

**MARSHALL ISLANDS
SOCIAL SECURITY ADMINISTRATION**

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

**MARSHALL ISLANDS
SOCIAL SECURITY ADMINISTRATION**

Years Ended September 30, 2006 and 2005
Table of Contents

	<u>Page No.</u>
I. FINANCIAL STATEMENTS	
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Statements of Net Assets	7
Statements of Changes in Net Assets	8
Notes to Financial Statements	9
II. INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS	
Independent Auditors' Report on Internal Control Over Financial Reporting and Compliance and on Other Matters Based on an Audit Performed in Accordance with <i>Government Auditing Standards</i>	22

INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshall Islands Social Security Administration:

We have audited the accompanying statements of net assets of the Marshall Islands Social Security Administration (MISSA), a component unit of the Republic of the Marshall Islands, as of September 30, 2006 and 2005, and the related statements of changes in net assets for the years then ended. These financial statements are the responsibility of the management of MISSA. Our responsibility is to express an opinion on these financial statements based on our audits.

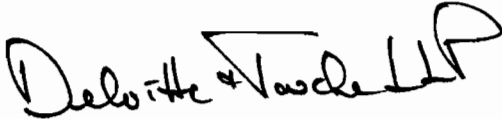
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan 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 MISSA's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial status of MISSA as of September 30, 2006 and 2005, and the changes in financial status for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 1 through 6 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 MISSA'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.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of MISSA taken as a whole. The accompanying Combining Statement of Net Assets (page 19) and Combining Statement of Changes in Net Assets (page 20) as of and for the year ended September 30, 2006 are presented for purposes of additional analysis and are not a required part of the basic financial statements of MISSA. This schedule is the responsibility of MISSA's management. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 3, 2007, on our consideration of MISSA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink, appearing to read "Deloitte & Touche LLP". The signature is stylized and includes a large, sweeping flourish at the end.

May 3, 2007

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

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

The following Management's Discussion and Analysis of the Marshall Islands Social Security Administration's (MISSA) financial performance provides an overview to the financial statements of MISSA for the years ended September 30, 2006 and 2005. Since the MD&A is designed to focus on current activities, resulting changes and current known facts, we encourage the readers to consider it in conjunction with the audited financial statements, which follow this section.

REQUIRED FINANCIAL STATEMENTS

MISSA, a component unit of the Republic of the Marshall Islands (RepMar), prepares its financial statements on the accrual basis in accordance with generally accepted accounting principles promulgated by the Governmental Accounting Standards Board (GASB). The Statements of Net Assets reflects all of MISSA's assets and liabilities and provides information on the nature and amount of investments available to ensure payment of retirement, survivors and disability benefits. All additions to and deductions from the net assets held in trust for retirement, disability and survivors' benefits are accounted for in the Statements of Changes in Net Assets. This statement measures MISSA's success over the past year in increasing the net assets available for future benefits.

FINANCIAL ANALYSIS OF MISSA

The Statements of Net Assets on page 7 and the Statements of Changes in Net Assets on page 8 provide an indication of MISSA's financial condition. An increase in net assets over time typically indicates an improvement in financial condition. While these statements measure the value of MISSA's net assets and the changes to them, another important factor to consider in determining the financial health of MISSA is its actuarial funded status.

Fiscal year 2006 may not be the best year for MISSA but nevertheless it closed with an addition of \$5,308,875 to MISSA's net assets, which is lower by \$2,981,180 or 36%, as compared to \$8,290,055 in fiscal year 2005. This year's performance of MISSA's investments was slightly off as compared to that of last year's results wherein there were some months that showed a decrease in valuation. MISSA's investment income for 2005 of \$7,698,351, which exceeded this year's total investment income of \$5,486,859 by 29%.

Another factor that contributed to the decrease in the change in net assets of MISSA from 2005 to 2006 was the slight decrease in contributions collected for the year despite the aggressive implementation of payroll audit conducted on certain businesses.

Although MISSA's assets continue to grow largely due to the performance of its investments and its aggressive implementation of tax collection and audit practices, the continued growth in benefit payments is a cause for great concern over the future sustainability of the system. A ten year benefits projection study released in January 2006 recommended a progressive increase in the Retirement Fund tax rate to as much as 9.1% in 2015 in order for MISSA to meet its benefit payment obligations at current levels. The most recent actuarial valuation dated October 1, 2003 indicated an unfunded actuarial accrued liability of \$164.2 million or 80%. The next actuarial valuation of the Retirement Fund is due on October 1, 2006.

