

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED DECEMBER 31, 2005 AND 2004

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Years Ended December 31, 2005 and 2004
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INDEPENDENT AUDITORS' REPORT

Board of Trustees
FSM Social Security Administration:

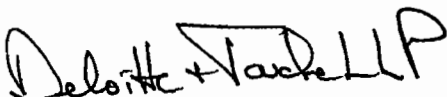
We have audited the accompanying statements of net assets of the Federated States of Micronesia Social Security Administration (FSMSSA), a component unit of the FSM National Government, as of December 31, 2005 and 2004, and the related statements of changes in net assets for the years then ended. These 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, 2005 and 2004, and the changes in its net assets 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 2-5 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 March 31, 2006, 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.



March 31, 2006

**FEDERATED STATES OF MICRONESIA
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Management's Discussion and Analysis
Year Ended December 31, 2005

Program Description

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

Charles L. Chieng	Chairman of the Board and 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 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 un-expired term only. Where a vacancy is 1 year or less, it shall be filled by appointment by the President; otherwise vacancies shall be filled by nomination by the President and confirmation by the Congress. Members of the Board who are not State or National Government employees shall be paid at the rate of \$30 per day and necessary travel expenses when actually attending meetings of the Board.

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

The FSM Social Security system is financed by employer/employee contributions at a rate of 6% each, or a combined tax rate of 12% 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.

Significant Events

- Public Law 14-37 was signed by the President in November 2005 as an amendment to Title 53 – Social Security Act. The new law includes among other things: waiver of interest payments, lump sum benefits to survivors equal to four percent of the lesser benefits (in cases where a surviving spouse is also a retiree, and in cases where both parents of surviving children become deceased), lump sum payments to foreigners equal to 100% of their contributions, and other administrative matters.

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Management's Discussion and Analysis
Year Ended December 31, 2005

Significant Events, Continued

- The Totalization Agreement with MISSA and ROPSSA was signed by the President and ratified by the Congress for FSM. The agreement would allow a member to combine his or her earnings from the three countries to determine eligibility and to receive social security benefits from each country on a pro-rata basis.
- Completed the computerization upgrade to Visual Fox Pro 10, a grant from the U.S. Department of Interior and jointly shared with MISSA and ROPSSA for \$215,000. At the same time during the system's upgrade in August, all HQ and Pohnpei Branch staff received comprehensive computer training.
- Continue to build staff capacity: knowledge, skills and abilities – through participation of key personnel to the APIPA conference held in Palau in July. As of this writing, we have also just concluded the 5-day biannual employees' conference held at the Headquarters and attended by all staff from HQ and from the four branch offices. The conference focused mainly on the newly upgraded system where HQ staff led training of all other branch employees. The new system will significantly improve the processing of information, one key toward better service to the growing number of recipients, employers and members.
- Celebrated the social security week and 37th anniversary by conducting conferences in the branch level attended by members and retirees.
- Work with National Leadership in seeking assistance from U.S. Department of Interior and U.S. Congress in financing the Prior Service Program. Working towards administering the Prior Service Trust Fund – FSM.
- Translated the Program's booklets and brochures into 4 FSM languages.

Financial Highlights

- The System's net assets increased 7.2% from \$39,781,837 as of December 31, 2004 to \$42,657,062 as of December 31, 2005. This increase was primarily due to the investment's net gain and was approximately 55% higher than the previous year's. At the end of 2005, net investment gain comprised the following:

Interest and dividends earned	\$ 837,883
Realized gains on sale	1,221,389
Unrealized gains on Market Value	4,882,324
Realized losses on sale	(261,160)
Unrealized losses on Market Value	(2,768,249)
Investment fees	<u>(263,189)</u>
Net Investment gain	\$ <u>3,648,998</u>

The investment's market value as of December 31, 2005 reached \$39,675,318 including automated cash management fund of \$1,866,258.

**FEDERATED STATES OF MICRONESIA
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Management's Discussion and Analysis
Year Ended December 31, 2005

- Tax collections in 2005 totaled \$12,129,796. While this amount exceeded projection, it declined slightly by 1.2% when compared to 2004 total of \$12,275,901. The administration continues to pursue an aggressive campaign of audit of public and private sector employers to ensure compliance with the Social Security Act.

Other income during the year included reimbursement from Prior Service Trust Fund Administration amounting to \$41,330 and miscellaneous collections of \$24,594 from ss card and other fees.

