

***Trust Fund for the People of the Federated States  
of Micronesia***

Financial Report

September 30, 2006

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Table of Contents**

**September 30, 2006 and 2005**

	<b><u>Page</u></b>
<b>Managements' Discussion and Analysis</b>	1
<b>Financial Statements</b>	
Independent Auditor's Report	4
Statement of Net Assets	5
Statements of Changes in Net Assets	6
Notes to Financial Statements	7
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	15

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Management's Discussion and Analysis**

**For the Fiscal Years Ended September 30, 2006 and 2005**

This section of the annual report presents the Joint Trust Fund Committee's management discussion and analysis of the Trust Fund for the People of the Federated States of Micronesia's (Trust Fund) financial performance for the years ended September 30, 2006 and 2005. Please read it in conjunction with the Trust Fund's financial statements, which follow this section.

### **The Trust Fund for the People of the Federated States of Micronesia Net Assets Summary**

	<b>September 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Assets</b>		
Cash and investments	\$86,525,037	\$64,240,149
<b>Liabilities</b>		
Accrued expenses	60,719	13,356
<b>Restricted Net Assets</b>	<b>\$86,464,318</b>	<b>\$64,226,793</b>

### **Financial Highlights - Net Assets at September 30, 2006**

The fair value of the Trust Fund's net assets was \$86.4 million as of September 30, 2006, compared to \$64.2 million at September 30, 2005. The increase is attributed to the United States contribution of \$16.4 million on October 6, 2005 and investment income of \$5.9 million. From October 1, 2005 until mid-August 2006, the assets were held entirely in certificates of deposit. In August 2006, the Trust Fund's assets were invested in two common trust funds. One common trust fund (State Street's Russell 3000 index fund) is invested primarily in U.S. marketable equity securities, and represents approximately 58% of the Trust Fund's net assets. The other common trust fund (State Street's MSCI EAFE international index fund) is invested primarily in international marketable equity securities, and represents approximately 41% of the Trust Fund's net assets. Accrued expenses represent amounts payable for legal and other professional services incurred during the fiscal year.

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Management's Discussion and Analysis**

**For the Fiscal Years Ended September 30, 2006 and 2005**

### **Financial Highlights - Net Assets at September 30, 2005**

At the end of fiscal year 2005, the Trust Fund's net assets were \$64.2 million consisting entirely of contributions by the Government of the United States and the Government of the Federated States of Micronesia (FSM), and earnings on these funds invested in certificates of deposit. The account was held by Wachovia Bank as custodian for the Trust Fund pending selection of a Trustee.

#### The Trust Fund for the People of the Federated States of Micronesia Changes in Net Assets Summary

	<b>Year ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Contributions	\$16,441,694	\$16,188,000
Net investment income	5,805,289	1,793,766
<b>Total Additions</b>	<b>22,246,983</b>	<b>17,981,766</b>
Administrative expenses	9,458	13,356
<b>Total Deductions</b>	<b>9,458</b>	<b>13,356</b>
<b>Change in Net Assets</b>	<b>22,237,525</b>	<b>17,968,410</b>
<b>Net Assets - Beginning</b>	<b>64,226,793</b>	<b>46,258,383</b>
<b>Net Assets - Ending</b>	<b>\$86,464,318</b>	<b>\$64,226,793</b>

### **Financial Highlights - Changes in Net Assets for Fiscal Year Ended September 30, 2006**

On October 6, 2005, a contribution of \$16.4 million was made by the United States. Investment income represents a total weighted return on invested assets, net of investment expenses of \$132,040 for the fiscal year ended September 30, 2006 of approximately 6.9%. Investment advisory fees charged by asset managers vary between approximately 0.5 percent and 1.0 percent of assets under management. The Trust Fund has entered into a cancellable agreement to pay a professional investment advisory firm \$125,000 annually (billed quarterly) and indexed to the U.S. Consumer Price Index. The Trust Fund incurred \$125,385 of fees to the investment advisory firm in fiscal year 2006, this amount is included in investment expenses.

The U.S. Department of the Interior contributed staff time, equipment usage and incidental expenses during the fiscal year ended September 30, 2006. No amounts have been recorded in the accompanying financial statements to reflect these transactions since they do not meet the criteria necessary for recognition.