As of September 30, 2006, MISSA's total net assets held in reserve for future benefits have increased to \$61,179,319.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

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

A summary of MISSA's Statements of Net Assets as of September 30, 2006, 2005 and 2004 is presented below:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets:			
Cash and cash equivalents	\$ 1,474,481	\$ 1,092,394	\$ 1,912,722
Time certificate of deposit	4,060,743	3,865,788	3,680,934
Receivables, net:			
Contributions	2,088,814	2,251,928	1,867,027
Other	90,373	243,493	189,906
Due from affiliates, net	546,809	807,223	1,043,122
Investments:			
Cash Management	112,795	205,540	111,041
Stocks	14,770,070	12,887,219	9,158,921
Mutual funds	38,623,258	35,105,892	30,486,218
Fixed assets, net	<u>104,279</u>	<u>163,464</u>	<u>224,983</u>
Total assets	<u>61,871,622</u>	<u>56,622,941</u>	<u>48,674,874</u>
Liabilities:			
Accounts payable	99,600	89,463	293,275
Other liabilities and accruals	157,031	147,002	163,467
Due to Ministry of Health	<u>435,672</u>	<u>516,032</u>	<u>637,743</u>
Total liabilities	<u>692,303</u>	<u>752,497</u>	<u>1,094,485</u>
Net Assets:			
Held in trust for future benefits	\$ <u>61,179,319</u>	\$ <u>55,870,444</u>	\$ <u>47,580,389</u>

A summary of MISSA's Statements of Changes in Net Assets for the years ended September 30, 2006, 2005 and 2004 is presented below:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Additions:			
Contributions	\$ 11,443,526	\$ 11,921,222	\$ 10,627,661
Net investment income	5,371,742	7,596,963	5,875,008
Other	<u>409,031</u>	<u>272,370</u>	<u>136,493</u>
Total additions	<u>17,224,299</u>	<u>19,790,555</u>	<u>16,639,162</u>
Deductions:			
Benefit payments	11,018,951	10,673,660	9,747,850
Administrative	<u>896,473</u>	<u>826,840</u>	<u>859,676</u>
Total deductions	<u>11,915,424</u>	<u>11,500,500</u>	<u>10,607,526</u>
Change in net assets	\$ <u>5,308,875</u>	\$ <u>8,290,055</u>	\$ <u>6,031,636</u>

Management's Discussion and Analysis for the year ended September 30, 2005 is set forth in MISSA's report on the audit of financial statements, which is dated May 10, 2006. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be obtained from MISSA's Administrator via the contact information on page 7.

Additions:

Of the total \$17,224,299 in additions for 2006, \$11,443,526 or (66%) was generated from contributions, \$5,371,742 or (31%) was generated from investments, and the remaining \$409,031 or (3%) was generated from other income. The decrease of 13% in additions for 2006 as compared with 2005 is due primarily to the performance of MISSA's investments in the global stock market.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

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

The following table presents MISSA's investment allocations as of September 30, 2006 with comparative figures in 2005.

Investment Type	As of September 30, 2006				As of September 30, 2005			
	Weight %	Target %	Market Value (\$'000)	Target Value (\$'000)	Weight %	Target %	Market Value (\$'000)	Target Value (\$'000)
Small Cap	4.8%	4.8%	\$ 2,278	\$ 2,266	5.4%	4.8%	\$ 2,301	\$ 2,039
Small Cap Value	7.5%	7.2%	\$ 3,536	\$ 3,398	8.2%	7.2%	\$ 3,476	\$ 3,059
Large Cap	5.3%	4.8%	\$ 2,501	\$ 2,266	4.8%	4.8%	\$ 2,058	\$ 2,039
Large Cap Value	8.1%	7.2%	\$ 3,806	\$ 3,398	7.9%	7.2%	\$ 3,376	\$ 3,059
Int'l Small Cap	5.2%	4.8%	\$ 2,477	\$ 2,266	5.7%	4.8%	\$ 2,420	\$ 2,039
Int'l Small Cap Value	6.6%	6.0%	\$ 3,119	\$ 2,832	7.3%	6.0%	\$ 3,090	\$ 2,549
Int'l Large Cap	5.6%	4.8%	\$ 2,661	\$ 2,266	5.3%	4.8%	\$ 2,241	\$ 2,039
Int'l Large Cap Value	7.0%	6.0%	\$ 3,283	\$ 2,832	6.8%	6.0%	\$ 2,891	\$ 2,549
Emerging Markets	2.8%	2.4%	\$ 1,304	\$ 1,133	3.0%	2.4%	\$ 1,283	\$ 1,020
Real Estate Inv Trust	7.0%	6.0%	\$ 3,303	\$ 2,832	6.8%	6.0%	\$ 2,874	\$ 2,549
Commodities	5.2%	6.0%	\$ 2,454	\$ 2,832	7.1%	6.0%	\$ 3,027	\$ 2,549
Bonds	34.7%	39.5%	\$ 16,367	\$ 18,644	31.2%	39.5%	\$ 13,242	\$ 16,781
Cash and Equivalents	0.2%	0.5%	\$ 113	\$ 236	0.5%	0.5%	\$ 205	\$ 213
TOTAL	100%	100%	\$ 47,201	\$ 47,201	100%	100%	\$ 42,484	\$ 42,484

