

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED DECEMBER 31, 2004 AND 2003

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Years Ended December 31, 2004 and 2003
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INDEPENDENT AUDITORS' REPORT

Board of Trustees
FSM Social Security Administration:

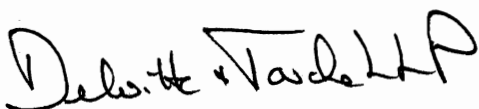
We have audited the accompanying statements of net assets of the Federated States of Micronesia Social Security Administration (FSMSSA), a component unit of the FSM National Government, as of December 31, 2004 and 2003, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of FSMSSA'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 FSMSSA'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 position of the FSMSSA as of December 31, 2004 and 2003, and the results of its operations 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 2-6 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 FSMSSA's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 8, 2005, on our consideration of FSMSSA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.



June 8, 2005

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Management's Discussion and Analysis
Year Ended December 31, 2004

Program Description

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

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

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

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

The FSM Social Security system is financed by employer/employee contributions at a rate of 6% each, or a combined tax rate of 12% paid to the system every quarter. State and national governments and all private employers incorporated or doing business in the FSM are subject to social security tax. At present, the maximum taxable wages per employee for each quarter is \$5,000, which was effectuated in the 4th quarter of 2003.

Management Perspective

The management of the FSMSSA is responsible for the accuracy of the data. We believe that the information enclosed is accurate in all material aspects and is reported in such a manner as to accurately represent the financial condition of the FSMSSA operations. Net assets at the end of calendar year 2004 increased by \$2,434,935. This increase is primarily attributable to the positive returns of 6.8% on our investment portfolio or \$2,351,940. The rest came from the excess of contributions collected and miscellaneous receipts after payments of benefits and administrative expenses. Total revenue for CY 2004 was \$14,679,843 while benefits, administrative expenses and other disbursements were \$12,244,907.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Management's Discussion and Analysis
Year Ended December 31, 2004

Significant Events – 2004

- Extending our public forums on all four States to include Board of Trustees;
- Celebrated the social security week and 36th anniversary with a visit to government offices and conducted open forum with the employees. Promotional items were distributed to instill public awareness of what the Program has to offer;
- Continue to enhance employees' knowledge particularly in Accounting and Auditing through participation in the APIPA Conference held in Majuro, Marshall Islands;
- Joint Proposal to DOI with Palau SSA and Marshall SSA for computerization upgrade to Visual FoxPro, approved and authorized for \$215,000 grants. FSMSSA has received its share of the grant specifically allocated for computer system hardware. \$18,024 worth of computer hardware were purchased this year; and the upgrading of our FoxPro Software is nearly completed – will be implemented in FSMSSA sometime in August 2005;
- Continue the efforts to finalize the totalization agreement with Palau SSA and Marshall SSA;
- Establish annual conference between all Administrators from MRI, ROP, and FSMSSA to compare and contrast regarding a better operation of the program.

Statements of Net Assets

	<u>2004</u>	<u>2003</u>
Cash and equivalents	\$ 1,789,785	\$ 2,171,221
Investments	35,855,045	33,318,406
Other current assets	2,156,189	1,859,674
Fixed assets, net	<u>91,221</u>	<u>80,527</u>
Total assets	\$ <u>39,892,240</u>	\$ <u>37,429,828</u>
Liabilities	\$ <u>110,403</u>	\$ <u>82,926</u>
Net assets:		
Held in trust for retirement, disability and survivors' benefits	<u>39,781,837</u>	<u>37,346,902</u>
Total liabilities and net assets	\$ <u>39,892,240</u>	\$ <u>37,429,828</u>

Statements of Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Total revenues	\$ 14,679,843	\$ 15,585,287
Expenses	<u>12,244,908</u>	<u>11,769,979</u>
Change in net assets	2,434,935	3,815,308
Net assets at beginning of year	<u>37,346,902</u>	<u>33,531,594</u>
Net assets at end of year	\$ <u>39,781,837</u>	\$ <u>37,346,902</u>

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Management's Discussion and Analysis
Year Ended December 31, 2004

Contributions

Contributions collected during fiscal year 2004 totaled \$12,275,901, a 7.7% increase over CY 2003. The administration continues to pursue an aggressive campaign of audits of public and private sector employers to ensure compliance with the Social Security Act.

