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, 2009 AND 2008

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

Years Ended December 31, 2009 and 2008

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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 (FSM) Social Security Administration (the Administration), a component unit of the FSM National Government, as of December 31, 2009 and 2008, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of the Administration's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Administration's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial status of the Administration as of December 31, 2009 and 2008, and the changes in financial status for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This information is the responsibility of the Administration's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of the Administration taken as a whole. The accompanying Combining Statement of Net Assets (page 23) and Combining Statement of Changes in Net Assets (page 24) as of and for the year ended December 31, 2009 are presented for purposes of additional analysis and are not a required part of the basic financial statements of the Administration. These statements are the responsibility of the Administration's management. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 3, 2010, on our consideration of the Administration's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

June 3, 2010

The following discussion and analysis provides an understanding of the FSM Social Security Administration's (FSMSSA) financial performance for fiscal year ended December 31, 2009. This section has been prepared by the management and should be read in conjunction with the FSMSSA's financial statements and accompanying notes.

Administration

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

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

Garrison Irons	State of Chuuk	Chairman of the Board
Rose N. Nakanaga	State of Pohnpei	Vice Chairman of the Board
Nahoy G. Selifis	National Government	Member
Charles L. Chieng	State of Yap	Member
Jefferson Timothy	State of Kosrae	Member
Alexander R. Narruhn	Administrator	Member, Ex officio

The Administrator, who is selected by the Board, is responsible for daily operations 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 6% each, or a combined tax rate of 12% 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 1, 2008, the maximum quarterly taxable wage of $5,000 is subject to an increment of $1,000 and every 5 years thereafter for a maximum of $10,000 until January 1, 2028. Under Public Law 15-73 passed in March 2009, the tax rate was increased from 6% to 7% (employee 7%, employer 7%) effective October 1, 2009. However, the rate increased has been delayed for one year from October 1, 2009 to October 1, 2010.

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 2009 based on projected income of $12M was $1.35M. However, as part of management's cost cutting measures, the budget was streamlined at $1.15M which is 9.3% of the projected income. The actual administrative costs incurred for FY2009 was $961,778, or a 16% surplus compared to the approved budget.

Significant Events

For the past three years since year 2007, two laws have been passed amending the FSM Social Security Act: Public Law 14-86 which was fully implemented on January 1, 2007 and Public Law 15-73 which was passed into law in March 2009. The following are the amendments included in the said laws:

<u>Public Law 14-86</u>

- Raise to 55 years of age the limit on wage earners adopting children so children adopted after December 1, 2006 by wage earners who are 55 years or more would not be eligible for survivor benefits; However, the administrator is given the authority to determine if a wage earner can be eligible for benefits due to exceptional circumstances. The administrator must satisfy himself or herself that future eligibility for ss benefits was not a significant factor in the decision to adopt. Please refer to the law for the exceptions;

- To be eligible, the minimum contribution of $2,500 is required for a retiree or individual who dies after December 31, 2006 and the minimum contribution of $1,500 for an individual who becomes disabled after December 31, 2006;

- Raise the minimum monthly benefit from $50 to $75;

- FSM citizens working abroad may participate in the Program through voluntary contributions of 12% of $5,000 wages per year; and

<u>Public Law 15-73</u>

- An individual aged 60 to 64 will receive 50% of his/her calculated retirement amount and work at the same time with no earnings test adjustment.

  At age 65, he or she will receive 100% but the earnings test will apply if he or she works.

  This amendment becomes effective January 1, 2011.

- Increase the tax rate from 6% to 7% (employee 7%, employer 7%) on October 1, 2010.

  Increase the tax rate from 7% to 7.5% (employee 7.5%, employer 7.5%) on January 1, 2013.

- Individuals who attain age 60 or die on or after January 1, 2010, must earn at least 50 quarters of coverage to be fully insured for death or old age benefits.

- Individuals who become disabled on or after January 1, 2010 must earn at least 45 quarters of coverage to be fully insured for disability benefits.

  Individuals who become disabled on or after January 1, 2010, must also meet the definition of currently insured to qualify for a disability benefit.