The above allocations are based on the revised policy on investments, which was adopted by the MISSA Board of Directors on October 21, 2002 wherein MISSA's total investment portfolio requires an allocation of 60% for equities and 40% for bonds. With the exception of MISSA's investment in the Bank of the Marshall Islands (BOMI)*, all investments are limited to no-load mutual funds, unit investment trusts, Exchange Trade Funds, close-end mutual funds, and other diversified marketable securities.

For the year ended September 30, 2006, the fair market value of MISSA's investments in the U.S. and International markets increased by \$4,716,445. In addition, a total of \$1,238,319 in dividends and interest payments were received and subsequently reinvested. On the other hand, investment management fees have increased by 14% from \$101,388 in 2005 to \$115,117 in 2006.

MISSA presently holds a 31% interest in the Bank of the Marshall Islands. For the year ended September 30, 2006, MISSA's 65,285 shares at BOMI increased in value by \$561,028. Annual dividend payments of \$226,397 and \$161,212 were received from BOMI in April 2006 and 2005, respectively. As of September 30, 2006 and 2005, the shares at BOMI were valued at \$6,275,464 and \$5,714,436, respectively. MISSA also acquired 3,000 shares of stock at \$10.00 par value from Marshall Islands Service Corporation, a newly opened business managed by Bank of the Marshall Islands.

Deductions:

Deductions represent benefit payments and administrative expenses. For the year ended September 30, 2006, total deductions amounted to \$11,915,424, which is 4% higher than \$11,500,500 from the previous year. Due to the implementation of various controls on eligibility, benefit payments for fiscal year 2006 increased by 2.6% for a total of \$11,018,951 for 2006 as compared to \$10,673,660 for 2005. Administrative expenses were maintained within the allowable limits. For the years ended September 30, 2006 and 2005, MISSA's administrative expenses totaled \$892,601 and \$826,840, respectively. These amounts represent 5% and 4%, respectively, of total revenues generated during these years. As mandated by the Social Security Act of 1990, MISSA's administrative expenses have an allowable ceiling of as much as 20% of total revenues for any given year.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

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

FUTURE ECONOMIC OUTLOOK

MISSA's efforts to bridge the widening gap between the continual rise in benefit payments and the leveling off of collections have been the focal point of the Administration's plans of action in the past year.

As collections have remained virtually unchanged in the last two years at just under \$12 million, the steady increases in benefits over the years have caused great concern over the Retirement Fund's ability to pay benefits in the coming years. This has forced the Administration to focus on two very fundamental but highly critical areas in FY2006:

1. Revenue generation through (1) increasing taxes, (2) increasing taxable wage ceilings, and (3) implementing employer audits; and
2. Indirect and direct reduction of benefit payments through (1) comprehensive verification of living beneficiaries, (2) medical re-examination of disabled retirees, (3) screening for continued eligibility for dependent children and non-citizens, and (4) full implementation of the Earnings Test provision of the SS Act.

MISSA was for the most part successful in implementing all of the above actions, except for increasing taxes and increasing taxable wage ceilings as they were met with unfavorable response from certain local employers and the general public.

The methodical and aggressive audit of employers has resulted in hundreds of thousands of additional tax dollars for MISSA in FY2006. Although the audits proved successful, they were not enough and MISSA coupled its efforts with plans to reduce benefit payments through a comprehensive and systematic review process which was conducted successfully in four stages. The positive outcomes of these processes are evident in the slowing down of the benefit growth rate in FY2006 as compared to previous years (2% vs 6-8%).

The timely and consistent remittance of taxes from MISSA's major contributors, which include the RMI Government, USAKA, and other large-scale agencies and private businesses have brought a sense of relief as MISSA was able to make its payments in FY2006. However, an increasing number of government agencies and private businesses are falling behind on their tax remittances, a trend which seems all the more prevalent and alarming at the end of FY2006. A continuation of this trend in the coming year would require MISSA to take on more drastic measures to ensure that a reasonable balance between revenues and expenditures is maintained.