Benefit Payments

A total of \$11,320,348 was disbursed in benefit payments during fiscal year 2004 which are offset by \$10,541 of prior year credits. The following benefits were paid during fiscal year 2004:

<u>Type</u>	<u>2004</u>	<u>2003</u>
Old Age	\$6,550,765	\$6,290,710
Survivor	\$4,025,827	\$3,859,375
Disability	\$ 710,668	\$ 635,004
Lump Sum	\$ 33,088	\$ 60,941

Administrative Expenses & Fixed Assets Purchases

Net administrative expenses of \$886,492 and fixed assets of \$29,848 were paid during fiscal year 2004. This was 6.2% less than the approved budget of \$977,245 and 24.3% less than the \$1,210,000 ceiling imposed by the Social Security Act, but represented a 1.4% increase from 2003 administrative expenses. Among the highest expenses paid this year were Actuarial Services of \$26,000 and Professional Services of \$81,015. These two items combined increased by 46% compared to last year and account for 12% of the total administrative costs this year. Other expense items in CY2004 were relatively stable compared to CY2003.

Investments

Fiscal year 2004 saw another gain in our investment portfolio with a net investment income of \$2,351,940. However, this year's net gain was 41% lower compared to 2003, which registered a net gain of \$3,982,671.

Net investment gain for the year ended December 31, 2004, comprises the following:

Interest and dividends-investments	\$ 901,714
Realized gains on sale	1,925,027
Unrealized gains	3,748,234
Realized losses on sale	(214,276)
Unrealized Losses	(3,769,275)
Investment fees	<u>(239,484)</u>
Net investment gain	\$ <u>2,351,940</u>

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Management's Discussion and Analysis
Year Ended December 31, 2004

Our professional service providers for our investment portfolio consist of the following:

Investment Advisor

Merrill Lynch
Pauahi Tower Penthouse
1001 Bishop Street
Honolulu, HI 96813

Custodial Trustee

Pacific Century Trust
P.O. Box 3170
Honolulu, HI 96802

Money Managers (Fixed Income)

Provident Investment Counsel
300 North Lake Avenue
Pasadena, CA 91101

Money Manager (Equity)

Atlanta Sosnoff Capital Cor
101 Park Avenue
New York, NY 10178

Money Manager (Small Cap US Stock)

Missouri Valley Partners
135 N. Meramec, Suite 500
St. Louis, MO 63105

Treasury Inflation Protected Securities

Provident Investment Counsel
300 North Lake Avenue
Pasadena, CA 91101

Conclusion

During the calendar years 2003 and 2004, the program's net assets increased by \$3,815,308 and \$2,434,935, respectively. With intensified efforts in our audit and collection of delinquent accounts, close monitoring of our investment portfolio to ensure it's higher returns, and watching and keeping administrative costs down, we are hoping to maintain a yearly positive bottom line in the years to come.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Statements of Net Assets
December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<u>ASSETS</u>		
Cash and equivalents	\$ 1,789,785	\$ 2,171,221
Investments, at fair value	35,855,045	33,318,406
General receivables	1,979,938	1,712,396
Accrued interest receivable	167,605	138,278
Advances	5,941	7,500
Prepaid expenses	2,705	1,500
Fixed assets, net	<u>91,221</u>	<u>80,527</u>
Total assets	<u>\$ 39,892,240</u>	<u>\$ 37,429,828</u>
<u>LIABILITIES</u>		
Accounts payable - general	\$ 76,807	\$ 11,643
Taxes/personnel benefits payable	20,666	50,464
Accrued PCT monthly fees	<u>12,930</u>	<u>20,819</u>
Total liabilities	<u>110,403</u>	<u>82,926</u>
Contingencies		
<u>NET ASSETS</u>		
Held in trust for retirement, disability and survivors' benefits	<u>39,781,837</u>	<u>37,346,902</u>
Total liabilities and net assets	<u>\$ 39,892,240</u>	<u>\$ 37,429,828</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Statements of Changes in Net Assets
Years Ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Additions:		
Contributions	\$ <u>12,275,901</u>	\$ <u>11,398,884</u>
Investment income:		
Net increase in the fair value of investments	2,351,940	3,982,671
Interest income	-	138,278
Miscellaneous income	<u>52,002</u>	<u>65,454</u>
Total investment income	<u>2,403,942</u>	<u>4,186,403</u>
Total additions	<u>14,679,843</u>	<u>15,585,287</u>
Deductions:		
Benefit payments	11,309,808	10,835,214
Refund contributions	11,430	30,634
Administrative expenses, net	<u>923,670</u>	<u>904,131</u>
Total deductions	<u>12,244,908</u>	<u>11,769,979</u>
Change in net assets	2,434,935	3,815,308
Net assets at beginning of year	<u>37,346,902</u>	<u>33,531,594</u>
Net assets at end of year	<u>\$ <u>39,781,837</u></u>	<u>\$ <u>37,346,902</u></u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2004 and 2003

(1) 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.

