012. 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 of Trustees was reorganized on February 01, 2011. The new members and officers of the Board of Trustees are as follows:

Rose N. Nakanaga	State of Pohnpei	Chairwoman of the Board
VACANT	State of Kosrae	Member
Gillian Doone	National Government	Member
Innocente Oneisom	State of Chuuk	Vice-Chairman
VACANT	State of Yap	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 States of the FSM.

Funding

The FSM Social Security System is financed by employer/employee contributions at a rate of 7% each, or a combined tax rate of 14% paid to the system every quarter. The FSM 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 01, 2013, the maximum quarterly taxable wage of \$6,000 is subject to an increment of \$1,000 and every 5 years thereafter for a maximum of \$10,000 until January 1, 2028. Effective January 01, 2013, both the tax rate and the maximum quarterly taxable wage will increase from 7% to 7.5% (employee 7.5%, employer 7.5%) and from \$6,000 to \$7,000, respectively.

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 2012 based on projected income of \$15.50 million was \$1.70 million. However, as part of management's cost cutting measures, the budget was streamlined at \$1.12 million which is 7.2% of the projected income. The actual administrative costs incurred for FY2012 was \$1.04 million, or 7% surplus compared to the approved budget. The remaining administrative costs incurred for FY2012 of \$0.04 million pertained to the Prior Service Fund.

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Management's Discussion and Analysis
Years Ended December 31, 2012 and 2011

Highlights

- Contributions collected decreased by 1.33% from \$16.59 million in 2011 to \$16.37 million in 2012.
- Total benefit payments to members or their beneficiaries increased by 2.05% from \$17.62 million in 2011 to \$17.98 million in 2012.
- 5,854 beneficiaries received Social Security benefits as of end of fiscal year 2012.
- 752 new retirement, survivor and disability claims were received, processed, and approved in fiscal year 2012.
- Investment portfolio increased by 5.64% from \$35.22 million in 2011 to \$37.21 million in 2012.
- FSMSSA received \$1.0 million in funding from the FSM National Government and \$0.5 million from Prior Service, which was used to supplement benefit payments.
- Net position totaled \$42.84 million in December 31, 2012, compared to \$40.41 million in December 31, 2011, an increase of 6.01%.
- \$896 thousand from delinquent accounts were collected in fiscal year 2012.
- Close monitoring of expenses led to a budget surplus of 7% in fiscal year 2012.
- Minimum benefit increased from \$75 to \$100 effective January 01, 2012 as per P.L.14-86.

RESULTS OF OPERATIONS / CHANGES IN NET POSITION

FSMSSA follows the calendar year as its fiscal year. The following table presents information about the FSMSSA Retirement Fund's results of operations for CY2012, 2011 and 2010.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Contributions	\$ 16,371,874	\$ 16,593,155	\$ 14,525,608
Benefit Payments	(17,745,448)	(17,366,480)	(16,488,738)
Admin Expenses	(1,035,997)	(1,032,036)	(946,951)
Other Income	<u>1,044,444</u>	<u>1,247,807</u>	<u>1,543,882</u>
Operating Deficit	(1,365,127)	(557,554)	(1,366,199)
Investment Income/(Loss), net	<u>3,669,947</u>	<u>(1,421,047)</u>	<u>2,981,703</u>
Change in Net Position	2,304,820	(1,978,601)	1,615,504
Net Position at beginning of year	<u>40,382,469</u>	<u>42,361,070</u>	<u>40,745,566</u>
Net Position at end of year	\$ <u>42,687,289</u>	\$ <u>40,382,469</u>	\$ <u>42,361,070</u>

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Years Ended December 31, 2012 and 2011

Contributions

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Government	\$ 7,901,969	\$ 7,495,281	\$ 6,690,931
Private	8,266,665	8,772,936	7,566,503
Judgment	18,854	82,192	44,201
Penalties & Interests	<u>184,386</u>	<u>242,746</u>	<u>223,973</u>
Total	\$ <u>16,371,874</u>	\$ <u>16,593,155</u>	\$ <u>14,525,608</u>

The total amount of contributions collected was \$16.37 million, averaging a collection of \$4.09 million per quarter. This amount constitutes a decrease of 1.33% compared to 2011 at \$16.59 million. The lower collection is attributed to lower contribution of private sectors including lower collection from delinquent accounts.