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Management's Discussion and Analysis**

**For the Fiscal Years Ended September 30, 2006 and 2005**

### **Financial Highlights - Changes in Net Assets for Fiscal Year Ended September 30, 2005**

The United States contribution of \$16.2 million for fiscal year 2005 was credited to the Fund's account on October 5, 2004. The total yield on invested cash balances is 2.79% for the year ended September 30, 2005.



## Independent Auditor's Report

To the Joint Trust Fund Committee  
Trust Fund for the People of the Federated States of Micronesia

We have audited the accompanying statements of net assets of the Trust Fund for the People of the Federated States of Micronesia (Trust Fund) 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 Trust Fund's management. Our responsibility is to express opinions 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the 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, the financial statements referred to above present fairly, in all material respects, the statement of net assets of the Trust Fund for the People of the Federated States of Micronesia as of September 30, 2006 and 2005 and its changes in net assets for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2007, on our consideration of the Trust Fund for the People of the Federated States of Micronesia's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 1 through 3, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. 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 the information and express no opinion on it.

*Beard Miller Company LLP*

Beard Miller Company LLP  
Paoli, Pennsylvania  
December 3, 2007

# *Trust Fund for the People of the Federated States of Micronesia*

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## Statement of Net Assets September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 789,303	\$64,240,149
Investments, at fair value:		
Domestic equity common trust fund	49,823,198	0
International equity common trust fund	<u>35,912,536</u>	<u>0</u>
	<u>85,735,734</u>	<u>0</u>
<b>Total Assets</b>	<u><u>\$86,525,037</u></u>	<u><u>\$64,240,149</u></u>
<b>Liabilities and Restricted Net Assets</b>		
<b>Liabilities</b>		
Accrued expenses	<u>\$ 60,719</u>	<u>\$ 13,356</u>
<b>Restricted Net Assets</b>	<u>86,464,318</u>	<u>64,226,793</u>
<b>Total Liabilities and Restricted Net Assets</b>	<u><u>\$86,525,037</u></u>	<u><u>\$64,240,149</u></u>

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Statements of Changes in Net Assets**

**Year Ended September 2006 and 2005**

	<u>2006</u>	<u>2005</u>
<b>Additions</b>		
Contributions:		
Government of the United States of America	<u>\$16,441,694</u>	<u>\$16,188,000</u>
Investment income:		
Interest and dividends	3,661,452	1,793,766
Net increase in fair value of investments	<u>2,275,877</u>	<u>0</u>
<b>Investment Earnings</b>	5,937,329	1,793,766
Less: investment expenses	<u>132,040</u>	<u>0</u>
<b>Net Investment Income</b>	<u>5,805,289</u>	<u>1,793,766</u>
<b>Total Additions</b>	<u>22,246,983</u>	<u>17,981,766</u>
<b>Deductions</b>		
Administrative expenses	<u>9,458</u>	<u>13,356</u>
<b>Change in Net Assets</b>	22,237,525	17,968,410
<b>Net Assets - Beginning</b>	<u>64,226,793</u>	<u>46,258,383</u>
<b>Net Assets - Ending</b>	<u><u>\$86,464,318</u></u>	<u><u>\$64,226,793</u></u>

*See notes to financial statements.*



# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2006 and 2005**

### **Note 1 - Summary of Significant Accounting Policies**

#### **Overview of the Trust Fund:**

##### **Compact**

The Compact of Free Association Between the United States and the Federated States of Micronesia and the Marshall Islands was approved by the United States Congress in section 201 of Public Law 99-239 (January 14, 1986) and went into effect with respect to the Federated States of Micronesia on November 3, 1986 as amended by Public Law 108-188 approved December 17, 2003 (Compact) and provided legislation to establish The Trust Fund for the People of The Federated States of Micronesia (Trust Fund).

##### **Trust Fund**

The Compact provides for the establishment of the Trust Fund. After fiscal year 2023, the purpose of the Trust Fund will be to provide an ongoing source of revenue for assistance in the public sectors of the Federated States of Micronesia which are receiving annual grant assistance from the Government of the United States through fiscal year 2023.