  To be currently insured, one must have at least 20 quarters of coverage within the 25-quarter period ending with the quarter in which a person retires, dies or becomes disabled.

- Clarify the definition of "employer" whether it is an individual, a partnership, a corporation, national government, a municipal or state government or organization or agency thereof, or any other type of business or non-business organization and its responsibilities as far as social security taxes are concerned in order to improve the FSMSSA's ability to collect social security taxes.

- Impose criminal penalties on an employer for intentional failure to pay taxes and identify the chief financial officer of the national government, state governments, municipal governments, or any agencies of any of the above as the individual liable to the program.

- All taxes, including penalties and interest accrued thereon, imposed or authorized under this subtitle and owed by a state or municipal government, or any agency thereof, shall be subject to a writ of garnishment of all moneys owed by the FSM National Government to any state or municipal government or any agency thereof, and such writ of garnishment shall have priority over any claim for such moneys in any manner by the particular state or municipal government or agency thereof.

- Foreigners who are not citizens of the Marshall Islands, Palau or the U.S. will be paid in lump sums equal to their total contributions while employed in the FSM as of the date the employee turns 60 or dies. Further, they must be fully insured to be qualified for this lump sum benefit. Payment will be made over a six month period.

- Allow the FSMSSA to invest in BBB grade bonds.

- Allow for investments in the international market but only with those who exchange their currency in American Depository Receipts.

- Change the percentage of the market value of the fund that can be invested in any one industry group from ten to twenty-five percent; and to insert a security measure so as to ensure that the portfolio is being invested only on a recognized national or regional stock exchange, physical or electronic.

RESULTS OF OPERATIONS / CHANGES IN NET ASSETS

FSMSSA follows the calendar year as its fiscal year. The following table presents information about FSMSSA results of operations for fiscal years 2009, 2008 and 2007.

	2009	2008	2007
Contributions	$ 12,955,409	$ 12,488,497	$ 12,783,551
Investment income (loss), net	6,149,139	(8,274,430)	3,723,433
Benefit payments	(15,304,704)	(14,222,788)	(13,663,880)
Administrative expenses	(961,778)	(989,810)	(969,030)
Other, net	1,190,244	394,280	72,212
Change in net assets	4,028,310	(10,604,251)	1,946,286
Net assets at beginning of year	36,717,256	47,321,507	45,375,221
Net assets at end of year	$ 40,745,566	$ 36,717,256	$ 47,321,507

Contributions

	2009	2008	2007
Government	$ 6,827,298	$ 6,658,920	$ 6,992,581
Private	5,967,099	5,655,537	5,575,799
Judgment	14,887	28,099	16,226
Penalties and interests	146,125	145,941	198,945
Total	$ 12,955,409	$ 12,488,497	$ 12,783,551

Contributions increased by 3.74 % or $466,912 compared to the prior year. The government and private sector's contributions both increased by 2.53% and 5.51%, respectively, and this was attributed mainly from government employment on temporary contract projects and from private sector's increased workforce.

Total delinquent taxes collected in 2009 amounted to $1.2M. Forty four percent of this amount or $530,540 pertains to prior years.

Benefit Payments

	2009	2008	2007
Retirement	$ 9,188,597	$ 8,309,308	$ 7,885,913
Survivors	4,646,298	4,603,842	4,563,095
Disability	1,264,648	1,046,397	947,870
Lump sum	205,161	263,241	267,002
Total	$ 15,304,704	$ 14,222,788	$ 13,663,880

Benefit payments increased by 7.61% or $1,081,916 compared to prior year. Retirement, survivors, and disability benefits all increased by 11%, 1% and 21%, respectively. The overall increase was partially offset by a decrease in lump sum benefits which was lower this year by 22%. The unfavorable variance was attributed mainly to increased number of beneficiaries.

Administrative Expense

	2009	2008	2007
Budget	$ 1,149,058	$ 1,104,132	$ 1,039,581
Actual	$ 961,778	$ 989,810	$ 969,030
Surplus	$ 187,280	$ 114,322	$ 70,551
%	16%	10%	7%

Administrative expense decreased by 3% or $28,032, which was the result of management's cost cutting measures. There were no items individually material in comparison to the prior year.

