

MICARE PLAN, INC.

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

MICARE PLAN, INC.

Table of Contents
Year Ended September 30, 2006

	<u>Page No.</u>
I. FINANCIAL STATEMENTS	
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Statement of Net Assets	7
Statement of Revenues, Expenses, and Changes in Net Assets	8
Statement of Cash Flows	9
Notes to Financial Statements	10
II. INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS	
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit Performed in Accordance with <i>Government Auditing Standards</i>	19
Schedule of Findings	21

INDEPENDENT AUDITORS' REPORT

Chairman
Board of Directors
MiCARE Plan, Inc.:

We have audited the accompanying statements of net assets of the MiCare Plan, Inc. (the "Plan"), a component unit of the Federated States of Micronesia National Government, as of September 30, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

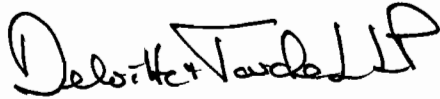
Except as discussed in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 Plan'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.

Because of the inadequacy of accounting records, we were unable to form an opinion regarding medical claims payable amounting to \$438,968 and \$30,864, respectively, for two related parties as of September 30, 2005. We were unable to satisfy ourselves as to the fairness of these amounts by means of other auditing procedures.

In our opinion, except for such adjustments, if any, as might have been determined to be necessary had the abovementioned 2005 medical claims been supported, such financial statements present fairly, in all material respects, the financial position of the MiCARE Plan, Inc. as of September 30, 2006 and 2005, and the changes in its net assets and its cash flows 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 3-6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Federated States of Micronesia Development Bank's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 23, 2007, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain 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.

A handwritten signature in black ink, appearing to read "Deloitte Touche LLP". The signature is stylized and cursive.

May 23, 2007

MICARE PLAN, INC.

Management's Discussion and Analysis Year Ending September 30, 2006

The following discussion and analysis of the financial performance and activity of MiCare Plan is to provide an introduction and understanding of the basic financial statements of the Plan for the year ended September 30, 2006. This discussion has been prepared by the management and should be read in conjunction with the financial statements and notes thereto, which follow this section.

MiCare Plan was established by the Federated States of Micronesia Public Law 3-82 enacted December 26, 1984 for the purpose of establishing a fund to pay for eligible members' certain medical expenses both on-island and off-island.

Participation to the Plan is optional for employees and employers both public and private entities in the Federated States of Micronesia. Premiums are paid on a fixed bi-weekly rate for the three plan options.

The Plan is under the governance of the Board of Directors consist of four (4) member representatives from each state government, one (1) from the National Government and one (1) member representing private health sector, all of which are appointed by the President and confirmed by the FSM Congress. The seventh member of the board is the Administrator who is appointed by the Board of Directors and serves as an ex-officio member.

The year 2006 produced an encouraging result in reducing medical expenditures. Although the total premium collections for this year are essentially the same as premiums collected in the previous year, medical expenditures for 2006 dramatically went down which resulted in a significant change and impact on the financial operations of the Plan, which ended with a net operating loss of \$113,764 compared to a prior year loss of \$557,261, a reduction of \$443,497 or 80%.

The following table summarizes the financial condition and operations of MiCare for FY 2006 and FY 2005.

Assets:	<u>2006</u>	<u>2005</u>	<u>2004</u>
Current assets	\$ 1,563,028	\$ 1,642,366	\$ 1,476,604
Noncurrent assets	<u>10,004</u>	<u>15,427</u>	<u>29,185</u>
	<u>\$ 1,573,032</u>	<u>\$ 1,657,793</u>	<u>\$ 1,505,789</u>
Liabilities and Net Assets			
Current liabilities	\$ 3,127,336	\$ 3,098,333	\$ 2,389,068
Net assets	<u>(1,554,304)</u>	<u>(1,440,540)</u>	<u>(883,279)</u>
	<u>\$ 1,573,032</u>	<u>\$ 1,657,793</u>	<u>\$ 1,505,789</u>
Revenues, Expenses and Changes in Net Assets			
Operating revenues	\$ 5,538,932	\$ 5,492,969	\$ 4,132,265
Operating expenses	<u>5,708,232</u>	<u>6,073,117</u>	<u>5,335,443</u>
Net operating loss	(169,300)	(580,148)	(1,203,178)
Interest income and others	<u>55,536</u>	<u>22,887</u>	<u>13,314</u>
Decrease in net assets	<u>\$ (113,764)</u>	<u>\$ (557,261)</u>	<u>\$ (1,189,864)</u>

MICARE PLAN, INC.