CONTACTING MISSA'S FINANCIAL MANAGEMENT

This financial report is designed to provide our beneficiaries and others a general overview of MISSA's finances and to demonstrate its accountability for the money it collects. If you have questions about this report or need additional financial information, contact the Administrator, P.O. Box 175, Majuro, MH 96960 or via email at missa3@ntamar.net.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Statements of Net Assets
September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<u>ASSETS</u>		
Cash and cash equivalents	\$ 1,474,481	\$ 1,092,394
Time certificates of deposit	<u>4,060,743</u>	<u>3,865,788</u>
Receivables, net:		
Contributions	2,088,814	2,251,928
Other	<u>90,373</u>	<u>243,493</u>
Total receivables, net	<u>2,179,187</u>	<u>2,495,421</u>
Due from affiliates, net	<u>546,809</u>	<u>807,223</u>
Investments:		
Cash management	112,795	205,540
Stocks	14,770,070	12,887,219
Mutual funds	<u>38,623,258</u>	<u>35,105,892</u>
Total investments	<u>53,506,123</u>	<u>48,198,651</u>
Fixed assets, net	<u>104,279</u>	<u>163,464</u>
Total assets	<u>61,871,622</u>	<u>56,622,941</u>

LIABILITIES

Accounts payable	99,600	89,463
Other liabilities and accruals	157,031	147,002
Due to the Ministry of Health	<u>435,672</u>	<u>516,032</u>
Total liabilities	<u>692,303</u>	<u>752,497</u>

Contingencies

NET ASSETS

Held in trust for retirement, disability and survivors' benefits	<u>\$ 61,179,319</u>	<u>\$ 55,870,444</u>
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See accompanying notes to financial statements.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Statements of Changes in Net Assets
Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Additions:		
Contributions:		
Private employees	\$ 7,487,349	\$ 7,968,979
Government employees	3,642,155	3,704,239
Penalties and interest	<u>314,022</u>	<u>248,004</u>
Total contributions	<u>11,443,526</u>	<u>11,921,222</u>
Investment income:		
Net increase in the fair value of investments	4,023,719	6,542,638
Dividends	1,234,072	938,346
Interest	<u>229,068</u>	<u>217,367</u>
Total investment income	5,486,859	7,698,351
Less investment expense:		
Investment management and custodial fees	<u>115,117</u>	<u>101,388</u>
Net investment income	<u>5,371,742</u>	<u>7,596,963</u>
Other	<u>409,031</u>	<u>272,370</u>
Total additions	<u>17,224,299</u>	<u>19,790,555</u>
Deductions:		
Benefit payments:		
Retirement	5,995,686	5,880,146
Survivors	3,675,112	3,476,577
Disability	1,262,293	1,275,140
Lump sum	<u>85,860</u>	<u>41,797</u>
Total benefit payments	11,018,951	10,673,660
Administrative	<u>896,473</u>	<u>826,840</u>
Total deductions	<u>11,915,424</u>	<u>11,500,500</u>
Change in net assets	5,308,875	8,290,055
Net assets at beginning of year	<u>55,870,444</u>	<u>47,580,389</u>
Net assets at end of year	<u>\$ 61,179,319</u>	<u>\$ 55,870,444</u>

See accompanying notes to financial statements.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(1) Organization

The Marshall Islands Social Security Administration (MISSA), a component unit of the Republic of the Marshall Islands (RepMar), was established pursuant to RepMar Public Law 1990-75 (the Social Security Act of 1990), as amended. The law repealed the Social Security Act of 1987 and established MISSA to administer the Marshall Islands Social Security Retirement Fund (the Retirement Fund). The Retirement Fund was established to provide a financially sound social security system with pension benefits and early retirement, whereby workers would be ensured a measure of security in their old age and during disability, and whereby surviving spouses and surviving children of deceased workers would be ensured support after the loss of the family's income. Additionally, MISSA is responsible for processing, monitoring and distributing benefit claims under the Prior Service Benefits Program (see note 3). Accordingly, MISSA established the Prior Service Fund to account for activities under this program.

Contributions to the Retirement Fund are governed by the Social Security Act of 1990, as amended, which imposes a tax on the quarterly income of every employee, not currently subject to the United States Social Security System or any other recognized Social Security System, equal to seven percent of wages received.