Total delinquent taxes collected in 2012 totaled \$896 thousand. Of this amount, 51% or \$456 thousand pertains to prior years.

Benefit Payments

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Retirement	\$ 11,038,569	\$ 10,870,989	\$ 10,137,489
Survivors	5,068,023	4,881,958	4,738,969
Disability	1,456,825	1,395,552	1,356,728
Lump Sum	<u>182,031</u>	<u>217,981</u>	<u>255,552</u>
Total	\$ <u>17,745,448</u>	\$ <u>17,366,480</u>	\$ <u>16,488,738</u>

Benefit payments increased by 2.18% from \$17.37 million in 2011 to \$17.74 million in 2012. The increase was attributed mainly to new claims received processed and approved during the year. It is worthwhile to note that the amount of increase in benefit payments this year is much lower compared to 2011. And this is because of the survey conducted in the last quarter of 2012 for the entire FSM. Benefits were withheld for those individuals who did not complete the survey during the period. As of December 31, 2012, there were 5,854 members or their beneficiaries who received benefits in fiscal year 2012.

Administrative Expense

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Budget	\$ 1,115,902	\$ 1,063,046	\$ 1,069,053
Actual	\$ 1,035,997	\$ 1,032,036	\$ 946,951
Surplus	\$ 79,905	\$ 31,010	\$ 122,102
% of Budget	7%	3%	11%

Administrative expense increased by a minimal amount of \$4 thousand. Management enforced several approaches to reduce the System's operating costs. Continuous monitoring of fuel, telephone and communication, utilities, and supplies and materials were in place to reduce costs. As a result, a budget surplus of 7% or \$80 thousand was attained this year.

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Investment Income / (Loss)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Investment	\$37,206,732	\$35,220,871	\$36,910,189
Income /(Loss)	\$ 3,669,947	\$ (1,421,047)	\$ 2,981,702
Drawdowns	\$ 1,000,000	\$ 500,000	\$ 2,000,000

Investment income increased by 358.21% from \$1.42 million net loss in 2011 to \$3.67 million net gain in 2012. The net gain is attributed to the good performance of both the equity and fixed income investment accounts. As a result, the market value of the investment portfolio as of the end of FY2012 rose to \$37.21 million from \$35.22 million in 2011. This end of year market value is net of \$1.0 million drawdown during the year to supplement benefit payments in addition to the \$1.0 million funding received from the FSM National Government.

Other Income

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Contribution from FSM Government	\$ 1,000,000	\$ 1,200,000	\$ 1,495,000
Prior Service Reimbursement	47,334	35,359	33,834
Miscellaneous Receipts	31,661	43,078	35,112
Tax Refunds	<u>(34,551)</u>	<u>(30,630)</u>	<u>(20,064)</u>
Total	\$ <u>1,044,444</u>	\$ <u>1,247,807</u>	\$ <u>1,543,882</u>

Other Income decreased by 16.32% from \$1.25 million in 2011 to \$1.04 million in 2012. The decrease was attributed mainly to appropriation from the FSM National Government, which was reduced by \$200 thousand in 2012. Out of the \$1.0 million appropriation granted by the FSM National Government for 2012, \$500 thousand was collected by end of year 2012. The remaining \$500 thousand was received in February 2013.

NET POSITION

FSMSSA Retirement Fund's Statement of Net Position as of December 31, 2012, 2011 and 2010 follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets:			
Cash and equivalents	\$ 2,244,250	\$ 1,209,552	\$ 2,780,258
Investments	37,206,732	35,220,871	36,910,189
Other current assets	3,424,074	4,059,782	2,770,894
Fixed assets, net	<u>102,841</u>	<u>109,787</u>	<u>77,190</u>
Total	42,977,897	40,599,992	42,538,531
Liabilities	<u>290,608</u>	<u>217,523</u>	<u>177,461</u>
Net Position:			
Held in trust for retirement, Disability and survivors; benefit	\$ <u>42,687,289</u>	\$ <u>40,382,469</u>	\$ <u>42,361,070</u>

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Net position for the retirement fund (excluding the Prior Service Fund) increased 5.71% from \$40.38 million in 2011 to \$42.69 million in 2012. The increase was attributed to net investment gain as a result of a higher market value of the investment portfolio as of the end of the year 2012.

