

**FEDERATED STATES OF MICRONESIA  
SOCIAL SECURITY ADMINISTRATION**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**YEAR ENDED DECEMBER 31, 2003**

**FEDERATED STATES OF MICRONESIA  
SOCIAL SECURITY ADMINISTRATION**

Year Ended December 31, 2003  
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## **INDEPENDENT AUDITORS' REPORT**

Board of Trustees  
FSM Social Security Administration:

We have audited the accompanying statement of net assets of the Federated States of Micronesia (FSM) Social Security Administration, a component unit of the FSM National Government, as of December 31, 2003, and the related statement of changes in net assets for the year then ended. These financial statements are the responsibility of the FSM Social Security Administration's management. Our responsibility is to express an opinion on these financial statements based on our audit.

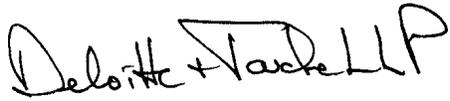
We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the FSM Social Security Administration as of December 31, 2003, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the financial statements, the FSMSSA adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and GASB Statement No. 38, *Certain Financial Statements Note Disclosures*, as of January 1, 2003.

The Management's Discussion and Analysis on pages 3-7 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 May 7, 2004, on our consideration of FSM Social Security Administration's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. 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.

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

May 7, 2004

**FEDERATED STATES OF MICRONESIA  
SOCIAL SECURITY ADMINISTRATION**

Management's Discussion and Analysis  
Year Ended December 31, 2003

Program Description

The FSMSSA is one of the successor systems from the former Trust Territory Social Security System that closed down its operation on March 31, 1988. The FSMSSA began its full operation on January 1, 1988 and is administered by a six-member Board of Trustees. Five members of the Board are nominated by the President and confirmed by the Congress of the FSM while the FSMSSA Administrator serves as an ex-officio member. The FSM Social Security Administration Board of Trustees 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 Administration Board of Trustees are nominated by the President and confirmed by the Congress of the FSM to operate the Social Security Program authorized under the FSM Code title 53. Their nominations to the Board should take into account the need to have adequate geographical representation and to have representatives from public and private sector employers and employees. The members of the Board serve a 3-year term, and they shall provide for its own organization and procedure. Should there be any vacancies on the Board, it shall be filled for the 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. The Social Security Administrator serves an ex-officio member of the Board. Members of the Board who are not State or National Government employees shall be paid at the rate of \$30 per day and necessary travel expenses when actually attending meetings of the Board.

The FSMSSA was established by the Federated States of Micronesia Public Law 2-74 enacted February 02, 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 4<sup>th</sup> quarter of 2003.

Management Perspective

The management of the FSMSSA is responsible for the accuracy of the data. We believe that the information enclosed is all material aspects and is reported in such a manner as to accurately represent the financial condition of the FSMSSS operations. Compared to calendar year 2002 when the trust fund suffered a net loss of \$3,621,067, calendar year 2003 showed a recovery from those losses and ended the year with the fund increased by \$3,657,963. This increase was the result of the net gain from our investment portfolio, which we continue to see although at a minimal rate compared to the rate we enjoyed during 1990s. Contributions income increased by 10.4% compared to the previous year while benefit payments increased by 8.67%. While contributions increased, so did benefits payments, which resulted in a gross profit of only \$382,234. Deducting from this amount total administrative expenses of \$904,131 results in a net operating loss of \$521,897.

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During the 4<sup>th</sup> quarter of calendar year 2003, the maximum wage base was increased from \$3,000 to \$5,000 per quarter. With this increase, it is estimated that an additional \$1 million in revenues will be added to the system. This would reduce the un-funded liability currently posted at \$139.4M based on the latest actuarial valuation made on January 2002. Recently on January 27, 2004, the 13<sup>th</sup> FSM Congress passed on First Reading Congressional Bill No. 13-59 that would allow surviving spouses to continue to receive benefits after remarriage. This amendment by FSM Congress is alarming knowing that the FSMSSA doesn't have any other resources for the un-funded liability. If this were to become law, the un-funded liability would increase by at least \$1M and more.