Management's Discussion and Analysis Year Ending September 30, 2006

Financial Highlights

- Operating revenues in fiscal year 2006 increased by \$45,963 or almost 1% from the previous fiscal year.
- During fiscal year 2006, the Plan's total operating expenses were \$ 5.7 million, which decreased by 6% compared to prior year of \$ 6.1 million.
- In fiscal year 2006, the Plan posted investment income of \$55,536 as compared to \$22,887 in fiscal year 2005.
- For fiscal year 2006, the Plan recorded a decrease in net assets of \$113,764 compared to \$557,261 in fiscal year 2005.

Operating Revenue

Premium collections is the major source of revenue for the Plan's operation. In fiscal year 2006, premium collections resulted a minimal increase of \$41,940 to \$5,529,637 compared to the previous fiscal year of \$5,487,697. The increase of approximately 1% in collection was due to meager increase in enrollment in fiscal year 2006.

Total premium contributions from public sectors were \$4,491,440 in fiscal year 2006, which represents 81% of total operating revenues from premium collections while total contributions from private sectors were \$1,038,197 or (19%).

Of the total premiums collected of \$4,491,440 from five participating government accounts, FSM National Government and agencies top the lead in terms of premium contributions, (\$1,700,429), followed by Pohnpei (\$1,615,107), Kosrae (\$603,974), Chuuk (\$370,767) and Yap (\$201,163).

For private sector contributions, participating private businesses in Pohnpei contributed \$854,933 in fiscal year 2006 followed by Chuuk (\$87,161), Yap (\$72,516) and Kosrae (\$23,587).

Operating Expense

Medical expenditures and administrative expenses are the two types of Plan operating expenses. Operating expenses for fiscal year 2006 of \$5,708,232 were 6% less than the \$6,073,117 incurred in fiscal year 2005.

As compared to fiscal year 2005, total medical expenses decreased by \$347,461 while general and administrative expenses decreased by \$17,424 for an overall decrease for the year of \$364,885. The decrease of 6% was largely due to a decrease in off-island medical expenses and patients' airfare costs. The following table below indicates the medical expenses by type of claims for fiscal year 2006.

MICARE PLAN, INC.

Management's Discussion and Analysis Year Ending September 30, 2006

<u>Type of Claims</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Local State Hospitals	\$ 487,316	\$ 390,248	\$ 395,289
Local Private Providers	1,915,921	1,703,611	1,222,043
Off-island Hospitals	2,509,568	2,970,896	2,810,983
Patients Airfare	395,284	585,805	461,021
Patients Stipend	7,220	12,210	31,040
Other	-	-	998
Total Medical Claims	\$ <u>5,315,309</u>	\$ <u>5,662,770</u>	\$ <u>4,921,374</u>

For fiscal year 2006, medical claims from local state hospitals increased by 25% or \$97,068 from the prior year. The increase was primarily due to a change of payment basis with Pohnpei State Hospital from a capitation amount to a fee for service.

Medical utilization for local private providers continues to grow every year. In fiscal year 2006, medical claims for local private clinics/hospital went up to \$1,915,921 compared to the prior fiscal year total of \$1,703,611. The significant increase of \$212,310 or 12% for on-island private providers was due to increase of outpatient claims and the coverage of inpatient care at Genesis Hospital. With more local clinics providing healthcare services to Plan members, mounting cost of utilization of benefits offered by the Plan tremendously increased due to more members preferred treatment at the private clinics over the state hospitals.