No significant changes occurred in capital assets during the year ended December 31, 2012. For more information concerning capital assets activity please refer to note 2 to the financial statements.

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 2012, total funds received from the Prior Service Trust Fund Administration (PSTFA) amounted to \$408.88 thousand while benefits paid and administrative expenses totaled \$236.64 thousand and \$47.37 thousand, respectively.

As of December 31, 2012, the Prior Service Fund had net position of \$152.25 thousand. Contributions increased by 49.88% while benefit payments decreased by 6.75%.

Following are the Statements of Net Position as of December 31, 2012, 2011 and 2010 and Statements of Changes in Net Position for the years ended December 31, 2012, 2011 and 2010 of PSTFA.

Statements of Net Position
(Prior Service Fund)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets	\$ 196,297	\$ 70,650	\$ 86,139
Liabilities	<u>(44,050)</u>	<u>(43,750)</u>	<u>(43,104)</u>
Net position	\$ <u>152,247</u>	\$ <u>26,900</u>	\$ <u>43,035</u>

Statements of Changes in Net Position
(Prior Service Fund)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
PSTFA contributions	\$ 408,879	\$ 272,797	\$ 89,593
Benefit Payments	(236,645)	(253,765)	(271,407)
Administrative expenses	(47,373)	(35,398)	(33,844)
Other	<u>486</u>	<u>231</u>	<u>814</u>
Change in net position	125,347	(16,135)	(214,844)
Net position at beginning of year	<u>26,900</u>	<u>43,035</u>	<u>257,879</u>
Net position at end of year	\$ <u>152,247</u>	\$ <u>26,900</u>	\$ <u>43,035</u>

Management's Discussion and Analysis for the year ended December 31, 2011 is set forth in the Administration's report on the audit of financial statements, which is dated June 15, 2012. That Discussion and Analysis explains the major factors impacting the 2011 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmopa.fm.

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Conclusion:

Fiscal Year 2012 was a good year for the Program in that its net position grew by 5.71% or \$2.30 million compared to fiscal year 2011 when it suffered a decline of \$1.98 million. The investment portfolio performed well with a net gain of \$3.67 million during the year.

Contributions decreased by 1.33%. While contributions were lower this year, the increase in benefit payments was also lower compared to previous years' percentage increases. The lower benefit payments were the result of a survey conducted in the last quarter of 2012 for the entire FSM. Benefits were withheld for those individuals who did not complete the survey. Another contributing factor to the lower increase in benefit payments is the new provision mandating 50% of benefits for individuals who turned age 60 on or after January 01, 2011. Although, there is a closer gap now between contributions and benefit payments, collections were still not enough to cover benefit payments and administrative expenses. A total of \$1.0 million withdrawn from the investment portfolio plus \$1.4 million funding received from the FSM National Government were used to supplement benefit payments and admin expenses.

One of the major challenges the system is currently facing is to enforce the recovery and collection of outstanding social security taxes from delinquent employers. For fiscal year 2012, we have managed to recover over \$896.0 thousand in delinquent taxes, which is an achievement considering the slow economic growth in the FSM.

With increased benefit payments of 2.18% and 5.32% respectively for fiscal years 2012 and 2011, and unfunded accrued liability of \$245.4M (as of Jan 1, 2011), management endeavors to improve its operation through the following:

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

We would also request supplemental funding from the FSM National Government to help with the weak cash flow as experienced during the past several years due to imbalances between collected contributions and benefit payments including administrative expenses.