As in the past, administrative expenses were lower than the approved budget, and this year's budget surplus was 16% or $187,280.

Investment Income / (Loss)

	2009	2008	2007
Investments*	$ 36,869,621	$ 33,715,607	$ 43,356,178
Income (loss), net	$ 6,149,139	$ (8,274,430)	$ 3,723,433
Drawdowns	$ 3,000,000	$ 1,400,000	$ 2,900,000

*includes cash management fund of $460,108, $2,078,126 and $3,737,499 as of December 31, 2009, 2008 and 2007, respectively.

The investment portfolio generated $6.1M gain during the year compared to an $8.3M loss sustained in the prior year. However, because of the $3.0M drawdown from the investment to supplement benefit payments, the investment portfolio increased by $3.1M only from $33.7M last year to $36.8M this year. Management was prompted to withdraw from investments due to operating deficits as a result of lower contributions against benefit payments and administrative expenses.

Other Income

	2009	2008	2007
Contribution from FSM National Government	$ 1,150,000	$ 250,000	$ -
Prior Service Reimbursement	24,140	103,821	68,903
Miscellaneous Receipts	33,514	59,045	23,397
Refunds paid	(17,410)	(18,586)	(20,088)
Total	$ 1,190,244	$ 394,280	$ 72,212

Other income increased by 192% or $794,788 mainly due to appropriation from FSM National Government. Prior Service reimbursements decreased by 77% or $79,681 due to reduced rate from 20% of allotment received to 10% of actual prior service benefit payments.

NET ASSETS

FSMSSA Statement of Net Assets as of December 31, 2009, 2008 and 2007 follows:

	2009	2008	2007
Assets:			
Cash and equivalents	$ 1,600,034	$ 3,162,579	$ 4,298,083
Investments	36,409,513	31,637,481	39,618,679
Other current assets	2,831,584	1,997,740	3,468,620
Fixed assets, net	66,491	87,352	85,352
Total	$ 40,907,622	$ 36,885,152	$ 47,470,734
Liabilities	$ 162,056	$ 167,897	$ 149,227
Net Assets:			
Held in trust for retirement, disability and survivors; benefit	$ 40,745,566	$ 36,717,255	$ 47,321,507

Net assets for the Retirement Fund (non-inclusive of the Prior Service Fund) increased 11% or $4.0M mainly due to investment gains. Net investment gain totaled $6.1M; however, operating deficits of $2.1M partially reduced the total gain during the year.

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 Insular Affairs. For FY 2009, total funds received from the Prior Service Trust Fund Administration (PSTFA) amounted to $445,052 while benefits paid and administrative expenses totaled $282,835 and $24,171, respectively..

As of December 31, 2009, the Prior Service Fund has net assets of $257,879. Reimbursements decreased by 14.3% while benefit payments also decreased by 3.5%.

Following are the Statements of Net Assets as of December 31, 2009, 2008 and 2007 and the Statements of Changes in Net Assets for the years ended December 31, 2009, 2008 and 2007 of the Prior Service Fund:

Statements of Net Assets
(Prior Service Fund)

	2009	2008	2007
Assets	$ 295,261	$ 190,998	$ 30,378
Liabilities	(37,382)	(71,859)	(34,669)
Net assets (deficiency)	$ 257,879	$ 119,139	$ (4,291)

Statements of Changes in Net Assets
(Prior Service Fund)

	2009	2008	2007
PSTFA contributions	$ 445,052	$ 519,107	$ 344,513
Benefit payments	(282,835)	(292,964)	(313,995)
Administrative expenses	(24,171)	(103,922)	(68,957)
Other	694	1,209	1,732
Change in net assets	138,740	123,430	(36,707)
Net assets at beginning of year	119,139	(4,291)	32,416
Net assets at end of year	$ 257,879	$ 119,139	$ (4,291)

Capital Assets and Debt Administration

No significant changes in capital assets occurred during the years ended December 31, 2009, 2008 and 2007. Please see note 2F to the accompanying financial statements for additional information concerning capital assets.