Off-island medical cost in 2006 considerably changed the trend. Compared with last year figures, medical expenses from off-island providers in 2006 were \$2,509,568, a 16% decrease from \$2,970,896 in 2005. The decrease of off-island costs was due to strict implementation of Plan rules and regulations and effective cost containment measures in managing off-island referrals without sacrificing the quality of healthcare services offered to Plan members.

Another major expense that continues to soar every year is the cost of airfare tickets provided to basic off-island referrals. However in fiscal year 2006, airfare expenses dramatically changed and the cost went down to \$395,284, a decrease of \$190,521 or 33% compared with previous year. The change in cost was primarily due to a decrease with number of basic referrals sent off-island from 625 patients in 2005 to 318 patients in 2006. The decline of airfare cost was the result of strict screening of referral patients through proper and constant coordination and dialogue with state hospital physicians. Management believes that by reducing in the number of referrals will automatically decrease the cost of off-island expenses and the Plan was successful in implementing this formula by strictly scrutinizing off-island referrals.

Administrative Expenses and Fixed Assets Purchases

Net administrative expenses of \$392,923 and fixed assets of \$5,034 were paid during fiscal year 2006. This was 17% less than the approved budget of \$471,824 in 2006 and 24% less than the level of administrative cost allowed by law. The biggest administrative expenses were salaries and benefits, travel and communication in the amount of \$237,925, \$48,604 and \$23,514 respectively. In line with the accumulated deficits the Plan experienced to date, management was strictly monitoring expenditures to only necessary and important expenses were incurred. The cost containment program will continue in effect to monitor and restrain the increasing cost of health care on-island and off-island.

MICARE PLAN, INC.

Management's Discussion and Analysis Year Ending September 30, 2006

Investment

In fiscal year 2006, the Plan received interest from investments totaling \$55,536, an increase of \$32,649 or 143% compared with previous year income of \$22,887. The increase of income was due to spreading out the investment portfolio into different securities such as investment in US treasury notes and corporate bonds with different maturity dates and higher interest rates.

While the Plan is still experiencing cash flow problem, in fiscal year 2006, the Plan was authorized to redeem \$382,000 from long-term investment to pay long overdue accounts payable to healthcare providers. With this, the value of the long-term investment account decreased to \$833,636 at the end of fiscal year 2006.

Future Plans

MiCare Plan will continue to uphold its commitment to provide and improve benefit programs so as to meet the healthcare needs of our members by providing them quality, accessible and affordable health insurance. While the Plan continues to seek ways to have better solutions and alternatives in addressing accumulated deficits, some plan of actions enumerated in fiscal 2005 were successfully done in 2006 and some were initiated with government intervention, such as seeking financial assistance to pay prior year debts and considering another premium adjustment. The Plan is also in constant consultation and discussion with different local private providers to examine the current agreement, to revise the scheduled fees and to realign existing realties to further control utilization cost. Discussions to amend the health insurance law were initiated in 2006 making the enrollment mandatory to increase revenue collections. The cost containment program to closely monitor and control operational costs will continue to be implemented to ensure expenses are effectively managed within available resources.

Management's Discussion and Analysis for the year ended September 30, 2005 is set forth in the Micare Plan's report on the audit of financial statements, which is dated June 30, 2006. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be obtained via the Office of the Public Auditor's website at www.fsmpublicauditor.fm.

MICARE PLAN, INC.

Statements of Net Deficiency
September 30, 2006 and 2005

<u>ASSETS</u>	<u>2006</u>	<u>2005</u>
Current assets:		
Cash and cash equivalents	\$ 135,234	\$ 48,857
Investments	833,637	1,158,922
Premiums receivable	280,730	137,340
Accounts receivable, net	53,357	33,945
Prepaid expenses	260,070	263,302
Total current assets	<u>1,563,028</u>	<u>1,642,366</u>
Noncurrent assets:		
Fixed assets, net	<u>10,004</u>	<u>15,427</u>
Total assets	<u>\$ 1,573,032</u>	<u>\$ 1,657,793</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable	<u>\$ 3,127,336</u>	<u>\$ 3,098,333</u>
Total liabilities	<u>3,127,336</u>	<u>3,098,333</u>
Commitments and contingencies		
Net deficiency:		
Invested in fixed assets	10,004	15,427
Unrestricted	<u>(1,564,308)</u>	<u>(1,455,967)</u>
Total net deficiency	<u>(1,554,304)</u>	<u>(1,440,540)</u>
Total liabilities and net deficiency	<u>\$ 1,573,032</u>	<u>\$ 1,657,793</u>

See accompanying notes to financial statements.