During calendar year 2003, the Administration sets objectives and goals for the program. Following were some of the actions taken during Fiscal Year 2003, which will be continued in Fiscal Year 2004:

- Administers the increasing number of retirees, survivors and disabled beneficiaries – notice that benefit payments increased by 8.6% due to the increasing number of recipients;
- Strengthen the Offices' functions thru continued training of staff members and automation of offices – selected members of the staff participate in the Association of the Pacific Island Auditors Workshop held in Pohnpei. In addition, the staffs' semi-annual conference was held at the HQ Office. Both conferences' objective - enhance staffs' skills and knowledge not only in dealing with their work but also the public which is very important for the program;
- Strengthen the collection activities for both the private and government sectors through periodic audits – although the end of Compact I was one of the hardest year for the program, FSMSSA managed to collect \$999,134 in delinquent accounts, an increase of 1.8% over calendar year 2002. This is a major accomplishment given the economic situation in the country;
- Continue to improve its computer capability; maintain a partnership with Palau and Marshall Islands Social Security Administration in proposing to the U.S. Department of the Interior to subsidize advance computerization program (Visual Fox Pro) – Department of the Interior, Insular Affairs for Technical Assistance awarded us of about \$215,000 for upgrading our software and hardware for the three systems. FSMSSA has begun the project and the designing stage has been completed. FSMSSA is anticipating a testing of the program in early 2005;
- Seek other means and resources for the nationwide networking of Offices at reasonable cost- as much as FSMSSA would like to network our headquarter office with the States' Offices, it's too costly for the program at this time. FSMSSA will continue to look for resources;
- Continue to monitor its investment accounts through its investment advisors and money managers under the direction of the Board of Trustees – being so proactive in managing the FSMSS portfolio, the Board of Trustees in its annual portfolio meeting, changes the asset allocation with our money manager but maintain the 60% in equity and 40% in fixed income overall asset allocation as recommended by the investment consultant. This change is a result of the Asset Liability Study;
- Work with leadership in seeking assistance from the U.S. Department of Interior and U.S. Congress in financing the Prior Service Program – the PS fund is nearly depleted. FSMSSA is still in the process of requesting additional funding from the United States Government;
- Work with Social Security Medical Examiner on final documentation of disability application – it has increased tremendously in the process of disability applications; and

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- Ensures that the public educational campaign is on going with the new means of medium – FSMSSA has journeyed into creating its quarterly newsletter and website at [www.fm/fsmss](http://www.fm/fsmss), monthly radio programs and community public forums.

Statement of Net Assets

Cash and equivalents	\$ 2,171,221
Investments	33,318,406
Other current assets	1,859,674
Fixed assets, net	<u>80,527</u>
	<u>37,429,828</u>
Liabilities	<u>82,926</u>
Net assets:	
Held in trust for retirement, disability and survivors' benefits	\$ <u>37,346,902</u>

Statement of Changes in Net Assets

Total revenues	\$ 15,585,287
Expenses	<u>11,769,979</u>
Change in net assets	3,815,308
Net assets at beginning of year	<u>33,531,594</u>
Net assets at end of year	\$ <u>37,346,902</u>

Contributions

Contributions collected during fiscal year 2003 totaled \$11,398,884. The administration continues to pursue an aggressive campaign of audits of public and private sector employers to ensure compliance with the Social Security Act.

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Management's Discussion and Analysis  
Year Ended December 31, 2003

Benefit Payments

A total of \$10,846,032 was disbursed in benefit payments during fiscal year 2003 which are offset by \$10,817 of prior year credits. The following benefits were paid during fiscal year 2003:

<u>Type</u>	<u>Amount</u>
Old Age	\$6,290,710
Survivor	\$3,859,375
Disability	\$ 635,004
Lump Sum	\$ 60,941

Administrative Expenses

Net administrative expenses of \$904,131 were paid during fiscal year 2003. This was 7% less than the approved budget of \$972,872 and 15.8% less than the \$1,074,348 ceiling imposed by the Social Security Act, but represented a 17.7% increase from the prior year. The bulk of the increase is for Repairs and Maintenance, which totaled \$24,269. Of this amount \$19,946 was accrued for the cost of the Yap Branch Office extension project, which is 75% completed to date. Training of staff contributed also to the overall increase with \$39,439 incurred this year compared to \$9,528 for 2002 or a 314% increase. Other expense items were relatively stable compared to 2002.

Investments

Fiscal year 2003 saw a gain in the investment portfolio, which registered a total income of \$4.2M for the year compared to losses sustained last year at \$2.9M. This gain resulted in the increased in the trust fund balance by \$3.8M.