- Benefits payments increased nearly 6.2% due to an increasing number of recipients. Total benefits paid in 2005 were \$12,006,929 compared to \$11,309,808 paid in 2004. At the end of 2005, the total number of beneficiaries reached 6,404 compared to 6,255 at the end of 2004.

A breakdown of benefits according to entitlement follows:

	<u>2005</u>	<u>2004</u>
Retirement	\$ 6,870,291	\$ 6,540,224
Survivor	4,269,263	4,025,827
Disability	830,813	710,668
Lump Sum	36,562	33,088

- Administrative expenses in 2005 totaled \$940,444. It was higher by 1.8% compared to 2004 due to increased utilities rates; higher fuel costs, repairs & maintenance, and printing. Also, training expense contributed to the increase. Other expense items remained virtually unchanged during the year's operation.

Fixed assets acquisition during the year amounted to \$24,032. The major asset acquired was a vehicle worth \$12,000 for Kosrae Branch. The rest of the acquisitions were for office equipment comprised mostly of computers and computer items.

Although slightly higher by 1.8% when compared to last year, this year's total administrative expenses were lower than the approved budget by 5.4% and 29.6% lower than the budget ceiling provided in the Social Security Act.

In November 2005, the Board approved \$1,007,412 as budget for FY2006. This amount is 2.57% higher than FY2005 approved budget.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Management's Discussion and Analysis
Year Ended December 31, 2005

Statement of Net Assets

	<u>2005</u>	<u>2004</u>
Cash and equivalents	\$ 2,873,476	\$ 1,789,785
Investments	37,809,060	35,855,045
Other current assets	1,970,466	2,156,189
Fixed assets, net	<u>79,944</u>	<u>91,221</u>
	<u>42,732,946</u>	<u>39,892,240</u>
Liabilities	<u>75,884</u>	<u>110,403</u>
Net assets:		
Held in trust for retirement, disability and survivors' benefit	<u>\$ 42,657,062</u>	<u>\$ 39,781,837</u>

Statement of Changes in Net Assets

Revenues	\$ 15,844,718	\$ 14,679,843
Expenses	<u>12,969,493</u>	<u>12,244,908</u>
Changes in net assets	2,875,225	2,434,935
Net assets at beginning of year	<u>39,781,837</u>	<u>37,346,902</u>
Net assets at end of year	<u>\$ 42,657,062</u>	<u>\$ 39,781,837</u>

Conclusion

The System's net assets increased 14.2% over the two year period in 2004 and 2005 primarily due to positive returns of the investment portfolio. During 2005, however, total benefits and administrative expenses exceeded collected revenues and resulted in drawdown of funds from the investments to meet benefits payment in December 2005.

It is the hope of the administration to achieve a better ratio between benefits and contributions, and to realize surplus earlier than what has been projected. We believe that our continued efforts in auditing and pursuing delinquent employers as well as controlling administrative expenses will help pave the way toward achieving this objective.

Furthermore, it is the direction of the administration to move into a defined contribution plan and therefore, has submitted a proposed amendment to Congress for that purpose.

Overall, the System's operating results during fiscal years 2005 and 2004 generated net income of \$2,875,225 and \$2,434,935, respectively.

**FEDERATED STATES OF MICRONESIA
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Statements of Net Assets
December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
<u>ASSETS</u>		
Cash and equivalents	\$ 2,873,476	\$ 1,789,785
Investments, at fair value	37,809,060	35,855,045
General receivables	1,813,151	1,979,938
Accrued interest receivable	144,007	167,605
Advances	9,708	5,941
Prepaid expenses	3,600	2,705
Fixed assets, net	<u>79,944</u>	<u>91,221</u>
Total assets	<u>\$ 42,732,946</u>	<u>\$ 39,892,240</u>
<u>LIABILITIES</u>		
Accounts payable - general	\$ 42,569	\$ 76,807
Taxes/personnel benefits payable	19,604	20,666
Accrued PCT monthly fees	<u>13,711</u>	<u>12,930</u>
Total liabilities	<u>75,884</u>	<u>110,403</u>
Contingencies		
<u>NET ASSETS</u>		
Held in trust for retirement, disability and survivors' benefits	<u>42,657,062</u>	<u>39,781,837</u>
Total liabilities and net assets	<u>\$ 42,732,946</u>	<u>\$ 39,892,240</u>

See accompanying notes to financial statements.