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

Retirement benefits are paid to every person who is a service insured or a fully insured individual as defined by the Social Security Act of 1990, as amended, has attained an age of sixty years 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. Eligible children who are not married and are not working may also receive benefits until age eighteen (18) or up until age twenty-two (22), if in school. Eligible children who become disabled before age twenty-two will continue to receive benefits for the duration of the disability. Disability benefits are paid to qualified workers for the duration of the disability or until retirement or death, at which time retirement or survivor benefits become available.

Effective October 1, 1990, benefits are paid monthly and are computed as follows:

- a) Pension element - two percent of index covered earnings, plus;
- b) Social element - 14.5% of the first \$11,000 of cumulative covered earnings plus 0.7% of cumulative covered earnings in excess of \$11,000 but not in excess of \$44,000. The \$11,000 and \$44,000 bend points may be increased from time to time by wage index adjustments granted by the Board of MISSA.

The minimum benefit is \$129 per month, effective October 1, 1995.

MISSA operates under the authority of a seven-member Board of Directors appointed by the Cabinet of RepMar.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies

Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus* and modified by Statement No. 38, *Certain Financial Statement Disclosures*. These statements establish financial reporting standards for governmental entities, which includes the requirement for MISSA to present Management's Discussion and Analysis (MD&A). The MD&A is considered to be required supplementary information and precedes the financial statements. In addition, these statements require that resources be classified for accounting and reporting purposes as held in trust for retirement, disability and survivors' benefits.

Management of MISSA has determined that per its enabling legislation, all net assets of MISSA are held in trust for retirement, disability and survivors' benefits.

A. Basis of Accounting

MISSA prepares its financial statements using the accrual basis of accounting. It recognizes employee and employer contributions as revenues in the quarter employee earnings are paid. Retirement benefits are recognized as expenses when payable. Expenses are recorded when the corresponding liabilities are incurred regardless of when payment is made.

B. Future Liabilities and Contributions

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

C. Cash and Cash Equivalents and Time Certificates of Deposit

For the purposes of the statements of net assets, cash and cash equivalents include cash in checking and savings accounts as well as short-term investments with original maturities of three months or less from the date acquired. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statements of net assets.

D. Investments

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

Investments of 20% or more of the voting stock of an investee are presumed to give the investor significant influence and are carried using the equity method. Under the equity method, the investor records, as earnings or loss, its proportionate share of the investee's earnings or loss.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

E. Receivables and the Allowance for Doubtful Accounts

Contributions receivable are due from employers located within the Republic of the Marshall Islands. These receivables are not collateralized and are non-interest bearing.

The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts. The allowance is established through a provision for bad debts charged to expense.

F. Fixed Assets

Fixed assets with a cost that equals or exceeds \$100 are generally capitalized at the time of acquisition. Depreciation is provided using the straight-line basis over the estimated useful lives of the respective assets. The estimated useful lives of these assets are as follows:

Building and improvements	20 years
Motor vehicles	3 years
Computer equipment	3 years
Office equipment	5 years
Furniture	8 years

G. Compensated Absences

Annual vacation leave is earned by all permanent employees and accumulates at the rate of one working day per bi-weekly pay period. Upon termination, employees are eligible to receive compensation for their accrued annual leave balances. At September 30, 2006 and 2005, a liability existed for accumulated annual leave calculated at the employee's September 30, 2005 pay rate in the amount of \$27,571 and is included in the statements of net assets within other liabilities and accruals. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits. The accumulated estimated amount of unused sick leave as of September 30, 2006 and 2005 is \$18,883 and \$15,694, respectively.

H. New Accounting Standards

In fiscal year 2006, MISSA 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 service 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.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

H. New Accounting Standards, Continued

GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34*), which improves the understandability and comparability of net assets information by making the assessment of legal enforceability more uniform across governments. This Statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation.

GASB Statement No. 47, *Accounting for Termination Benefits*, which requires employees to disclose a description of the termination benefit arrangement, the cost of termination benefits, and significance methods and assumptions used to determine termination benefits liabilities.

Implementation of GASB Statements Nos. 42, 44, 46 and 47 had no material impact on the financial statements of MISSA.

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 MISSA.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*, which 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 MISSA.

In December 2004, GASB issued Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit 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. Management does not believe the implementation of this pronouncement will have a material effect on the financial statements of MISSA.