MICARE PLAN, INC.

Statements of Revenues, Expenses, and Changes in Net Deficiency
Years Ended September 30, 2006 and 2005

	2006	2005
Operating revenues:		
Insurance premiums	\$ 5,529,637	\$ 5,487,697
Miscellaneous	9,295	5,272
Total operating revenues	5,538,932	5,492,969
Operating expenses:		
Medical claims	5,315,309	5,662,770
Personnel services	237,925	256,479
Travel	48,604	46,997
Communication	23,514	27,652
Rent	17,488	14,029
Supplies	14,322	12,441
Depreciation	10,458	21,003
Contractual services	10,288	3,190
Utilities	8,881	6,993
Printing	4,662	7,480
Repairs and maintenance	4,219	3,585
Insurance	510	1,386
Miscellaneous	12,052	9,112
Total operating expenses	5,708,232	6,073,117
Loss from operations	(169,300)	(580,148)
Non-operating revenues:		
Net increase in the fair value of investments	55,536	22,887
Change in net assets	(113,764)	(557,261)
Net deficiency at beginning of year	(1,440,540)	(883,279)
Net deficiency at end of year	\$ (1,554,304)	\$ (1,440,540)

See accompanying notes to financial statements.

MICARE PLAN, INC.

Statements of Cash Flows
Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Premiums received	\$ 5,398,643	\$ 5,368,975
Medical claims and benefits paid	(5,092,459)	(4,964,952)
Cash paid to suppliers and employees	(604,888)	(389,429)
Other cash received	9,295	5,272
	<u>(289,409)</u>	<u>19,866</u>
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	(5,035)	(7,245)
	<u>(5,035)</u>	<u>(7,245)</u>
Cash flows from investing activities:		
Net change in investments	325,285	(23,941)
Investment income	55,536	22,887
	<u>380,821</u>	<u>(1,054)</u>
Net change in cash and cash equivalents	86,377	11,567
Cash and cash equivalents at beginning of year	48,857	37,290
Cash and cash equivalents at end of year	<u>\$ 135,234</u>	<u>\$ 48,857</u>
Reconciliation of operating loss to net cash (used for) provided by operating activities:		
Loss from operations	\$ (169,300)	\$ (580,148)
Adjustment to reconcile loss from operations to net cash (used for) provided by operating activities:		
Depreciation	10,458	21,003
Bad debts	12,396	18,553
(Increase) decrease in assets:		
Premiums receivable	(143,390)	(137,340)
Accounts receivable	(31,808)	1,457
Prepaid expenses	3,232	(12,904)
Increase in liabilities:		
Accounts payable	29,003	709,265
	<u>\$ (289,409)</u>	<u>\$ 19,886</u>

See accompanying notes to financial statements.

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(1) Nature of Operations and Summary of Significant Accounting Policies

Reporting Entity

The MiCare Plan (the Plan) was created in 2003 by Public Law 12-77 of the Twelfth Congress of the Federated States of Micronesia. The MiCare Plan, Inc. began its operations in 1984. The purpose of the MiCare Plan is to provide, arrange for, pay for, or reimburse the costs of medical, dental and vision treatment and care, hospitalization, surgery, prescription drugs, medicine, prosthetic appliances, out-patient care, and other medical care benefits, in cash or the equivalent in medicines and supplies.