Pursuant to the provisions of the Compact and its subsidiary *Agreement Between the Government of the United States of America and the Government of the Federated States of Micronesia (Original Parties) Implementing Section 215 and Section 216 of the Compact, as Amended, regarding a Trust Fund (Trust Fund Agreement)*, the *Trust Fund for the People of the Federated States of Micronesia* was incorporated in Washington, D.C. on August 17, 2004, as a nonprofit corporation. The purpose of the Trust Fund is to contribute to the economic advancement and long-term budgetary self-reliance of the Federated States of Micronesia by providing an annual source of revenue, after fiscal year 2023, for assistance in specific sectors described in Section 211 of the Compact, or other sectors as mutually agreed by the Original Parties, with priorities in education and health care. In accordance with the agreement, the situs of the Fund was established within the United States. The Original Parties are committed to contribute to the Trust Fund amounts described in the Compact, subsequent contributors may contribute to the Trust Fund if first approved by all Joint Trust Fund Committee (Committee) voting members. By a majority vote of the Committee, other voting or non-voting members may be appointed from Subsequent Contributors that contribute to the Fund from time to time, provided that the United States maintains the majority vote in the Committee.

After the initial twenty (20) years beginning October 1, 2023, the Original Parties will consult regarding the future composition of the Committee. The Committee shall remain the same, unless otherwise agreed by the Original Parties.

The composition of the Committee consists of three voting members from the United States appointed by the Government of the United States, which include the Chairman of the Joint Trust Fund Committee, and, two voting members appointed by and for the Federated States of Micronesia. The Committee has the authority to make decisions, appoint administrators and managers, and significantly influence operations. It also has the primary accountability for fiscal matters.

# ***Trust Fund for the People of the Federated States of Micronesia***

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## **Notes to Financial Statements**

**September 30, 2006 and 2005**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Trust Fund (Continued)**

The Government of the United States may unilaterally withdraw the accumulated market value of its contributions to the Fund, plus any undistributed income under certain circumstances including the Government of the Federated States of Micronesia's gross misuse of the Trust Fund's financial resources. The Fund's operations may be terminated by written agreement of the Original Parties.

#### **Tax Exempt Status**

Pursuant to the terms of the Compact, the Trust Fund is exempt from income tax by the Governments of the United States of America and the Federated States of Micronesia to the extent that income is derived from investment in instruments issued by the Government or other investments as approved by the Committee.

#### **Trust Fund Financial Statements**

The statement of net assets and the statement of changes in net assets are private purpose trust financial statements. They report information on all of the Trust Fund's assets, liabilities, net assets, and activities. Trust Fund activities are supported primarily by contributions by the Original Parties and investment income. The Trust Fund has no business or proprietary type activities that rely on fees and charges for support.

Contributions represent amounts paid by the Original Parties to help meet the operational requirements of the Trust Fund and represent principal.

The financial statements provide information on the net assets and changes in net assets of the Trust. The Trust Fund is designed to contribute to the long-term budgetary self-reliance of the Federated States of Micronesia by establishing a trust fund to provide the Government of the Federated States of Micronesia with an ongoing source of revenue after Fiscal Year 2023; recognizing that it is the mutual intention of the Governments of the United States and the Federated States of Micronesia that the Government of the United States discontinue annual grant assistance beyond fiscal year 2023. The Trust Fund consists of three accounts the "A" Account, the "B" Account and the "C" Account, respectively (collectively, the Accounts). Each account has a specific purpose with respect to the use of contributions and income derived from investments as specified by the Trust Fund Agreement in accordance with the special purpose of the Trust Fund.

#### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The Trust Fund financial statements use the economic resources measurement focus and are prepared using the accrual basis of accounting. Contributions are recorded when due and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Additional contributions are recognized as revenue as soon as all eligibility requirements imposed by the Compact have been met. Investment earnings are recorded as earned, since they are both measurable and available.

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Notes to Financial Statements**

**September 30, 2006 and 2005**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation (Continued)**

The Fund has adopted applicable Government Accounting Standards Board (GASB) pronouncements. With this measurement focus, all assets and all liabilities associated with the operation of the Trust Fund are included in the accompanying statement of net assets. The Trust Fund's net assets are restricted for future use after fiscal year 2023.