I. 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 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.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(3) Prior Service Benefits Program

Under the terms of a Prior Service Claim Adjudication Service Agreement between MISSA and the Trust Territory Prior Service Trust Fund, MISSA is to provide for the processing of benefit claims and to assist in the monitoring of continuing eligibility under the Prior Service Program. The Prior Service Trust Fund Administration (PSTFA) will reimburse MISSA \$2,000 per annum plus an amount equal to eight percent of the total amount of automated and manual benefit payments. Any cost for MISSA personnel who assist in searching and locating prior service documents in cooperation with the Prior Service Administration will be reimbursed on a dollar for dollar basis.

On September 15, 2005, an agreement was entered into between the PSTFA Board and the U.S. Department of the Interior to delegate the Board's obligations 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 Mariana Islands. Based on the agreement, the Social Security Administration (SSA) of each Government shall be entitled to an administrative fee not to exceed 20% of the share of allocated funds.

MISSA assumed administrative functions and received an allocation of \$105,409 from PSTFA in April 2006, of which \$65,387 has been paid out as benefits for the year ended September 30, 2006. However, while MISSA accepts the liability for any amounts received, MISSA does not accept the obligation to pay future benefits unless additional funds are received from PSTFA. At September 30, 2006, the amount available for future benefit payments under the Prior Service Benefits Program amounted to \$36,150.

(4) Deposits and Investments

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

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

- (i) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the RepMar or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by MISSA's investment advisor at the time of purchase, that not more than fifteen percent (15%) percent of the market value of the Fund shall be invested in the stock of any one corporation, and that not more than twenty-five percent (25%) percent of the market value of the Fund shall be invested in any one industry group.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(4) Deposits and Investments, Continued

- (ii) Government obligations - Obligations issued or guaranteed as to principal and interest by the Government of Republic of the Marshall Islands (RepMar) or by the Government of the United States, provided that the total market value of the investments in obligations guaranteed by Government of RepMar shall at the time of purchase not exceed twenty-five percent (25%) of the total market value of all investments of MISSA, and further provided that the principal and interest on each obligation are payable in the currency of the United States.
- (iii) Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the RepMar or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or pass through and other mortgage-backed securities provided that the obligation is an agency of the United States Government or is rated in one of the four highest categories by two nationally recognized rating agencies in the United States. No investment under this heading shall exceed five percent of the market value of the Fund or ten percent of the outstanding value of the issue at the time of purchase.
- (iv) Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the RepMar or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent (10%) of all investments of the Fund.

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

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(4) Deposits and Investments, Continued

A. Deposits, Continued:

As of September 30, 2006 and 2005, the carrying amount of MISSA's cash and cash equivalents and time certificates of deposit was \$5,535,224 and \$4,958,182, respectively, and the corresponding bank balances were \$5,891,752 and \$5,318,005, respectively. As of September 30, 2006 and 2005, bank deposits in the amount of \$57,242 and \$9,597, respectively, were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. MISSA does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

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 MISSA or its agent in MISSA'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 MISSA'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 MISSA's name.

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

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

	<u>2006</u>	<u>2005</u>
Mutual funds	\$ 38,623,258	\$ 35,105,892
Domestic equities	5,803,516	4,932,331
Foreign equities	2,661,090	2,240,452
Cash management funds	<u>112,795</u>	<u>205,540</u>
	<u>\$ 47,200,659</u>	<u>\$ 42,484,215</u>

Additionally, MISSA owns 65,285 shares of the common stock of the Bank of Marshall Islands (BOMI), which engages in commercial banking services in the Republic of the Marshall Islands. The investment is accounted for on the equity method since the investment constitutes a 31% ownership share. At September 30, 2006 and 2005, MISSA's investment in BOMI amounted to \$6,275,464 and \$5,714,436, respectively.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(4) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2006 and 2005, MISSA maintained bank deposits and a time certificate of deposit with BOMI totaling \$5,834,509 and \$5,308,409, respectively.

A summary of unaudited financial information as of and for the nine months ended September 30, 2006, for investees accounted for using the equity method of accounting for investments, is as follows:

Assets	\$ <u>57,295,971</u>
Liabilities	\$ <u>37,723,605</u>
Net earnings	\$ <u>1,743,069</u>

As of September 30, 2006 and 2005, net increase in fair value of investments included equity in net earnings of BOMI amounting to \$733,425 and \$777,123, respectively.

During the year ended September 30, 2006, MISSA purchased 3,000 shares of \$10 par value common stock of Marshall Islands Service Corporation (MISC), which were authorized and acquired through Board Resolution # 2006-04. Shareholders of MISC are comprised primarily of BOMI shareholders. As MISC is still being formed, there is currently no difference between book and estimated market value.