For the year ended December 31, 2003, the Administration adopted GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* (GASB 34) as amended by GASB Statement No.s 37 and 38 and applied those standards on a retroactive basis. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that FSM Social Security Administration resources be classified, for accounting and reporting purposes, as held in trust for retirement disability and survivors' benefits.

B. Future Liabilities and Contributions

No recognition is given 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 Equivalents

For the purposes of the statement of net assets, cash and equivalents is defined as cash on hand, in bank checking and savings accounts, time certificates of deposit with initial maturities of ninety days or less and funds held by Pacific Century Trust, the trustee, in an automated cash management fund.

Cash and equivalents as of December 31, 2004 and 2003, are comprised of the following:

	<u>2004</u>	<u>2003</u>
Petty cash	\$ 1,400	\$ 1,400
Cash in bank – operations	17,953	855
Cash in bank - payroll	1,158	1,250
Cash in bank - benefits 3	(265,383)	(254,843)
Cash in bank - benefits 4	-	(3,384)
Savings accounts	1,126,558	1,320,496
Pacific Century Trust – automated cash management fund	<u>908,099</u>	<u>1,105,447</u>
	<u>\$ 1,789,785</u>	<u>\$ 2,171,221</u>

Of the cash and equivalents, \$300,000 is subject to coverage by the Federal Deposit Insurance Corp. (FDIC) as of December 31, 2004 and 2003. The remaining balance is uninsured. The Administration does not require collateralization of its deposits. Therefore, amounts exceeding FDIC insurable limitations are characterized as uncollateralized.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

D. Investments

Investments in securities are stated at fair value.

Generally, the FSM Social Security Administration can invest in bonds and other evidence of indebtedness of the FSM or U.S.; or of any State of the FSM and U.S.; in bonds, debentures, notes and other evidence of indebtedness issued or assumed by FSM or U.S. institutions; and in preferred or common stock of any corporation created or existing under the laws of the FSM or under the laws of the U.S., or any state, territory, or commonwealth.

Investments as of December 31, 2004 and 2003, comprise the following:

	<u>2004</u>	<u>2003</u>
Common stock	\$ 21,755,629	\$ 19,688,918
U.S. government obligations	225,252	308,760
U.S Treasury obligations	5,606,425	697,908
Government agency obligations	6,137,557	9,349,686
Corporate bonds, preferred stock and mutual funds	<u>2,130,182</u>	<u>3,273,134</u>
	<u>\$ 35,855,045</u>	<u>\$ 33,318,406</u>

Net investment gain for the years ended December 31, 2004 and 2003, comprises the following:

	<u>2004</u>	<u>2003</u>
Interest and dividends-investments	\$ 901,714	\$ 660,917
Realized gains on sale	1,925,027	1,299,038
Unrealized gains	3,748,234	4,377,976
Realized losses on sale	(214,276)	(715,493)
Unrealized losses	(3,769,275)	(1,421,567)
Investment fees	<u>(239,484)</u>	<u>(218,200)</u>
Net investment gain	<u>\$ 2,351,940</u>	<u>\$ 3,982,671</u>

D. Investments

Governmental Accounting Standards Board (GASB) Statement No. 3 requires government entities to categorize investments in the following categories to give an indication of the level of risk assumed by the entity.

Category 1 - Insured or registered, or securities held by the Administration or its agent in the Administration's name.

Category 2 - Uninsured and unregistered, or securities held by a party other than the Administration or its agent, in the Administration's name.

Category 3 - Uninsured and unregistered, securities held by a party other than the Administration and not in the Administration's name.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

D. Investments, Continued

The Administration's demand deposits are non-categorized investments in accordance with Governmental Accounting Standards Board (GASB) Statement No. 3. All other investments held by the Administration have been classified as category 1 investments in accordance with GASB No. 3 as all investments are held in the name of the FSM Social Security Administration by Pacific Century Trust, the trustee.

