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June 15, 2012

The Board of Trustees
FSM Social Security Administration:

Dear Members of the Board:

We have performed an audit of the financial statements of the Federated States of Micronesia (FSM) Social Security Administration (the Administration), a component unit of the FSM National Government, as of and for the year ended December 31, 2011, in accordance with auditing standards generally accepted in the United States of America ("generally accepted auditing standards") and have issued our report thereon dated June 15, 2012.

We have prepared the following comments to assist you in fulfilling your obligation to oversee the financial reporting and disclosure process for which management of the Administration is responsible.

OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS AND GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS

Our responsibility under generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, have been described in our engagement letter dated September 13, 2011. As described in that letter, the objective of a financial statement audit conducted in accordance with the aforementioned standards is:

- To express an opinion on the fairness of the presentation of the Administration's basic financial statements and the accompanying supplementary information and to disclaim an opinion on the required supplementary information for the year ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"), in all material respects; and

- To report on the Administration's internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended December 31, 2011 based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*.

Our responsibilities under generally accepted auditing standards include forming and expressing an opinion about whether the financial statements that have been prepared with the oversight of management and the Board of Trustees are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The audit of the financial statements does not relieve management or the Board of Trustees of their responsibilities.

We considered the Administration's 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 do not express an opinion on the effectiveness of the Administration's internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.
We considered the Administration's 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 do not express an opinion on the effectiveness of the Administration's internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

AUDIT ADJUSTMENTS AND UNCORRECTED MISSTATEMENTS

As the result of our audit work, we identified matters that resulted in audit adjustments that we believe, either individually or in the aggregate, would have a significant effect on the Administration's financial reporting process. Such proposed adjustments, listed in Appendix II, have been recorded in the accounting records and are reflected in the 2011 financial statements. Those proposed adjustments that were not recorded by management are also included in the schedule described in the next paragraph.

In addition, we have attached to this letter, as Appendix I, a summary of uncorrected misstatements aggregated by us during the current engagement and pertaining to the periods presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

ACCOUNTING ESTIMATES

Accounting estimates are an integral part of the financial statements prepared with the oversight of management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the Administration's 2011 financial statements include management's estimate of the allowance for uncollectible accounts, which is determined based upon past collection experience and aging of the accounts, and management's estimate of depreciation expense, which is based on estimated useful lives of the respective capital assets. During the year ended December 31, 2011, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

SIGNIFICANT ACCOUNTING POLICIES

The Administration's significant accounting policies are set forth in Note 2 to the Administration's 2011 financial statements. During the year ended December 31, 2011, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by the Administration:

- GASB 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.

- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

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

For the year ending December 31, 2012, the following pronouncements will be adopted by the Administration:

- In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans.

- In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53),* which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced.

Management does not believe that the implementation of these statements will have a material effect on the financial statements of the Administration.

For the year ending September 30, 2013, the following pronouncements will be adopted by the Administration:

- In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements,* which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into.

- In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus,* which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity,* and No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively.

- In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements.

- In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position.

Management does not believe that the implementation of these statements will have a material effect on the financial statements of the Administration.

OTHER INFORMATION IN THE ANNUAL REPORTS

When audited financial statements are included in documents containing other information such as the Administration's 2011 Annual Report, we will read such other information and consider whether it, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements audited by us. We will read the other information in the Administration's 2011 Annual Report and will inquire as to the methods of measurement and presentation of such information. If we note a material inconsistency or if we obtain any knowledge of a material misstatement of fact in the other information, we will discuss this matter with management and, if appropriate, with the Board.

DISAGREEMENTS WITH MANAGEMENT

We have not had any disagreements with management related to matters that are material to the Administration's 2011 financial statements.

CONSULTATION WITH OTHER ACCOUNTANTS

We are not aware of any consultations that management may have had with other accountants about auditing and accounting matters during 2011.

MANAGEMENT'S REPRESENTATIONS

We have made specific inquiries of the Administration's management about the representations embodied in the financial statements. Additionally, we have requested that management provide to us the written representations the Administration is required to provide to its independent auditors under generally accepted auditing standards. We have attached to this letter, as Appendix III, a copy of the representation letter we obtained from management.

MAJOR ISSUES DISCUSSED WITH MANAGEMENT PRIOR TO OUR INITIAL ENGAGEMENT OR RETENTION

Throughout the year, routine discussions were held or were the subject of correspondence with management regarding the application of accounting principles or auditing standards in connection with transactions that have occurred, transactions that are contemplated, or reassessment of current circumstances. In our judgment, such discussions or correspondence were not held in connection with our retention as auditors.

SIGNIFICANT DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

In our judgment, we received the full cooperation of the Administration's management and staff and had unrestricted access to the Administration's senior management in the performance of our audit.

CONTROL-RELATED MATTERS

We have issued a separate report to you, also dated June 15, 2012, wherein no matters involving the Administration's internal control over financial reporting that were considered to be material weaknesses under standards established by the American Institute of Certified Public Accountants, and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, were reported.

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

We wish to thank the staff and management of the Administration for their cooperation and assistance during the course of this engagement.

Very truly yours,

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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.

30. In January 2012, the Administration obtained an actuarial valuation of the Retirement Fund as of January 1, 2011. The valuation reported actuarial accrued liabilities for the Retirement Fund of $287,771,000. As of December 31, 2011 and 2010, the Administration recorded total fund equity of $39,447,152 and $42,361,070, 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.

31. On September 15, 2005, an agreement was entered into between the Prior Service Trust Fund Administration (PSTFA) Board and the U.S. Department of the Interior to delegate the Board's obligations to and responsibility for the enrollees eligible for the 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 Marian Islands. Based on the agreement, the Administration shall be entitled to an administrative fee not to exceed 20% of the share of allocated funds. The Administration assumed administrative functions and received an allocation of $272,797 and $89,593 from PSTFA as of December 31 2011 and 2010, respectively, of which $253,846 and $271,407 has been paid out as benefits for the years ended December 31, 2011 and 2010, 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, 2011 and 2010, the amount available for future benefit payments under the Prior Service Benefits Program amounted to $62,217 and $43,035, respectively.

32. No events have occurred subsequent to December 31, 2011 to the date of our signatures below that require consideration as adjustments to or disclosures in the financial statements.

Alexander R. Narruhn
Administrator

Teresita Dayao
Controller