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. At September 30, 2006 and 2005, MISSA's investment portfolio did not include investments in debt securities. Accordingly, MISSA is not exposed to credit risk.

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, MISSA will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. MISSA's investments are held and administered by trustees. Except for mutual funds, MISSA's agent holds investment securities in MISSA's name. MISSA's agent is not affiliated or related to investment brokers. Accordingly, MISSA is not exposed to custodial credit risk.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for MISSA. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. There was no concentration of credit risk for investments as of September 30, 2006 and 2005.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. MISSA 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. At September 30, 2006 and 2005, MISSA's investment portfolio did not include investments in debt securities. Accordingly, MISSA is not exposed to interest rate risk.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(5) Receivables

Receivables as of September 30, 2006 and 2005, including applicable allowances for doubtful accounts, are as follows:

	<u>2006</u>	<u>2005</u>
Contributions	\$ 2,088,814	\$ 2,251,928
Other	<u>4,077,751</u>	<u>4,177,453</u>
	6,166,565	6,429,381
Less allowance for doubtful accounts	<u>(3,987,378)</u>	<u>(3,933,960)</u>
	\$ <u>2,179,187</u>	\$ <u>2,495,421</u>

(6) Due from Affiliates

Receivables from affiliates as of September 30, 2006 and 2005, including applicable allowances for doubtful accounts, are as follows:

	<u>2006</u>	<u>2005</u>
Ministry of Health	\$ 521,309	\$ 766,691
Other	<u>216,263</u>	<u>441,461</u>
	737,572	1,209,152
Less allowance for doubtful accounts	<u>(190,763)</u>	<u>(401,929)</u>
	\$ <u>546,809</u>	\$ <u>807,223</u>

On November 4, 2003, MISSA entered into a debt reduction agreement with the Ministry of Health (MOH) for the repayment of certain receivables in the amount of \$1,177,964. Under the terms of this agreement, MOH is required to make interest-free quarterly payments of \$60,000, commencing on January 1, 2004.

(7) Capital Assets

Capital asset activity for the years ended September 30, 2006 and 2005, was as follows:

	<u>October 1, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>September 30, 2006</u>
Buildings and improvements	\$ 476,060	\$ 8,794	\$ -	\$ 485,854
Motor vehicles	79,339	-	-	79,339
Computer equipment	92,111	4,832	(6,421)	90,522
Furniture	65,145	3,747	-	68,892
Office equipment	<u>71,893</u>	<u>2,733</u>	<u>(750)</u>	<u>73,876</u>
	784,548	20,105	(7,171)	797,483
Less accumulated depreciation and amortization	<u>(621,084)</u>	<u>(79,124)</u>	<u>7,004</u>	<u>(693,204)</u>
	\$ <u>163,464</u>	\$ <u>(59,018)</u>	\$ <u>(167)</u>	\$ <u>104,279</u>

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Notes to Financial Statements
September 30, 2006 and 2005

(7) Capital Assets, Continued

	October 1, <u>2004</u>	<u>Additions</u>	<u>Retirements</u>	September 30, <u>2005</u>
Buildings and improvements	\$ 466,797	\$ 9,263	\$ -	\$ 476,060
Motor vehicles	79,339	-	-	79,339
Computer equipment	74,362	22,858	(5,109)	92,111
Furniture	63,897	1,471	(223)	65,145
Office equipment	<u>66,597</u>	<u>6,363</u>	<u>(1,067)</u>	<u>71,893</u>
	750,992	39,955	(6,399)	784,548
Less accumulated depreciation and amortization	<u>(526,009)</u>	<u>(101,340)</u>	<u>6,265</u>	<u>(621,084)</u>
	\$ <u>224,983</u>	\$ <u>(61,385)</u>	\$ <u>(134)</u>	\$ <u>163,464</u>

(8) Contingencies

In September 2004, MISSA obtained an actuarial valuation of the Retirement Fund as of October 1, 2003. The valuation reported actuarial accrued liabilities for the Retirement Fund of \$205,747,000. As of September 30, 2006, MISSA recorded total fund equity of \$61,143,169 in the Retirement Fund, as funds available to fund future benefit obligations. These conditions indicate that MISSA may be unable to meet its future benefit obligations.