2013 OUTLOOK

Collection is expected to increase at least \$1.20 million in 2013 as a result of the increased tax rate (from 14% to 15% employer and employee combined) as well as increased maximum quarterly taxable wages (from \$6,000 to \$7,000) which took effect in January 01, 2013. Total projected collection by end of year 2013 including collection from delinquent accounts is \$17.50 million.

Benefit payments will continue to increase in 2013 because of new claims that will be received, processed and approved during the year. In addition, benefit payments will also increase due to provision of P.L.14-86 increasing the minimum benefit from \$75 to \$100 effective January 01, 2012. However, the expected increase brought about by these 2 factors could be partially offset by the new provision mandating 50% of benefits for individuals who attained age 60 on or after January 01, 2011. Also, the 2 Investigation Officers position that were filled in 2012 and the annual survey to be conducted this year could help bring the benefit payments lower in 2013. Having said all these, it is projected that benefit payments in 2013 will be around \$18.30 million or an increase of 3% compared to 2012.

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Administrative cost is projected to be lower if not approximately equal compared to 2012. Management will continue to implement the cost cutting measures being practiced during the past several years.

Foregoing, benefit payments will increase faster than collection. It is projected that at least \$2.0 million will be needed in additional funding to supplement benefit payments and administrative expenses in 2013. The deficit is anticipated to be funded with cash withdrawal from investment and/or funding from the FSM National Government.

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 Position
December 31, 2012 and 2011

<u>ASSETS</u>	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 2,440,547	\$ 1,280,202
Receivables:		
Contributions	2,842,350	3,051,613
Due from FSM National Government	500,000	900,000
Accrued interest	63,599	91,721
Other	14,525	11,668
Total receivables	<u>3,420,474</u>	<u>4,055,002</u>
Prepayments	<u>3,600</u>	<u>4,780</u>
Investments:		
Fixed income	13,033,746	13,384,226
Stocks	24,172,986	21,836,645
Total investments	<u>37,206,732</u>	<u>35,220,871</u>
Depreciable fixed assets, net	<u>102,841</u>	<u>109,787</u>
Total assets	<u>43,174,194</u>	<u>40,670,642</u>

LIABILITIES

Accounts payable	305,286	230,235
Other liabilities and accruals	24,865	22,598
Accrued management fees	4,507	8,440
Total liabilities	<u>334,658</u>	<u>261,273</u>

Contingencies

NET POSITION

Held in trust for retirement, disability and survivors' benefits	<u>\$ 42,839,536</u>	<u>\$ 40,409,369</u>
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See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
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Statements of Changes in Net Position
Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Additions:		
Contributions	\$ 16,371,874	\$ 16,593,155
Investment income (loss):		
Net change in the fair value of investments	3,102,803	(2,181,438)
Interest and dividends	<u>736,904</u>	<u>969,271</u>
Total investment income (loss)	3,839,707	(1,212,167)
Less investment expense:		
Investment management and custodial fees	<u>(169,274)</u>	<u>(208,649)</u>
Net investment income (loss)	<u>3,670,433</u>	<u>(1,420,816)</u>
Other additions:		
Contributions from FSM National Government	1,000,000	1,200,000
Other	<u>487,874</u>	<u>351,234</u>
Total additions	<u>1,487,874</u>	<u>1,551,234</u>
Total additions	<u>21,530,181</u>	<u>16,723,573</u>
Deductions:		
Benefit payments:		
Retirement	11,133,092	10,973,220
Survivors	5,210,145	5,033,492
Disability	1,456,825	1,395,552
Lump sum	<u>182,031</u>	<u>217,981</u>
Total benefit payments	17,982,093	17,620,245
Refunds	34,551	30,630
Administrative	<u>1,083,370</u>	<u>1,067,434</u>
Total deductions	<u>19,100,014</u>	<u>18,718,309</u>
Change in net position	2,430,167	(1,994,736)
Net position at beginning of year	<u>40,409,369</u>	<u>42,404,105</u>
Net position at end of year	<u>\$ 42,839,536</u>	<u>\$ 40,409,369</u>

See accompanying notes to financial statements.