Professional service providers for the investment portfolio consist of the following:

Investment Advisor

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

Custodial Trustee

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

Money Managers (Fixed Income)

Provident Investment Counsel  
300 North Lake Avenue  
Pasadena, Ca. 91101

Money Manager (Equity)

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

Due to the changes made earlier this year in the investment portfolio, FSMSSA has made addition of other types of investment into the portfolio. As of early 2004, the investment portfolio includes Small Cap and US Stocks and Treasury Inflation Protected Securities (TIPS). These two asset classes could help diversify the fund and improve returns without taking on an imprudent level of risk.

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Money Manager (Small Cap US Stock)

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

Treasury Inflation Protected Securities

Provident Investment Counsel  
300 North Lake Avenue  
Pasadena, Ca. 91101

Conclusion

Benefit payments and administrative expenses exceeded collected revenues at a very modest amount. By increasing the wage base to \$5,000 per quarter, FSMSSA is hoping for a better ratio between benefit payments and the program's revenues. In the meantime, FSMSSA objects to any amendment in the Social Security Act that may increase the un-funded liability. For instance, the famous C.B. 13-59 to allow surviving spouse to continue to receive benefits after remarriage. If the bill passes second reading, the program may face with a dilemma of which an additional \$1 million or more will be added to the existing un-funded liability.

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Statement of Net Assets  
December 31, 2003

ASSETS

Cash and equivalents	\$ 2,171,221
Investments, at fair value	33,318,406
General receivables, net of an allowance for doubtful accounts of \$13,950	1,712,396
Accrued interest receivable	138,278
Advances, net of an allowance for doubtful accounts of \$22,083	7,500
Prepaid expenses	1,500
Fixed assets, net	<u>80,527</u>
 Total assets	 <u>37,429,828</u>

LIABILITIES

Accounts payable - beneficiaries	11,643
Accounts payable - general	50,464
Taxes/personnel benefits payable	<u>20,819</u>
 Total liabilities	 <u>82,926</u>

Contingencies

NET ASSETS

Restricted:	
Held in trust for retirement, disability and survivors' benefits	\$ <u><u>37,346,902</u></u>

See accompanying notes to financial statements.

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Statement of Changes in Net Assets  
Year Ended December 31, 2003

Additions:	
Contributions	\$ <u>11,398,884</u>
Investment income:	
Net increase in the fair value of investments	3,982,671
Interest income	138,278
Miscellaneous income	<u>65,454</u>
Total investment income	<u>4,186,403</u>
Total additions	<u>15,585,287</u>
Deductions:	
Benefit payments	10,835,214
Refund contributions	30,634
Administrative expenses, net	<u>904,131</u>
Total deductions	<u>11,769,979</u>
Change in net assets	3,815,308
Net assets at beginning of year	<u>33,531,594</u>
Net assets at end of year	\$ <u><u>37,346,902</u></u>

See accompanying notes to financial statements.

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Notes to Financial Statements  
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(1) Summary of Significant Accounting Policies

A. Basis of Accounting

The Federated States of Micronesia (FSM) Social Security Administration (the Administration) is accounted for as a Fiduciary Fund Type – Private Purpose Trust Fund and is a component unit of the FSM National Government.

For the year ended December 31, 2003, the Administration adopted GASB Statement No. 34, “Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments” (GASB 34) as amended by GASB Statement No.s 37 and 38 and applied those standards on a retroactive basis. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following four net asset categories:

- Invested in capital assets, net of related debt:

Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:

- Nonexpendable – Net assets subject to externally imposed stipulations that require the Administration to maintain them permanently. For the year ended December 31, 2003, the Administration does not have nonexpendable net assets.

- Expendable – Net assets whose use by the Administration is subject to externally imposed stipulations that can be fulfilled by actions of the Administration pursuant to those stipulations or that expire by the passage of time.

- Unrestricted:

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Management of the Administration has determined that per its enabling legislation, all net assets of the Administration are restricted for retirement, disability and survivors’ benefits.

B. Future Liabilities and Contributions

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

C. Cash and Equivalents

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

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December 31, 2003

(1) Summary of Significant Accounting Policies, Continued

C. Cash and Equivalents

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

Petty cash	\$ 1,400
Cash in bank – operations	855
Cash in bank - payroll	1,250
Cash in bank - benefits 3	(254,843)
Cash in bank - benefits 4	(3,384)
Savings accounts	1,320,496
Pacific Century Trust – automated cash management fund	<u>1,105,447</u>
	<u>\$ 2,171,221</u>

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

D. Investments

Investment in securities are stated at fair value.