#### **Cash Equivalents**

The Committee considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents.

#### **Investments**

The Trust Fund's policy is to report cash equivalents at cost which approximates fair value. All investments are reported at fair value unless a legal contract exists which guarantees a higher value. Investment income consists of interest, dividends and net investment gains (if any) resulting from increases in the fair value of investments.

#### **Restricted Net Assets**

Restricted net assets consist of the "A", "B", and "C" accounts as described below are subject to legal, regulatory, budgetary, or other restrictions in accordance with the Compact.

1. The "A" Account:
  - a. The "A" Account, which established upon the effective date of the Compact, as amended, shall form the Corpus and consist of contributions from the Original Parties, and subsequent contributors. Except as otherwise provided in the Trust Fund Agreement, it also consists of the income from the investments made from contributions (principal), and transfers from the "B" Account and "C" Account in accordance with the Trust Fund Agreement.
  - b. Through September 30, 2022, payment of allowable expenses of the Fund shall be made from the "A" Account. During this period, the amount, if any, of income in each fiscal year which remains after such payment of expenses shall be reinvested into the "A" Account. Except as provided in the Trust Fund Agreement, or upon termination of the Trust Fund, no funds may be removed from the "A" Account.

Total amounts included in the "A" Account as of September 30, 2006 and 2005, were \$85,645,392 and \$64,226,793, respectively.

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Notes to Financial Statements**

**September 30, 2006 and 2005**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Restricted Net Assets (Continued)**

2. The "B" Account:

- a. On October 1, 2022 the "B" Account shall be created.
- b. During fiscal year 2023, all income earned in fiscal year 2023 shall be deposited into the "B" Account for disbursement in fiscal year 2024.
- c. For fiscal year 2024, and thereafter, the "B" Account shall consist of the prior year's income from investment of funds in the "A" Account.

3. The "C" Account:

- a. Shall be created at the same time as the "A" Account and, beginning in fiscal year 2004 through fiscal year 2022, any annual income on the Fund over six percent (6%) shall be deposited in the "C" Account, up to the limit specified in (b) below. Beginning in fiscal year 2023, the "C" Account shall be replenished from the "B" Account in accordance with paragraph 6 below;
- b. Shall contain no more than three times the estimated equivalent of the fiscal year 2023 annual grant assistance, including estimated inflation calculated in accordance with section 217 of the Compact. Any excess above the estimated amount shall return to the "A" Account; and,
- c. May be drawn on, to the extent it contains sufficient funds, to address any shortfall in the "B" Account after fiscal year 2023, if income on the "A" Account falls below the previous year's distribution (not including any amount distributed that year for special needs) adjusted for inflation, to the Government of the Federated States of Micronesia, and for special needs agreed to by the Committee.

Total amounts included in the "C" Accounts as of September 30, 2006 and 2005 were \$818,926 and \$-0-, respectively.

4. After fiscal year 2023, if the income in the "B" Account is less than the previous year's distribution to the Government of the Federated States of Micronesia, and the "C" Account cannot cover the shortfall in the "B" Account, then the principal and reinvested income not available for distribution (corpus) shall not be accessed to compensate for the shortfall.

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Notes to Financial Statements**

**September 30, 2006 and 2005**

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

#### **Restricted Net Assets (Continued)**

5. The Committee may disburse to the Government of the Federated States of Micronesia, from the “B” Account (supplemented from the “C” Account if the “B” Account is insufficient):
  - a. In fiscal year 2024, an amount equal to the annual grant assistance provided by the Government of the United States to the Government of the Federated States of Micronesia in fiscal year 2023, plus an inflation adjustment; and
  - b. Beginning in fiscal year 2025, and thereafter, an amount of funds no more than the amount equal to the United States annual financial assistance to the Federated States of Micronesia in fiscal year 2023 plus a cumulative inflation adjustment thereon, plus any additional amounts for special needs as approved above.
6. Beginning in fiscal year 2023, the Committee shall transfer to the “A” Account any funds in the “B” Account in excess of the amount approved for disbursement in the following fiscal year, in accordance with paragraph 5 above, unless such excess funds are needed to bring the “C” Account to its maximum permitted level.
7. A special account, (“D” Account), may be established to allow contribution by the Federated States of Micronesia for revenues or income from unanticipated sources. This account shall not be mixed with the Fund, but shall have a separate account number. The Federated States of Micronesia shall have access to funds in this account for unanticipated shortfalls or other purposes. Funds in this account are not part of the corpus. There were no contributions to the “D” Account during the periods presented in the accompanying financial statements.