The Plan is a discretely presented component unit of the FSM National Government. The financial statements in this report do not represent the financial position, results of operations or cash flows of the FSM National Government as a whole. The financial statements of the Plan are not obligations of the FSM National Government unless specifically authorized by the FSM National Government. To date, no such authorizations have been made. Until October 1, 2004, the Plan was accounted for as a proprietary fund type of the FSM National Government, which created a Board of Directors comprised of seven members appointed by the President, with the consent of Congress, to administer the Plan's affairs. The Board became responsible for the Plan's administration, effective October 1, 2004.

The accounting policies of the Plan conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Plan has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The Plan has adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement No. 37, "Basic Financial Statements – Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Disclosures" 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.

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(1) Nature of Operations and Summary of Significant Accounting Policies, Continued

Reporting Entity, Continued

- Restricted:

- Nonexpendable – Net assets subject to externally imposed stipulations that require the Plan to maintain them permanently. For the year ended September 30, 2006 and 2005, the Plan does not have nonexpendable net assets.
- Expendable – Net assets whose use by the Plan is subject to externally imposed stipulations that can be fulfilled by actions of the Plan 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.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. Expenses not meeting this definition are reported as nonoperating expenses.

Revenue Recognition

Health care premiums from enrolled members of the Plan are reported as revenue in the period such becomes due.

Premiums Receivable

Premiums receivable are primarily due from the FSM National Government.

The Plan establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information.

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(1) Nature of Operations and Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents

For the purposes of the statements of net deficiency and of cash flows, cash and cash equivalents are defined as cash in bank checking and savings accounts, and commercial paper with original maturities of three months or less from the date of acquisition.

Investments

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

Fixed Assets

Fixed assets are stated at cost, less accumulated depreciation. Depreciation is based on the straight-line method over the estimated useful lives of the respective assets. All of the assets have an estimated useful life of three to five years. The Plan capitalizes assets with individual values of \$1,000 and over. Assets with a value below \$1,000 are expensed in the year of purchase.

New Accounting Standards

During fiscal year 2006, the Plan implemented the following pronouncements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its serviced utility has declined significantly and unexpectedly.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*, which improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination of Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

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

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(1) Nature of Operations and Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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

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

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of unbilled medical claims.

(2) 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.

A. 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 Plan or its agent in the Plan'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 Plan's name;
or

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(2) Deposits and Investments, Continued

A. Deposits, Continued:

Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Plan'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 Plan'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 Plan does not have a deposit policy for custodial credit risk.

As of September 30, 2006 and 2005, the carrying amount of the Plan's total cash and cash equivalents was \$135,234 and \$48,857 and the corresponding bank balance was \$403,242 and \$121,970, respectively, which is primarily maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006 and 2005, bank deposits in the amount of \$120,935 and \$116,557, respectively, were FDIC insured. The Plan does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are not exposed to custodial credit risk. Management's confidence in the financial strength of their banking institutions was the basis of the decision to not require collateralization. No losses as a result of this practice were incurred for the years ended September 30, 2006 and 2005.

B. 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 Plan or its agent in the Plan'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 Plan'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 Plan'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.

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(2) Deposits and Investments, Continued

B. Investments, Continued:

As of September 30, 2006 and 2005, investments at fair value are as follows:

	<u>2006</u>	<u>2005</u>
Fixed income securities:		
Domestic fixed income	\$ 815,838	\$ 1,071,844
Other investments:		
Money market funds	<u>17,799</u>	<u>87,078</u>
	<u>\$ 833,637</u>	<u>\$ 1,158,922</u>

As of September 30, 2006, the Plan's fixed income securities had the following maturities:

	<u>Moody's Credit Rating</u>	<u>Less Than 1 Year</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>	<u>Greater Than 10 Years</u>	<u>Fair Value</u>
U.S. Treasury obligations	Aaa	\$ 247,793	\$ 357,809	\$ -	\$ -	\$ 605,602
U.S. Government agencies obligations	Aaa	-	124,726	-	-	124,726
Corporate bonds	Aaa	-	5,044	-	-	5,044
Corporate bonds	Aa1	-	25,178	-	-	12,178
Corporate bonds	Aa3	-	30,057	-	-	30,057
Corporate bonds	A1	-	20,138	-	-	20,138
Corporate bonds	A2	-	5,093	-	-	5,093
		<u>\$ 247,793</u>	<u>\$ 568,045</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 815,838</u>

As of September 30, 2005, the Plan's fixed income securities had the following maturities:

	<u>Moody's Credit Rating</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>	<u>Greater Than 10 Years</u>	<u>Fair Value</u>
U.S. Treasury obligations	Aaa	\$ -	\$ -	\$ -	\$ 1,071,844
		<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,071,844</u>

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

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Plan will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Plan's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the Plan's name by the Plan's custodial financial institutions at September 30, 2006 and 2005.