FSMSSA has no long-term debt.

Management's Discussion and Analysis for the year ended December 31, 2008 is set forth in the report on the audit of FSMSSA's financial statements, which is dated June 22, 2009. That Discussion and Analysis explains the major factors impacting the 2008 financial statements and may be obtained from the contact information below.

Conclusion

FSMSSA Retirement Fund net assets increased by $4.0M in FY2009. Benefit payments and administrative expenses were satisfied with cash from social security tax contributions supplemented with proceeds from withdrawal of investments and funding from the FSM National Government.

With increased benefit payments of 7.6% and 4.1%, respectively for fiscal years 2009 and 2008, and unfunded accrued liability of $232.5M (as of Jan 1, 2009), management endeavors to improve its operation through the following:

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

We would also request supplemental funding from the FSM National Government to help with the weak cash flow being experienced during the past four years due to imbalances between contributions and benefits payments plus administrative expenses.

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.

2010 Outlook

FSMSSA is forecasting another operating deficit in 2010. Collection is expected to improve due to the new amendments to the law which increased the tax rate from 6% to 7%. However, the impact of the new law will not be realized until the 4th quarter when the new tax rate takes effect. Collections from contributions are estimated to be approximately $13.0M. The ongoing negotiation between management through its legal counsel and the delinquent employers on payment arrangement is proving to be beneficial and management expects to collect $1.0M from delinquent employers in 2010. Benefit payments are expected to increase 6% due to additional beneficiaries who will become eligible for benefits. We expect to pay $16.0M in benefits in 2010.

FSMSSA expects the administrative cost in 2010 to remain approximately equal to the 2009 level, which is by far the lowest in the last 5 years of its operation due to the cost cutting measures implemented by management.

Foregoing, benefit payments increase faster than collection. It is projected that $3.0M will be needed in additional funding to supplement benefit payments and administrative expenses in 2010. The deficit is anticipated to be funded with cash withdrawal from investment and/or funding from the FSM National Government.

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

Statements of Net Assets
December 31, 2009 and 2008

ASSETS	2009	2008
Cash and cash equivalents	$ 1,895,295	$ 3,353,578
Receivables:		
Contributions	1,776,339	1,797,223
Due from FSM National Government	900,000	-
Accrued interest	130,454	139,652
Prior Service Trust Fund	2,497	34,924
Other	16,943	18,969
Total receivables	2,826,233	1,990,768
Prepayments	5,351	6,972
Investments:		
Fixed income	14,013,363	16,524,883
Stocks	22,396,150	15,112,598
Total investments	36,409,513	31,637,481
Fixed assets, net	66,491	87,352
Total assets	41,202,883	37,076,151
LIABILITIES		
Accounts payable	168,188	173,503
Other liabilities and accruals	21,885	21,286
Accrued management fees	9,365	44,967
Total liabilities	199,438	239,756
Contingencies		
NET ASSETS		
Held in trust for retirement, disability and survivors' benefits	$ 41,003,445	$ 36,836,395

See accompanying notes to financial statements.

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

Statements of Changes in Net Assets
Years Ended December 31, 2009 and 2008

	2009	2008
Additions:		
Contributions	$ 12,955,409	$ 12,488,497
Investment income (loss):		
Net change in the fair value of investments	5,278,838	(8,037,625)
Interest and dividends	1,065,538	1,209
Total investment income (loss)	6,344,376	(8,036,416)
Less investment expense:		
Investment management and custodial fees	194,543	236,805
Net investment income (loss)	6,149,833	(8,273,221)
Other additions:		
Contributions from FSM National Government	1,150,000	250,000
Other	502,706	681,973
	1,652,706	931,973
Total additions	20,757,948	5,147,249
Deductions:		
Benefit payments:		
Retirement	9,311,710	8,439,906
Survivors	4,806,020	4,765,965
Disability	1,264,648	1,046,640
Lump sum	205,161	263,241
Total benefit payments	15,587,539	14,515,752
Refunds	17,410	18,586
Administrative	985,949	1,093,732
Total deductions	16,590,898	15,628,070
Change in net assets	4,167,050	(10,480,821)
Net assets at beginning of year	36,836,395	47,317,216
Net assets at end of year	$ 41,003,445	$ 36,836,395

See accompanying notes to financial statements.