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

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

Common stock	\$ 19,688,918
U.S. government obligations	308,760
U.S Treasury obligations	697,908
Government agency obligations	9,349,686
Corporate bonds, preferred stock and mutual funds	<u>3,273,134</u>
	<u>\$ 33,318,406</u>

Net investment gain for the year ended December 31, 2003, comprises the following:

Interest and dividends-investments	\$ 660,917
Realized gains on sale	1,299,038
Unrealized gains	4,377,976
Realized losses on sale	(715,493)
Unrealized losses	(1,421,567)
Investment fees	<u>(218,200)</u>
Net investment gain	<u>\$ 3,982,671</u>

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(1) Summary of Significant Accounting Policies, Continued

D. Investments

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

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

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

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

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

E. Fixed Assets

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

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

	<u>Estimated Useful Lives</u>	<u>January 1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31, 2003</u>
Motor vehicles	5 years	\$ 85,466	\$ 17,588	\$ -	\$ 103,054
Computer equipment	5 years	109,657	5,976	-	115,633
Furniture	5 years	106,674	9,497	1,979	114,192
Office equipment	5 years	<u>3,058</u>	<u>1</u>	<u>-</u>	<u>3,059</u>
		304,855	33,062	1,979	335,938
Less accumulated depreciation and amortization		<u>(214,604)</u>	<u>(40,807)</u>	<u>-</u>	<u>(255,411)</u>
		\$ <u>90,251</u>	\$ <u>(7,745)</u>	\$ <u>1,979</u>	\$ <u>80,527</u>

F. Contributions

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

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

F. Contributions

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

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

Government employment	\$ 5,960,268
Private employment	5,284,263
Penalties and interest	<u>154,353</u>
	\$ <u>11,398,884</u>

G. Benefit Obligations

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

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

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

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

Retirement pension	\$ 6,279,893
Survivor pension	3,859,376
Disability pension	635,004
Lump sum pension	<u>60,941</u>
	\$ <u>10,835,214</u>

H. Management Estimates

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

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(1) Summary of Significant Accounting Policies, Continued

I. New Accounting Standards

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. In June 2001, GASB issued Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus* and Statement No. 38, *Certain Financial Statement Disclosures*, which amended certain provisions of GASB Statement No. 34. The Administration is required to adopt GASB Statement No. 34, as amended by GASB Statement No. 37, and certain provisions of GASB Statement No. 38 in fiscal year 2003.

These statements establish new financial reporting standards for governmental entities, which results in a significant change in the financial reporting model used by governments, including statement formats and changes in fund types and account groups. In addition to the traditional fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus, and to present Management's Discussion and Analysis (MD&A). The MD&A is considered to be required supplementary information and precedes the financial statements.

For fiscal year 2004, the Administration will be implementing GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* and GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*. For fiscal year 2005, the Administration will be implementing GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. As of the date of the opinion, the Administration has not evaluated the financial statement impact of GASB Statement Nos. 39, 40 and 42.

J. Restatement

Due to the implementation of GASB Statement Nos. 34 and 37, the beginning net assets of the governmental activities in the Statement of Net Assets have been restated. Fund balance of the governmental funds at December 31, 2002 (as disclosed below) was increased by \$1,629,915 for the cumulative effect of these changes on years prior to fiscal year 2003:

The effect on those items are as follows:

Fund balance reported as of December 31, 2002	\$ <u>31,901,679</u>
Adjustments:	
Accrual of contributions	1,539,664
Capital assets	304,855
Accumulated depreciation	<u>(214,604)</u>
	<u>1,629,915</u>
Beginning net assets as of December 31, 2002	\$ <u>33,531,594</u>

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(1) Summary of Significant Accounting Policies, Continued

K. Risk Management

The Administration is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Administration has elected to purchase automobile insurance from independent third parties for the risks of loss to which it is exposed with. 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 Restriction

The restriction of net assets has been established 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.

The FSM Social Security Administration undergoes periodic actuarial evaluations. The latest is as of January 1, 2002. The report indicates that although there is sufficient uncertainty concerning future economic developments to recommend against any benefit improvements at the current time, and while such future developments may make future adjustments in benefits and contributions necessary, there is not yet sufficient indication to show a need for immediate adjustment.

(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.

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SOCIAL SECURITY ADMINISTRATION**

Notes to Financial Statements  
December 31, 2003

(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 COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING 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, 2003, and have issued our report thereon dated May 7, 2004. 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.

Compliance

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*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a 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. We noted no matters involving the internal control over financial reporting and its operations that we consider to be material weaknesses.

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 that reads "Deloitte + Touche LLP". The signature is stylized and appears to be written in a cursive or semi-cursive script.

May 7, 2004