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Notes to Financial Statements
December 31, 2012 and 2011

(1) Organization

The Social Security Administration of the Federated States of Micronesia (FSM) 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 administering the FSM Social Security Retirement Fund (the Retirement Fund) through the provision of retirement, disability and death benefits to qualified individuals and their survivors. The Administration is administered under the authority of a six-member Board of Trustees, 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 7). 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 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) 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*, 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 position 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 statements of net position, 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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(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

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 Retirement Fund shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of the Retirement 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 Retirement Fund.

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(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Deposits:

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, 2012 and 2011, the carrying amount of the Administration's total cash and cash equivalents was \$2,440,547 and \$1,280,202, respectively, and the corresponding bank balances were \$2,798,604 and \$1,539,638, respectively. As of December 31, 2012 and 2011, bank deposits in the amount of \$1,369,663 and \$831,696, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2012 and 2011, bank deposits in the amount of \$678,505 and \$500,000, respectively, 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 \$1,428,941 and \$728,000, 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, 2012 and 2011.

Investments:

As of December 31, 2012 and 2011, investments at fair value are as follows:

	<u>2012</u>	<u>2011</u>
Fixed income securities:		
Domestic fixed income	\$ 13,033,746	\$ 13,384,226
Other investments:		
Domestic equities	18,357,176	16,403,466
International equities	<u>5,815,810</u>	<u>5,433,179</u>
	\$ <u>37,206,732</u>	\$ <u>35,220,871</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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(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Investments, Continued

As of December 31, 2012, the Administration's investments in debt securities were as follows:

	<u>Investment Maturities (In Years)</u>				
	Less			Greater	Fair
	<u>Than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	<u>Than 10</u>	<u>Value</u>
U.S. Treasury obligations	\$ 1,999,980	\$ 1,660,123	\$ -	\$ 423,914	\$ 4,084,017
Mortgage and asset-backed securities	-	-	-	3,740,030	3,740,030
Corporate notes and bonds	<u>374,450</u>	<u>1,346,992</u>	<u>2,430,375</u>	<u>1,057,882</u>	<u>5,209,699</u>
	<u>\$ 2,374,430</u>	<u>\$ 3,007,115</u>	<u>\$ 2,430,375</u>	<u>\$ 5,221,826</u>	<u>\$ 13,033,746</u>

As of December 31, 2011, the Administration's investments in debt securities were as follows:

	<u>Investment Maturities (In Years)</u>				
	Less			Greater	Fair
	<u>Than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	<u>Than 10</u>	<u>Value</u>
U.S. Treasury obligations	\$ 599,976	\$ 626,392	\$ 121,369	\$ 643,337	\$ 1,991,075
Mortgage and asset-backed securities	-	100,912	483,225	4,882,302	5,466,439
Corporate notes and bonds	<u>204,263</u>	<u>2,163,290</u>	<u>2,110,852</u>	<u>1,448,308</u>	<u>5,926,712</u>
	<u>\$ 804,239</u>	<u>\$ 2,890,594</u>	<u>\$ 2,715,446</u>	<u>\$ 6,973,947</u>	<u>\$ 13,384,226</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, 2012, was as follows:

<u>Standard and Poors' Rating</u>	<u>Domestic</u>
AAA	\$ 8,078,722
AA+	338,040
AA	153,774
AA-	197,109
A+	294,588
A	669,096
A-	1,079,205
BBB+	641,672
BBB	1,429,141
BBB-	<u>152,399</u>
	<u>\$ 13,033,746</u>

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(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Investments, Continued:

The Administration's exposure to credit risk at December 31, 2011, was as follows:

<u>Standard and Poors' Rating</u>	<u>Domestic</u>
AAA	\$ 7,326,042
AA+	355,619
AA	387,237
AA-	58,464
A+	621,433
A	981,869
A-	1,361,560
BBB+	756,140
BBB	1,243,834
BBB-	<u>292,028</u>
	<u>\$ 13,384,226</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, 2012 and 2011. 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, 2012 and 2011.