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Statements of Changes in Net Assets
Years Ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Additions:		
Contributions	\$ <u>12,129,796</u>	\$ <u>12,275,901</u>
Investment income:		
Net increase in the fair value of investments	3,648,998	2,351,940
Miscellaneous income	<u>65,924</u>	<u>52,002</u>
Total investment income	<u>3,714,922</u>	<u>2,403,942</u>
Total additions	<u>15,844,718</u>	<u>14,679,843</u>
Deductions:		
Benefit payments	12,006,929	11,309,808
Refund contributions	22,120	11,430
Administrative expenses, net	<u>940,444</u>	<u>923,670</u>
Total deductions	<u>12,969,493</u>	<u>12,244,908</u>
Change in net assets	2,875,225	2,434,935
Net assets at beginning of year	<u>39,781,837</u>	<u>37,346,902</u>
Net assets at end of year	\$ <u><u>42,657,062</u></u>	\$ <u><u>39,781,837</u></u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2005 and 2004

(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.

The Administration has 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. 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. Deposits and Investments

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

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

- (i) Government obligations - Obligations issued or guaranteed as to principal and interest by the FSM National Government and/or State governments of the Federated States of Micronesia or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.
- (ii) Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the Federated States of Micronesia or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or pass through and other mortgage-backed securities provided that the obligation is issued by an agency of the United States Government, the FSM National Government, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the Fund or ten percent of the outstanding value of the issue at the time of purchase.

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Notes to Financial Statements
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

- (iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the Administration's investment advisor at the time of purchase, that not more than five percent of the market value of the Fund shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of the Fund shall be invested in any one industry group.
- (iv) Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments of the Fund.

Cash and Equivalents:

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

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

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

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.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

Cash and Equivalents, Continued:

As of December 31, 2005 and 2004, the carrying amount of the Administration's total cash and cash equivalents was \$2,873,476 and \$1,789,785, respectively, and the corresponding bank balances were \$1,007,218 and \$881,686, respectively. These bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC). As of December 31, 2005 and 2004, bank deposits in the amount of \$300,000 were FDIC insured. Accordingly, these deposits are exposed to custodial credit risk. The Administration does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. The remaining amounts of \$1,866,258 and \$908,099, respectively, represent short-term investments held and administered by Pacific Century Trust in accordance with a fiduciary trust agreement. Based on negotiated trust and custody contracts, all of these investments were held in the Administration's name by Pacific Century Trust at December 31, 2005 and 2004.

Investments:

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

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

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

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

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

Investments, Continued:

As of December 31, 2005 and 2004, investments at fair value are as follows:

	<u>2005</u>	<u>2004</u>
Fixed income securities:		
Domestic fixed income	\$ <u>13,346,830</u>	\$ <u>14,088,850</u>
Other investments:		
Domestic equities	24,462,230	21,755,629
Mutual funds	<u>-</u>	<u>10,566</u>
	<u>24,462,230</u>	<u>21,766,195</u>
	\$ <u>37,809,060</u>	\$ <u>35,855,045</u>

As of December 31, 2005, the Administration's fixed income securities had the following maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in years)</u>			
		<u>Less than 1</u>	<u>1-5</u>	<u>5-10</u>	<u>more than 10</u>
U.S Treasury obligations	\$ 12,776,207	\$ -	\$ 7,347,364	\$ 4,586,383	\$ 842,460
U.S. Government agency obligations	<u>570,623</u>	<u>-</u>	<u>-</u>	<u>31,869</u>	<u>538,754</u>
	\$ <u>13,346,830</u>	\$ <u>-</u>	\$ <u>7,347,364</u>	\$ <u>4,618,252</u>	\$ <u>1,381,214</u>

As of December 31, 2004, the Administration's fixed income securities had the following maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in years)</u>			
		<u>Less than 1</u>	<u>1-5</u>	<u>5-10</u>	<u>more than 10</u>
U.S Treasury obligations	\$ 5,606,425	\$ -	\$ -	\$ 5,022,508	\$ 583,917
U.S. government obligations	6,137,557	-	1,234,004	791,377	4,112,176
Municipal obligations	225,252	-	-	-	225,252
Corporate bonds	<u>2,119,616</u>	<u>-</u>	<u>823,942</u>	<u>898,686</u>	<u>396,988</u>
	\$ <u>14,088,850</u>	\$ <u>-</u>	\$ <u>2,057,946</u>	\$ <u>6,712,571</u>	\$ <u>5,318,333</u>