(1) Organization

The Social Security Administration of the Federated States of Micronesia National Government was established by Public Law 2-74, passed on February 8, 1983, and began operations on October 1, 1987, for the purpose of 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 Federated States of Micronesia (FSM) Social Security Administration (the Administration) is accounted for as a Fiduciary Fund Type - Private Purpose Trust Fund and is a component unit of the FSM National Government. The Administration prepares its financial statements using the accrual basis of accounting. It recognizes employee and employer contributions as revenues in the quarter employee earnings are paid. Retirement benefits are recognized as expenses when payable. Expenses are recorded when the corresponding liabilities are incurred regardless of when payment is made.

Governmental Accounting Standards Board (GASB) 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 assets of the Administration are held in trust for retirement, disability and survivors' benefits.

B. Future Liabilities and Contributions

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

C. Cash and Cash Equivalents

For the purposes of the statements of net assets, cash and cash equivalents include cash on hand, and cash in checking and savings accounts as well as short-term investments in money market funds with a maturity date within three months of the date acquired.

(2) Summary of Significant Accounting Policies, Continued

D. Investments

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

E. Deposits and Investments

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

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

(i) Government obligations - Obligations issued or guaranteed as to principal and interest by the FSM National Government and/or State governments of the Federated States of Micronesia or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.

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

(iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the Administration’s investment advisor at the time of purchase, that not more than five percent of the market value of the 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.

(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Deposits:

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

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

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

As of December 31, 2009 and 2008, the carrying amount of the Administration's total cash and cash equivalents was $1,895,295 and $3,353,578, respectively, and the corresponding bank balances were $2,126,461 and $3,598,476, respectively. As of December 31, 2009 and 2008, bank deposits in the amount of $1,666,353 and $1,518,860, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2009 and 2008, bank deposits in the amount of $500,000 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 $460,108 and $2,079,616, 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, 2009 and 2008.

(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Investments:

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

Category 1 Investments that are insured or registered, or securities held by the Administration or its agent in the Administration's name;

Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the Administration's name; or

Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Administration's name.

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

As of December 31, 2009 and 2008, investments at fair value are as follows:

	2009	2008
Fixed income securities:		
Domestic fixed income	$ 13,024,950	$ 16,054,705
International fixed income	988,413	470,178
	14,013,363	16,524,883
Other investments:		
Domestic equities	22,396,150	15,112,598
	$ 36,409,513	$ 31,637,481

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.

(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Investments, Continued:

As of December 31, 2009, the Administration's investments in debt securities were as follows:

	Investment Maturities (In Years)				
	Less Than 1	1 to 5	6 to 10	Greater Than 10	Fair Value
U.S. Treasury obligations	$ 556,150	$ 465,178	$ 19,456	$ 389,402	$ 1,430,186
Mortgage and asset-backed securities	-	-	-	5,513,264	5,513,264
U.S. Government agencies	-	435,371	255,964	-	691,335
Corporate notes and bonds	83,653	2,926,981	2,513,407	854,537	6,378,578
	$ 639,803	$ 3,827,530	$ 2,788,827	$ 6,757,203	$ 14,013,363

As of December 31, 2008, the Administration's investments in debt securities were as follows:

	Investment Maturities (In Years)				
	Less Than 1	1 to 5	6 to 10	Greater Than 10	Fair Value
U.S. Treasury obligations	$ 144,727	$ 2,967,155	$ 413,396	$ 899,120	$ 4,424,398
U.S. Government agencies	250,000	415,771	328,468	87,380	1,081,619
Mortgage and asset-backed securities	-	-	-	6,461,162	6,461,162
Corporate notes and bonds	-	1,879,158	1,941,420	558,924	4,379,502
Municipal bonds	-	-	-	178,202	178,202
	$ 394,727	$ 5,262,084	$ 2,683,284	$ 8,184,788	$ 16,524,883