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(2) Deposits and Investments, Continued

B. Investments, Continued:

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 Plan. As of September 30, 2006 the Plan's investment in agency obligations of the Federal Home Loan Bank Bonds constituted 15% of its total investments. As of September 30, 2005, the Plan did not hold an investment in any one issuer that represented more than 5% of the Plan's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Plan 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.

(3) Accounts Receivable

A summary of accounts receivable at September 30, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Accounts receivable	\$ 133,371	\$ 101,563
Allowance for doubtful accounts	<u>(80,014)</u>	<u>(67,618)</u>
	<u>\$ 53,357</u>	<u>\$ 33,945</u>

(4) Fixed Assets

A summary of fixed assets as of September 30, 2006, is as follows:

	Balance October 1, <u>2005</u>	<u>Additions</u>	<u>Deletions</u>	Balance September 30, <u>2006</u>
Office furniture, fixtures and equipment	\$ 49,870	\$ 5,035	\$ -	\$ 54,905
Vehicles	<u>64,438</u>	<u>-</u>	<u>-</u>	<u>64,438</u>
	114,308	5,035	-	119,343
Less accumulated depreciation	<u>(98,881)</u>	<u>(10,458)</u>	<u>-</u>	<u>(109,339)</u>
Net fixed assets	<u>\$ 15,427</u>	<u>\$ (5,423)</u>	<u>\$ -</u>	<u>\$ 10,004</u>

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(4) Fixed Assets, Continued

A summary of fixed assets as of September 30, 2005, is as follows:

	Balance October 1, <u>2004</u>	<u>Additions</u>	<u>Deletions</u>	Balance September 30, <u>2005</u>
Office furniture, fixtures and equipment	\$ 48,232	\$ 7,245	\$ (5,607)	\$ 49,870
Vehicles	<u>64,438</u>	<u>-</u>	<u>-</u>	<u>64,438</u>
	112,670	7,245	(5,607)	114,308
Less accumulated depreciation	<u>(83,485)</u>	<u>(21,003)</u>	<u>5,607</u>	<u>(98,881)</u>
Net fixed assets	\$ <u>29,185</u>	\$ <u>(13,758)</u>	\$ <u>-</u>	\$ <u>15,427</u>

(5) Related Party Transactions

For the years September 30, 2006 and 2005, the Plan recorded expenses of \$266,069 and \$241,447, respectively, related to claims by Pohnpei State Hospital and expenses of \$1,013,938 and \$838,109, respectively, related to claims by Genesis Island Family Clinic and Hospital. Management of these entities are on the Plan's Board of Directors. These medical claims are made under similar terms and conditions as exist with other health care providers. The Plan has recorded estimated payables to Pohnpei State Hospital and Genesis Island Family Clinic and Hospital of \$123,450 and \$438,965, respectively, as of September 30, 2005, but has not received underlying billing support from these entities. Accordingly, resolution of these liabilities could occur at an amount that materially varies from these estimates and such differences, if any, will be accounted for prospectively.

(6) Commitments and Contingencies

Litigation

The Plan is a party to various legal proceedings, the ultimate impact of which is not currently predictable. Therefore, no liability has been recorded in the accompanying financial statements due to management's inability to predict the ultimate outcome of these proceedings.