F. Depreciable 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.

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(2) Summary of Significant Accounting Policies, Continued

F. Depreciable Fixed Assets, Continued

Capital asset activity for the years ended December 31, 2012 and 2011, was as follows:

	<u>Estimated Useful Lives</u>	<u>January 1, 2012</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31, 2012</u>
Motor vehicles	5 years	\$ 105,913	\$ 11,438	\$ (9,471)	\$ 107,880
Computer software and hardware	5 years	168,408	6,383	(16,529)	158,262
Office furniture, fixtures and equipment	5 years	64,571	12,243	(8,657)	68,157
Home furnishings	5 years	<u>6,738</u>	<u>-</u>	<u>-</u>	<u>6,738</u>
		345,630	30,064	(34,657)	341,037
Less accumulated depreciation		<u>(235,843)</u>	<u>(37,009)</u>	<u>34,657</u>	<u>(238,196)</u>
		<u>\$ 109,787</u>	<u>\$ (6,945)</u>	<u>\$ -</u>	<u>\$ 102,841</u>
	<u>Estimated Useful Lives</u>	<u>January 1, 2011</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31, 2011</u>
Motor vehicles	5 years	\$ 105,193	\$ 720	\$ -	\$ 105,913
Computer software and hardware	5 years	123,873	55,603	(11,068)	168,408
Office furniture, fixtures and equipment	5 years	88,963	4,875	(29,267)	64,571
Home furnishings	5 years	<u>7,308</u>	<u>-</u>	<u>(570)</u>	<u>6,738</u>
		325,337	61,198	(40,905)	345,630
Less accumulated depreciation		<u>(248,147)</u>	<u>(28,601)</u>	<u>40,905</u>	<u>(235,843)</u>
		<u>\$ 77,190</u>	<u>\$ 32,597</u>	<u>\$ -</u>	<u>\$ 109,787</u>

G. Contributions

Contributions to the Retirement 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 seven percent of wages commencing October 1, 2010. The tax rate increased to 7.5% effective January 1, 2013.

Maximum quarterly taxable wages are currently \$6,000 which increased to \$7,000 effective January 1, 2013. Every employer is required to contribute an amount equal to that contributed by employees.

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(2) Summary of Significant Accounting Policies, Continued

G. Contributions, Continued

Contribution revenues received during the years ended December 31, 2012 and 2011 are comprised of the following:

	<u>2012</u>	<u>2011</u>
Government employment	\$ 7,901,969	\$ 7,495,281
Private employment	8,266,665	8,772,936
Judgments	18,854	82,192
Penalties and interest	<u>184,386</u>	<u>242,746</u>
	<u>\$ 16,371,874</u>	<u>\$ 16,593,155</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.

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, 2012 and 2011, the minimum monthly benefit payments are \$100 and \$75, respectively.

I. New Accounting Standards

During the year ended December 31, 2012, the Administration implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The implementation of this statement did not have a material effect on the accompanying financial statements.

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(2) Summary of Significant Accounting Policies, Continued

I. New Accounting Standards, Continued

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Administration.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of the Administration.

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(2) Summary of Significant Accounting Policies, Continued

K. 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 position 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.

L. 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 and property and casualty 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 Position Held in Trust

Net position are held in trust to comply with the Social Security Act of 1983. All net position 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 as a whole.

In January 2012, the Administration obtained an actuarial valuation of the Retirement Fund as of January 1, 2011. The valuation reported actuarial accrued liabilities for the Retirement Fund of \$287,771,000. As of December 31, 2012 and 2011, the Administration recorded total fund equity of \$42,687,289 and \$40,382,469, respectively, 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 from FSM National Government

The Administration receives periodic subsidies for its operations from appropriations received from the Congress of the FSM. During the years ended December 31, 2012 and 2011, contributions from the FSM National Government amounted to \$1,000,000 and \$1,200,000, respectively, of which \$500,000 and \$900,000 is receivable from the FSM National Government as of December 31, 2012 and 2011, respectively.

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(6) Contributions Receivable

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

(7) Prior Service Claims

Under the terms of a Prior Service Claim Adjudication Service Agreement between the 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, 2012 and 2011, had received an allocation of \$408,879 and \$272,797, respectively, from PSTFA of which \$236,645 and \$253,765 were paid as benefits during the years ended December 31, 2012 and 2011, 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, 2012 and 2011, the amount available for future benefit payments under the Prior Service Benefits Program amounted to \$152,247 and \$26,900, respectively.