E. 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.

Fixed assets as of December 31, 2004 and 2003, are as follows:

	<u>Estimated Useful Lives</u>	<u>January 1, 2004</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31, 2004</u>
Motor vehicles	5 years	\$ 103,054	\$ 9,634	\$ -	\$ 112,688
Computer equipment	5 years	115,633	32,860	(4,035)	144,458
Furniture	5 years	114,192	5,378	(9,035)	110,535
Office equipment	5 years	<u>3,059</u>	<u>-</u>	<u>(410)</u>	<u>2,649</u>
		335,938	47,872	(13,480)	370,330
Less accumulated depreciation and amortization		<u>(255,411)</u>	<u>(36,430)</u>	<u>12,732</u>	<u>(279,109)</u>
		\$ <u>80,527</u>	\$ <u>11,442</u>	\$ <u>(748)</u>	\$ <u>91,221</u>
	<u>Estimated Useful Lives</u>	<u>January 1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31, 2003</u>
Motor vehicles	5 years	\$ 85,466	\$ 17,588	\$ -	\$ 103,054
Computer equipment	5 years	109,657	5,976	-	115,633
Furniture	5 years	106,674	9,497	(1,979)	114,192
Office equipment	5 years	<u>3,058</u>	<u>1</u>	<u>-</u>	<u>3,059</u>
		304,855	33,062	(1,979)	335,938
Less accumulated depreciation and amortization		<u>(214,604)</u>	<u>(40,807)</u>	<u>-</u>	<u>(255,411)</u>
		\$ <u>90,251</u>	\$ <u>(7,745)</u>	\$ <u>(1,979)</u>	\$ <u>80,527</u>

F. 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.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

F. Contributions, Continued

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

Contributions as of December 31, 2004 and 2003, comprise of the following:

	<u>2004</u>	<u>2003</u>
Government employment	\$ 5,931,863	\$ 5,960,268
Private employment	5,896,019	5,284,263
SS Tax contributions	254,882	-
Penalties and interest	<u>193,137</u>	<u>154,353</u>
	\$ <u>12,275,901</u>	\$ <u>11,398,884</u>

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

Benefit payments as of December 31, 2004 and 2003, are comprised of the following:

	<u>2004</u>	<u>2003</u>
Retirement pension	\$ 6,540,224	\$ 6,279,893
Survivor pension	4,025,827	3,859,376
Disability pension	710,668	635,004
Lump sum pension	<u>33,089</u>	<u>60,941</u>
	\$ <u>11,309,808</u>	\$ <u>10,835,214</u>

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

H. Management Estimates

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

I. New Accounting Standards

For fiscal year 2005, the Administration will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (an Amendment of GASB Statement No. 3) and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The Administration has not evaluated the financial statement impact of GASB Statement No 42.

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.

(2) Establishment of the Social Security Administration

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.

(3) Net Assets Held in Trust

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

(4) Contingencies

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

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2004 and 2003

(4) Contingencies, Continued

In October 2004, the FSM Social Security Administration obtained an actuarial valuation of the Retirement Fund as of January 1, 2004. The valuation reported actuarial accrued liabilities for the Retirement Fund of \$240,247,000. As of January 1, 2004, the FSM Social Security Administration recorded a total fund equity of \$37,347,000 in the Retirement Fund, as funds available to fund future benefit obligations; these figures resulted in an accrued unfunded liability of \$202,900,000. The report indicates that the Administration should not increase future or current benefits until a long-term trend of decreasing the unfunded accrued liability is realized.

(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 the Prior Service Claim Adjudication Service Agreement between the Prior Service Trust Fund Administration and the Social Security Administration of the Federated States of Micronesia, the FSM Social Security Administration is to provide for the processing of benefit claims and to assist in the monitoring of continuing eligibility under the Prior Service Program. The Prior Service Trust Fund Administration will reimburse the Social Security Administrator \$8,000 per annum plus an amount equal to 8% of the total amount of automated and manual benefit payments.

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, as of and for the year ended December 31, 2004, and have issued our report thereon dated June 8, 2005. 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 FSM Social Security Administration's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the FSM Social Security Administration's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

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

Deloitte + Touche LLP

June 8, 2005