Self Insurance

The Plan carries vehicle insurance to cover its potential risks. The Plan is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

Lease Commitments

The Plan has four operating leases as of September 30, 2006. Two are residential real estate leases for contract employees and two represent leases for the main office in Pohnpei and a liaison office in Manila (two with lease term of one year, one for 2 years and one for 10 years). All leases have an option allowing the Plan to renew the lease upon expiration of the current term. It is likely that these options will be utilized by the Plan and the leases renewed. The approximate future minimum annual lease payments payable by the Plan are as follows:

MICARE PLAN, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(6) Commitments and Contingencies, Continued

<u>Fiscal year ending September 30,</u>	<u>Total</u>
2007	\$ 29,405
2008	26,400
2009	26,400
2010	26,400
2011	26,400
2012 – 2016	132,000
2017 – 2021	132,000
2022 – 2026	132,000
2027 – 2031	<u>132,000</u>
	\$ <u>663,005</u>

(7) Going Concern

As of September 30, 2006, the Plan has incurred a net asset deficiency of approximately \$1.55 million. Continuation of the Plan as a going concern is dependent on its ability to increase premiums, to reduce covered benefits and to obtain support, if necessary, from the FSM National Government. Management's plans to address this matter include: (1) continued negotiation for reductions in the amounts paid to the private providers for services rendered to its members and to carefully review and control member's utilization cost; (2) work closely with State Hospitals to implement strict screening of referral patients sent off-island and to introduce joint partnership with State Hospitals and Private Clinics to purchase diagnostic equipment to decrease the dependence on off-island care; (3) reexamine the current premium rates and consider increasing premiums to head off any further deficits of the Plan; (4) recommend to the FSM Congress to consider reinstating limitations on coverage for pre-existing conditions for new members; (5) aggressive collections of receivables, promote members' awareness on their healthcare benefits and improve public relations to government officials and members; (6) continue to provide training to employees to enhance competence level and knowledge to develop work efficiency and productivity; and (7) continue to improve the existing database by investing to a more unified computerization system for better tracking of medical cases and expenses, as well as the production of detailed reports needed to insure efficient operation.

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

The Board of Directors
MiCare Plan, Inc.:

We have audited the financial statements of the MiCare Plan, Inc. (the "Plan"), as of and for the year ended September 30, 2006, and have issued our report thereon dated May 23, 2007. 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

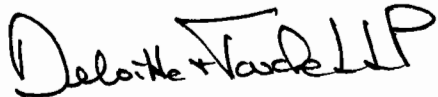
In planning and performing our audit, we considered the Plan's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Plan's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings (pages 20 through 22) as items 2006-01 through 2006-05.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Plan'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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors and management of the Plan 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 written in a cursive, stylized font.

May 23, 2007

MICARE PLAN, INC.

Schedule of Findings
Year Ended September 30, 2006

Finding No.: 2006-01
Area: Timeliness of Deposits

Criteria: Per policy, all daily collections must be deposited to the Plan's depository bank account on the day received or immediately on the following working day.

Condition: For 16 of 136 (12%) transactions tested, cash collected was deposited after two or more working days.

Cause: Internal controls over the timely deposit of cash collected appear to be weak.

Effect: The condition has no known material effect on the financial statements. However, there is a risk that cash collected could be misappropriated. Also, the entity is non-compliant with its policy.

Prior Year Status: This condition has been reported in FY 2005 audit.

Recommendation: We recommend that MiCARE strengthen its internal controls over the timely deposit of cash collections.

Auditee Response: The policy requires that all collections during the day must be deposited into the Plan's depository bank account on the day received or immediately on the following working day to avoid misappropriation of cash collected. The subject audit finding pertains to field offices collections wherein collections for the week are deposited every Friday. This was done because of the lesser number of transaction handled with an average of five to six receipts in a week issued to customers. Management will continue to adhere with the existing policy by reminding the staffs at the field offices to deposit their collections on a daily basis to ensure timely deposit of cash collections. We strongly believe that this is a good policy to safeguard cash collections however we have to consider also the level of collections wherein field offices collected only a dollar a day.

Finding No.: 2006-02
Area: Unpaid Premium

Criteria: The Plan should only pay medical claims incurred by covered persons.

Condition: For 1 of 136 (1%) transactions, the medical claim incurred by an uncovered person was paid by the Plan.