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Combining Statement of Net Position
December 31, 2012

	<u>Retirement Fund</u>	<u>Prior Service Fund</u>	<u>Total</u>
<u>ASSETS</u>			
Cash and cash equivalents	\$ 2,244,250	\$ 196,297	\$ 2,440,547
Receivables:			
Contributions	2,842,350	-	2,842,350
Due from FSM National Government	500,000	-	500,000
Accrued interest	63,599	-	63,599
Other	14,525	-	14,525
Total receivables	<u>3,420,474</u>	<u>-</u>	<u>3,420,474</u>
Prepayments	<u>3,600</u>	<u>-</u>	<u>3,600</u>
Investments:			
Fixed income	13,033,746	-	13,033,746
Stocks	24,172,986	-	24,172,986
Total investments	<u>37,206,732</u>	<u>-</u>	<u>37,206,732</u>
Depreciable fixed assets, net	<u>102,841</u>	<u>-</u>	<u>102,841</u>
Total assets	<u>42,977,897</u>	<u>196,297</u>	<u>43,174,194</u>
<u>LIABILITIES</u>			
Accounts payable	261,236	44,050	305,286
Other liabilities and accruals	24,865	-	24,865
Accrued management fees	4,507	-	4,507
Total liabilities	<u>290,608</u>	<u>44,050</u>	<u>334,658</u>
<u>NET POSITION</u>			
Held in trust for retirement, disability and survivors' benefits	<u>\$ 42,687,289</u>	<u>\$ 152,247</u>	<u>\$ 42,839,536</u>

See Accompanying Independent Auditors' Report.

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Combining Statement of Changes in Net Position
Year Ended December 31, 2012

	<u>Retirement Fund</u>	<u>Prior Service Fund</u>	<u>Total</u>
Additions:			
Contributions	\$ 16,371,874	\$ -	\$ 16,371,874
Investment income:			
Net change in the fair value of investments	3,102,803	-	3,102,803
Interest and dividends	736,418	486	736,904
Total investment income	3,839,221	486	3,839,707
Less investment expense:			
Investment management and custodial fees	(169,274)	-	(169,274)
Net investment income	3,669,947	486	3,670,433
Other additions:			
Contributions from FSM National Government	1,000,000	-	1,000,000
Other	78,995	408,879	487,874
Total additions	21,120,816	409,365	21,530,181
Deductions:			
Benefit payments:			
Retirement	11,038,569	94,523	11,133,092
Survivors	5,068,023	142,122	5,210,145
Disability	1,456,825	-	1,456,825
Lump sum	182,031	-	182,031
Total benefit payments	17,745,448	236,645	17,982,093
Refunds	34,551	-	34,551
Administrative	1,035,997	47,373	1,083,370
Total deductions	18,815,996	284,018	19,100,014
Change in net position	2,304,820	125,347	2,430,167
Net position at beginning of year	40,382,469	26,900	40,409,369
Net position at end of year	<u>\$ 42,687,289</u>	<u>\$ 152,247</u>	<u>\$ 42,839,536</u>

See Accompanying Independent Auditors' Report.

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

The Board of Trustees
FSM Social Security Administration:

We have audited, in accordance with the 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, the financial statements of the Federated States of Micronesia Social Security Administration (the Administration), which comprise the statement of net position as of December 31, 2012, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 27, 2013. Our report includes a reference for the adoption of new accounting standards.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Administration's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Administration's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

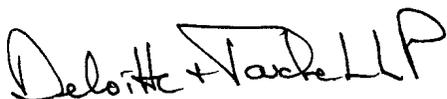
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Administration's financial statements are free from 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 certain matters that we reported to management of the Administration in a separate letter dated May 27, 2013.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

May 27, 2013

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

Summary Schedule of Prior Year Findings
Year Ended December 31, 2012

There are no prior year findings unresolved as of December 31, 2012.