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

C. Deposits and Investments, Continued

Investments, Continued:

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

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

<u>Moody's Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
AAA	\$ <u>13,346,830</u>	\$ <u>13,346,830</u>	\$ <u>-</u>
Total credit risk debt securities	\$ <u>13,346,830</u>	\$ <u>13,346,830</u>	\$ <u>-</u>

The Administration's exposure to credit risk at December 31, 2004, was as follows:

<u>Moody's Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
Aaa/AAA	\$ <u>14,088,850</u>	\$ <u>14,088,850</u>	\$ <u>-</u>
Total credit risk debt securities	\$ <u>14,088,850</u>	\$ <u>14,088,850</u>	\$ <u>-</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, 2005 and 2004.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Administration. There was no concentration of credit risk for investments as of December 31, 2005. As of December 31, 2004, the Administration's investment in agency obligations of Federal National Mortgage Association constituted 17% of its total investments.

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

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Notes to Financial Statements
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

D. Fixed Assets

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

	Estimated Useful Lives	January 1, 2005	Additions	Retirements	December 31, 2005
Motor vehicles	5 years	\$ 112,688	\$ 12,007	\$ -	\$ 124,695
Computer software and hardware	5 years	144,458	2,870	(11,439)	135,889
Office furniture, fixtures and equipment	5 years	110,535	6,198	(2,102)	114,631
Home furnishings	5 years	<u>2,649</u>	<u>2,957</u>	<u>(2,229)</u>	<u>3,377</u>
		370,330	24,032	(15,770)	378,592
Less accumulated depreciation and amortization		<u>(279,109)</u>	<u>(34,711)</u>	<u>15,172</u>	<u>(298,648)</u>
		\$ <u>91,221</u>	\$ <u>(10,679)</u>	\$ <u>(598)</u>	\$ <u>79,944</u>
	Estimated Useful Lives	January 1, 2004	Additions	Retirements	December 31, 2004
Motor vehicles	5 years	\$ 103,054	\$ 9,634	\$ -	\$ 112,688
Computer software and hardware	5 years	115,633	32,860	(4,035)	144,458
Office furniture, fixtures and equipment	5 years	114,192	5,378	(9,035)	110,535
Home furnishings	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>

E. Contributions

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

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

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

E. Contributions, Continued

Contributions as of December 31, 2005 and 2004, comprise of the following:

	<u>2005</u>	<u>2004</u>
Government employment	\$ 6,450,475	\$ 5,931,863
Private employment	5,662,080	5,896,019
SS Tax contributions	(158,138)	254,882
Judgement	16,320	-
Penalties and interest	<u>159,059</u>	<u>193,137</u>
	<u>\$ 12,129,796</u>	<u>\$ 12,275,901</u>

F. Benefit Obligations

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

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

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

Benefit payments as of December 31, 2005 and 2004, are comprised of the following:

	<u>2005</u>	<u>2004</u>
Retirement pension	\$ 6,870,291	\$ 6,540,224
Survivor pension	4,269,263	4,025,827
Disability pension	830,813	710,668
Lump sum pension	<u>36,562</u>	<u>33,089</u>
	<u>\$ 12,006,929</u>	<u>\$ 11,309,808</u>

G. 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.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

H. New Accounting Standards

During fiscal year 2005, the Administration implemented 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*. GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 42 establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.

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

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*. GASB Statement No. 44 improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the Administration.

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

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. GASB Statement No. 47 establishes guidance for state and local governmental employers on accounting and financial reporting for termination benefits. These benefits include incentives for voluntary terminations (e.g., early retirement window programs) and severance payments with respect to involuntary terminations. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the Administration.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

I. Risk Management

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

(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.

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.

**FEDERATED STATES OF MICRONESIA
SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements
December 31, 2005 and 2004

(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, 2005, and have issued our report thereon dated March 31, 2006. 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

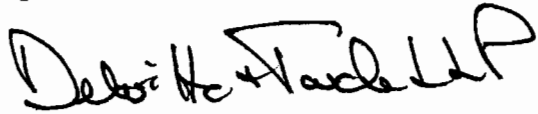
In planning and performing our audit, we considered the FSM Social Security Administration's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control 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.

A handwritten signature in black ink, appearing to read "Debi He + Harold LLP". The signature is written in a cursive, somewhat stylized font.

March 31, 2006