#### **Estimates**

The preparation of financial statements in conformity with general accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

### **Note 2 - Contributions**

The United States shall contribute to the Trust Fund annually for twenty years from the effective date of the Compact, amounts set forth in section 216 of the Compact. Upon termination of the annual financial assistance under section 211 of the Compact, the proceeds of the Trust Fund shall thereafter be used for the purposes described in section 211 of the Compact or as otherwise mutually agreed by the Original Parties.

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Notes to Financial Statements**

**September 30, 2006 and 2005**

### **Note 2 - Contributions (Continued)**

The United States contributions to the Trust Fund were conditioned on the Government of the Federated States of Micronesia contributing at least \$30 million to the Trust Fund, prior to September 30, 2004. Any funds received by the Federated States of Micronesia under section 111 (d) of Public Law 99-239 (January 14, 1986), or successor provisions, would be contributed to the Trust Fund as a Federated States of Micronesia contribution.

On October 1, 2004 the Government of the Federated States of Micronesia contributed approximately \$30.3 million which was followed by contributions by the Government of the United States of America on October 5, 2005 totaling approximately \$32.2 million which consisted of fiscal 2005 and 2004 scheduled contributions of \$16.2 million and \$16.0 million, respectively.

Future scheduled contributions to the Trust Fund by the Government of the United States during the Trust Fund period are as follows:

<b><u>Fiscal Year</u></b>	<b><u>Amount (Millions)</u></b>
2004	\$16.0
2005	16.0
2006	16.0
2007	16.8
2008	17.6
2009	18.4
2010	19.2
2011	20.0
2012	20.8
2013	21.6
2014	22.4
2015	23.2
2016	24.0
2017	24.8
2018	25.6
2019	26.4
2020	27.2
2021	28.0
2022	28.8
2023	29.6

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Notes to Financial Statements**

**September 30, 2006 and 2005**

### **Note 3 - Investments**

During 2006 and 2005, the Trust Fund did not realize any net gains or losses from the sale of investments. The calculation of net realized investment gain or loss is independent of the calculation of the net increase in the fair value of investments. The net increase in the fair value of investments during the fiscal years ended September 30, 2006 and 2005, was \$2,275,877 and \$-0-, respectively. This amount takes into account all changes in fair value (including purchases) that occurred during the year. The unrealized gain on investments held at September 30, 2006 and 2005 was \$2,275,877 and \$-0-, respectively.

<b>Investment Security</b>	<b>Cost</b>	<b>Fair Value (\$000)</b>				<b>Ending Fair Value 9/30/06</b>	<b>Change in Fair Value</b>
		<b>Beginning Fair Value 10/1/05</b>	<b>Purchases</b>	<b>Sales</b>	<b>Subtotal</b>		
Cash equivalents	\$ 789	\$ 0	\$ 789	\$ 0	\$ 789	\$ 789	\$ 0
Domestic Equity							
Common Trust Fund	47,533	0	47,533	0	47,533	49,823	2,290
International							
Equity Common Trust Funds	35,927	0	35,927	0	35,927	35,913	(14)
	<u>\$84,249</u>	<u>\$ 0</u>	<u>\$84,249</u>	<u>\$ 0</u>	<u>\$84,249</u>	<u>\$86,525</u>	<u>\$2,276</u>

The Trust Fund has an investment policy which has been established to reflect the growth objectives and risk tolerance of the Committee. The investment policy also permits a portion of the Trust Fund to engage in currency hedging and make investments in alternative investments. Not more than 5% of the Trust Fund's assets may be invested in any one security without specific consideration and approval by the Committee, except for United States Treasury and Agency Obligations. Investment risk will be limited by appropriate diversification between and within asset classes. The current investment policy includes the following parameters:

<b>Investment Class</b>	<b>% of Fund Strategic</b>	<b>% of Fund Tactical Range</b>
Marketable Equity Securities	50.5	22.5 - 100.0
Marketable Fixed Income Debt Securities	26.0	0.0 - 39.0
Alternative Investments	23.5	0.0 - 33.5
Cash and Equivalents	0.0	0.0 - 5.0

At September 30, 2006, 99% of the Trust Fund was in equity securities, which is in excess of the upper parameter of the strategic investment allocation.