Cause: The person who processed the payment did not exclude costs incurred by the uncovered person.

Effect: As a result of this condition, the Play may pay medical claims incurred by uncovered persons.

Recommendation: We recommend that the utilization department segregate claims incurred by uncovered persons to avoid processing related payments.

Auditee Response: The audit finding pertains to an individual member without chronic refill coverage. The utilization staff has reviewed the claims and disallowed this pharmacy charges however when the medical bills inputted into the system, the said charges was not excluded. Management acknowledged this oversight and directed the concern department to be extra careful in processing and inputting claims to avoid paying non-covered charges. The amount erroneously paid to the provider will be adjusted on their next billing payment.

MICARE PLAN, INC.

Schedule of Findings, Continued
Year Ended September 30, 2006

Finding No.: 2006-03
Area: Independent Checks

Criteria: Cash collection reports should be independently reviewed.

Condition: The entity has only one staff in each of their field offices in Chuuk, Kosrae, and Yap. Cash collection reports are not reviewed.

Cause: The entity appears to be understaffed in its field offices.

Effect: The condition has no known material effect on the financial statements. However, the risk of cash collections being misappropriated is increased due to the condition.

Prior Year Status: This condition has been reported in FY 2005 audit.

Recommendation: We recommend that MiCare have independent checks of cash collected from each of their field offices or inquire if such collections can occur at the FSM National Government Revenue offices.

Auditee Response: The recommendation of having an additional staff to do independent check is a sound management policy however is not feasible at this time due to small amount of transactions handled by field offices in Kosrae, Chuuk and Yap. The Plan found impractical at this time to hire additional staff considering the Plan has limited operational budget. Management will continue to apply the existing monitoring mechanism handled at the Central Office in Pohnpei by closely examining the collections of field offices, perform periodic checking of receipts against deposits and continue to do direct confirmation of accounts to our customers to make sure collections are collected on time.

Finding No.: 2006-04
Area: Late Posting

Criteria: Transactions should be recorded on a monthly basis to reflect correct balances on a timely manner.

Condition: Based on work performed and inquiry with the entity, cash receipts for accounts receivable are posted on a quarterly basis.

Cause: The root cause of this weakness is a potential inappropriate policy over the posting of cash receipts.

Effect: The condition has no known material effect on the financial statements. However, there is a risk that cash receipts would not be recorded. Also, the correct balances of cash and receivable are not reflected in a timely manner.

Prior Year Status: This condition has been reported in FY 2005 audit.

Recommendation: We recommend that MiCARE record cash receipts at least on a monthly basis.

Auditee Response: Management will adhere to the recommendation to post payment for account receivable accounts on a monthly basis accounts. This has already been implemented in fiscal year 2007 wherein all payments of A/R whether direct or through payroll allotment are recorded on a monthly basis to provide our customers with an updated billing statement.

MICARE PLAN, INC.

Schedule of Findings, Continued
Year Ended September 30, 2006

Finding No.: 2006-05
Area: IBNR Deficiency

Criteria: A formal IBNR system should be utilized to project medical bills incurred, but not received.

Condition: The entity does not have a formal IBNR process wherein it estimates associated medical referrals and then tracks the actual results against the estimates. Rather, it relies on after the fact reporting by hospitals and others and a very long time period in which it waits to obtain underlying invoices. Therefore, without such a time period available to it, the entity will not be able to project its actual liability at any point in time.

Cause: The cause of this condition is that a formal IBNR system has not been initiated.

Effect: The impact of this matter is that incorrect financial data is maintained during the year.

Prior Year Status: This condition has been reported in FY 2005 audit.

Recommendation: A full lag-analysis supported IBNR system should be developed and implemented.

Auditee Response: Management has designed a formal IBNR process wherein it estimates or accrues associated medical costs of services rendered but not yet reported. This IBNR system that has been developed will be implemented in fiscal year 2007 to ensure that the Plan can effectively record its liability for future payments on expenses which have already been occurred specifically on claims incurred by off-island referral patients.