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, 2009, was as follows:

Standard and Poors' Rating	Total	Domestic	International
AAA	$ 8,240,469	$ 7,738,952	$ 501,517
AA+	282,146	282,146	-
AA	786,348	786,348	-
AA-	568,936	479,250	89,686
A+	701,131	614,519	86,612
A	2,012,921	1,957,509	55,412
A-	1,099,376	844,190	255,186
BBB+	322,036	322,036	-
	$ 14,013,363	$ 13,024,950	$ 988,413

(2) Summary of Significant Accounting Policies, Continued

E. Deposits and Investments, Continued

Investments, Continued:

The Administration's exposure to credit risk at December 31, 2008, was as follows:

Standard and Poors' Rating	Total	Domestic	International
AAA	$ 12,539,500	$ 12,367,532	$ 171,968
AA	647,720	647,720	-
AA-	121,300	41,037	80,263
A+	843,464	807,650	35,814
A	1,579,274	1,527,213	52,061
A-	660,453	530,381	130,072
BBB+	133,172	133,172	-
	$ 16,524,883	$ 16,054,705	$ 470,178

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, 2009 and 2008. 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, 2009 and 2008.

F. Fixed Assets

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

(2) Summary of Significant Accounting Policies, Continued

F. Fixed Assets, Continued

Capital asset activity for the years ended December 31, 2009 and 2008, was as follows:

	Estimated Useful Lives	January 1, 2009	Additions	Retirements	December 31, 2009
Motor vehicles	5 years	$ 146,625	$ -	$ (18,467)	$ 128,158
Computer software and hardware	5 years	110,891	8,292	-	119,183
Office furniture, fixtures and equipment	5 years	113,150	3,351	(33,988)	82,513
Home furnishings	5 years	2,846	945	-	3,791
		373,512	12,588	(52,455)	333,645
Less accumulated depreciation		(286,160)	(31,232)	50,238	(267,154)
		$ 87,352	$ (18,644)	$ (2,217)	$ 66,491

	Estimated Useful Lives	January 1, 2008	Additions	Retirements	December 31, 2008
Motor vehicles	5 years	$ 130,603	$ 26,280	$ (10,258)	$ 146,625
Computer software and hardware	5 years	109,482	1,659	(250)	110,891
Office furniture, fixtures and equipment	5 years	110,800	4,054	(1,704)	113,150
Home furnishings	5 years	2,846	-	-	2,846
		353,731	31,993	(12,212)	373,512
Less accumulated depreciation		(268,379)	(29,993)	12,212	(286,160)
		$ 85,352	$ 2,000	$ -	$ 87,352

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 six percent of wages received.

Maximum quarterly taxable wages are currently $6,000. Every employer is required to contribute an amount equal to that contributed by employees.

Contribution revenues received during the years ended December 31, 2009 and 2008 are comprised of the following:

	2009	2008
Government employment	$ 6,827,298	$ 6,658,920
Private employment	5,967,099	5,655,537
Judgment	14,887	28,099
Penalties and interest	146,125	145,941
	$ 12,955,409	$ 12,488,497

(2) Summary of Significant Accounting Policies, Continued

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, 2009 and 2008, the minimum monthly benefit payment is $75.

I. Reclassifications

Certain reclassifications have been made to the 2008 financial statements in order to conform with the 2009 presentation.

J. New Accounting Standards

During fiscal year 2009, the Administration implemented the following pronouncements:

- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.

- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.

- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

(2) Summary of Significant Accounting Policies, Continued

J. New Accounting Standards, Continued

- GASB Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment.

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

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Administration.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent and Employers and Agent Multiple-Employer Plans*, and GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. GASB Statement No. 57 addresses issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit plans. GASB Statement No. 58 establishes accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. The provisions of these statements are effective for periods beginning after June 15, 2011 and June 15, 2009, respectively. Management does not believe that the implementation of these statements will have a material effect on the financial statements of the Administration.

(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 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.