As of September 30, 2006, the Trust Fund held investments in common trust funds managed by the Trust Fund's sub-trustee. A common trust fund is similar to an open-end investment company or mutual fund but participation is limited to those with trust accounts. As of September 30, 2006, the common trust funds were not rated by a nationally recognized statistical rating organization.

# ***Trust Fund for the People of the Federated States of Micronesia***

## **Notes to Financial Statements**

**September 30, 2006 and 2005**

### **Note 3 - Investments (Continued)**

The Trust funds exposure to foreign currency risk derives for its investment in the foreign currency denominated International Equity Common Trust Fund that holds investments in foreign country funds.

The Trust funds exposure to foreign currency risk is as follows:

<b>Investments</b>	<b>Currency</b>	<b>Fair Value (\$000)</b>
International Equity Common Trust Fund	Australian Dollar	\$ 1,817
International Equity Common Trust Fund	British Pound	7,741
International Equity Common Trust Fund	Denmark Krone	272
International Equity Common Trust Fund	European Euro	12,513
International Equity Common Trust Fund	Hong Kong Dollar	574
International Equity Common Trust Fund	Japanese Yen	8,324
International Equity Common Trust Fund	New Zealand Dollar	55
International Equity Common Trust Fund	Norway Krone	257
International Equity Common Trust Fund	Sweden Krona	844
International Equity Common Trust Fund	Singapore Dollar	303
International Equity Common Trust Fund	Switzerland France	2,656
		<u>\$35,356</u>





**Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards**

To the Joint Trust Fund Committee  
Trust Fund for the People of the Federated States of Micronesia

We have audited the accompanying statements of Net Assets of the Trust Fund for the People of the Federated States of Micronesia (a District of Columbia not for profit corporation) as of September 30, 2006, and the related Statements of Changes in Net Assets for the year then ended, and have issued our report thereon dated December 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 the Trust Fund for the People of the Federated States of Micronesia's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting.

Our consideration of the internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, errors or fraud may occur and not be detected by such controls. However, as discussed below, we noted certain deficiencies in internal control that we consider to be significant deficiencies.

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

We consider the following deficiencies to be significant deficiencies in internal control:

The lack of adequate record keeping, specifically a subsidiary ledger which is necessary to track accrued expenses delays the financial reporting process for a number of reasons, including preparation of accrual basis financial statements and calculation of the "C" Account. The delay in financial reporting will cause non compliance with the Compact Subsidiary Agreement for fiscal year ended September 30, 2007 if this is not rectified in a timely manner. The Agreement states that the Trustee is responsible for accounting. In response to this finding, the Joint Trust Fund Committee plans to retain a contract accounting service to ensure that the financial records of the Trust Fund are maintained on the accrual basis of accounting in order to facilitate preparation of financial statements in accordance with the Compact Subsidiary Agreement.

These significant deficiencies were considered in determining the nature, timing, and extent of the audit tests applied in our audit of the fiscal year end 2005 and 2006 financial statements, and this communication does not affect our report on those financial statements dated December 3, 2007. We have not considered internal control since the date of our report.

The following recommendation is not considered to be a significant deficiency:

We also recommend that all resolutions approved by the Joint Trust Fund Committee be documented in the minutes, including the approved time line for adopting the intermediate and final investment allocation policies prepared in consultation with the Trust's investment advisor.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Trust Fund for the People of the Federated States of Micronesia'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 audits, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended solely for the information and use of the Joint Trust Fund Committee, management, and Government of the United States of America and the Government of the Federated States of Micronesia and is not intended to be and should not be used by anyone other than these specified parties.

*Beard Miller Company LLP*

Beard Miller Company LLP  
Paoli, Pennsylvania  
December 3, 2007