(9) Risk Management

MISSA 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. MISSA has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. MISSA is also exposed to investment risk. This risk is limited by diversification of the portfolio, establishment and monitoring of investment policies and guidelines, and monitoring of investment performance. In addition, investment consultants monitor MISSA's activities and advise the Board of Directors.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Combining Statements of Net Assets
September 30, 2006

	<u>Retirement Fund</u>	<u>Prior Service Fund</u>	<u>Total</u>
<u>ASSETS</u>			
Cash and cash equivalents	\$ 1,438,331	\$ 36,150	\$ 1,474,481
Time certificates of deposit	<u>4,060,743</u>	<u>-</u>	<u>4,060,743</u>
Receivables, net:			
Contributions	2,088,814	-	2,088,814
Other	<u>90,373</u>	<u>-</u>	<u>90,373</u>
Total receivables, net	<u>2,179,187</u>	<u>-</u>	<u>2,179,187</u>
Due from affiliates, net	<u>546,809</u>	<u>-</u>	<u>546,809</u>
Investments:			
Cash management	112,795	-	112,795
Stocks	14,770,070	-	14,770,070
Mutual funds	<u>38,623,258</u>	<u>-</u>	<u>38,623,258</u>
Total investments	<u>53,506,123</u>	<u>-</u>	<u>53,506,123</u>
Fixed assets, net	<u>104,279</u>	<u>-</u>	<u>104,279</u>
Total assets	<u>61,835,472</u>	<u>36,150</u>	<u>61,871,622</u>
<u>LIABILITIES</u>			
Accounts payable	99,600	-	99,600
Other liabilities and accruals	157,031	-	157,031
Due to the Ministry of Health	<u>435,672</u>	<u>-</u>	<u>435,672</u>
Total liabilities	<u>692,303</u>	<u>-</u>	<u>692,303</u>
<u>NET ASSETS</u>			
Held in trust for retirement, disability and survivors' benefits	<u>\$ 61,143,169</u>	<u>\$ 36,150</u>	<u>\$ 61,179,319</u>

See Accompanying Independent Auditors' Report.

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Combining Statements of Changes in Net Assets
Year Ended September 30, 2006

	<u>Retirement Fund</u>	<u>Prior Service Fund</u>	<u>Total</u>
Additions:			
Contributions:			
Private employees	\$ 7,487,349	\$ -	\$ 7,487,349
Government employees	3,642,155	-	3,642,155
Penalties and interest	<u>314,022</u>	-	<u>314,022</u>
Total contributions	<u>11,443,526</u>	-	<u>11,443,526</u>
Investment income:			
Net increase in the fair value of investments	4,023,719	-	4,023,719
Dividends	1,234,072	-	1,234,072
Interest	<u>229,068</u>	-	<u>229,068</u>
Total investment income	5,486,859	-	5,486,859
Less investment expense:			
Investment management and custodial fees	<u>115,117</u>	-	<u>115,117</u>
Net investment income	<u>5,371,742</u>	-	<u>5,371,742</u>
Other	<u>303,622</u>	<u>105,409</u>	<u>409,031</u>
Total additions	<u>17,118,890</u>	<u>105,409</u>	<u>17,224,299</u>
Deductions:			
Benefit payments:			
Retirement	5,959,397	36,289	5,995,686
Survivors	3,646,716	28,396	3,675,112
Disability	1,261,591	702	1,262,293
Lump sum	<u>85,860</u>	-	<u>85,860</u>
Total benefit payments	10,953,564	65,387	11,018,951
Administrative	<u>892,601</u>	<u>3,872</u>	<u>896,473</u>
Total deductions	<u>11,846,165</u>	<u>69,259</u>	<u>11,915,424</u>
Change in net assets	5,272,725	36,150	5,308,875
Net assets at beginning of year	<u>55,870,444</u>	-	<u>55,870,444</u>
Net assets at end of year	<u>\$ 61,143,169</u>	<u>\$ 36,150</u>	<u>\$ 61,179,319</u>

See Accompanying Independent Auditors' Report.

**MARSHALL ISLANDS
SOCIAL SECURITY ADMINISTRATION**

**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

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

Board of Directors
Marshall Islands Social Security Administration:

We have audited the financial statements of the Marshall Islands Social Security Administration (MISSA) as of and for the year ended September 30, 2006, and have issued our report thereon dated May 3, 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

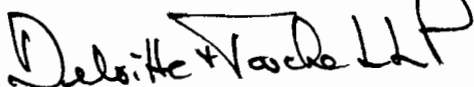
In planning and performing our audit, we considered MISSA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our 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 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether MISSA'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*.

We noted certain matters that we reported to management of MISSA in a separate letter dated May 3, 2007.

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



May 3, 2007

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

Unresolved Prior Year Findings
Year Ended September 30, 2006

There were no unresolved audit findings from prior year audits of MISSA.