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 insurance from independent third parties for the risks of loss to which it is exposed. The Administration is substantially self-insured for all other risks. Settled claims have not exceeded commercial coverage in any of the past three years.

(3) Net Assets Held in Trust

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

(4) Contingencies

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

In June 2009, the Administration obtained an actuarial valuation of the Retirement Fund as of January 1, 2009. The valuation reported actuarial accrued liabilities for the Retirement Fund of $232,474,000. As of December 31, 2009 and 2008, the Administration recorded total fund equity of $40,745,566 and $36,717,256, 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) Contribution from the 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, 2009 and 2008, contributions from the FSM National Government amounted to $1,150,000 and $250,000, respectively, of which $900,000 and $0 is receivable from the FSM National Government as of December 31, 2009 and 2008, respectively.

(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, 2009 and 2008, had received an allocation of $445,052 and $519,107, respectively, from PSTFA of which $282,835 and $292,964 were paid as benefits during the years ended December 31, 2009 and 2008, 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, 2009 and 2008, the amount available for future benefit payments under the Prior Service Benefits Program amounted to $257,879 and $119,139, respectively.

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

Combining Statement of Net Assets
December 31, 2009

	Retirement Fund	Prior Service Fund	Total
ASSETS			
Cash and cash equivalents	$ 1,600,034	$ 295,261	$ 1,895,295
Receivables:			
Contributions	1,776,339	-	1,776,339
Due from FSM National Government	900,000	-	900,000
Accrued interest	130,454	-	130,454
Prior Service Trust Fund	2,497	-	2,497
Other	16,943	-	16,943
Total receivables	2,826,233	-	2,826,233
Prepayments	5,351	-	5,351
Investments:			
Fixed income	14,013,363	-	14,013,363
Stocks	22,396,150	-	22,396,150
Total investments	36,409,513	-	36,409,513
Fixed assets, net	66,491	-	66,491
Total assets	40,907,622	295,261	41,202,883
LIABILITIES			
Accounts payable	130,806	37,382	168,188
Other liabilities and accruals	21,885	-	21,885
Accrued management fees	9,365	-	9,365
Total liabilities	162,056	37,382	199,438
NET ASSETS			
Held in trust for retirement, disability and survivors' benefits	$ 40,745,566	$ 257,879	$ 41,003,445

See Accompanying Independent Auditors' Report.

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

Combining Statement of Changes in Net Assets
Year Ended December 31, 2009

	Retirement Fund	Prior Service Fund	Total
Additions:			
Contributions	$ 12,955,409	$ -	$ 12,955,409
Investment income:			
Net change in the fair value of investments	5,278,838	-	5,278,838
Interest and dividends	1,064,844	694	1,065,538
Total investment income	6,343,682	694	6,344,376
Less investment expense:			
Investment management and custodial fees	194,543	-	194,543
Net investment income	6,149,139	694	6,149,833
Other additions:			
Contributions from FSM National Government	1,150,000	-	1,150,000
Other	57,654	445,052	502,706
	1,207,654	445,052	1,652,706
Total additions	20,312,202	445,746	20,757,948
Deductions:			
Benefit payments:			
Retirement	9,188,597	123,113	9,311,710
Survivors	4,646,298	159,722	4,806,020
Disability	1,264,648	-	1,264,648
Lump sum	205,161	-	205,161
Total benefit payments	15,304,704	282,835	15,587,539
Refunds	17,410	-	17,410
Administrative	961,778	24,171	985,949
Total deductions	16,283,892	307,006	16,590,898
Change in net assets	4,028,310	138,740	4,167,050
Net assets at beginning of year	36,717,256	119,139	36,836,395
Net assets at end of year	$ 40,745,566	$ 257,879	$ 41,003,445

See Accompanying Independent Auditors' Report.

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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 the financial statements of the Federated States of Micronesia Social Security Administration (the Administration) as of and for the year ended December 31, 2009, and have issued our report thereon dated June 3, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

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

Compliance and Other Matters

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

We noted other matters that we reported to management of the Administration in a separate letter dated June 3, 2010.

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

Deloitte & Touche LLP

June 3, 2010