

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

Financial Statements

September 30, 2010 and 2009

Trust Fund for the People of the Federated States of Micronesia

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Trust Fund for the People of the Federated States of Micronesia

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2010 and 2009

The following represents 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, 2010 and 2009. 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

| | September 30, | |
|------------------------------|-----------------------|-----------------------|
| | 2010 | 2009 |
| Assets | | |
| Cash and investments | \$ 177,263,672 | \$ 138,245,350 |
| Accrued investment income | 87,172 | 4,834 |
| Prepaid expenses | 22,000 | - |
| Total assets | 177,372,844 | 138,250,184 |
| Liabilities | | |
| Accrued expenses | 171,145 | 174,965 |
| Due to broker | 3,337 | - |
| Total liabilities | 174,482 | 174,965 |
| Restricted net assets | \$ 177,198,362 | \$ 138,075,219 |

Financial Highlights - Net Assets at September 30, 2010

The fair value of the Trust Fund's net assets was \$177.2 million as of September 30, 2010, compared to \$138.1 million at September 30, 2009. The increase is attributable to the Government of the United States of America contribution of \$21.5 million on October 2, 2009 and net investment income of \$17.8 million. At September 30, 2010, the Trust Fund's assets were primarily invested in domestic equity common trust funds, global equity common trust funds, global hedge funds, global private equity funds, domestic real estate funds, and domestic equity and debt securities.

Accrued expenses represent amounts payable for legal expenses, investment expenses, and other professional services incurred during the fiscal year which are unpaid at September 30.

Trust Fund for the People of the Federated States of Micronesia

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2010 and 2009

Financial Highlights - Net Assets at September 30, 2009

The fair value of the Trust Fund's net assets was \$138.1 million as of September 30, 2009, compared to \$117.5 million at September 30, 2008. The increase is attributable to the Government of the United States of America contribution of \$20.9 million on October 6, 2008 reduced by net investment loss of \$0.2 million. At September 30, 2009, the Trust Fund's assets were primarily invested in domestic equity common trust funds, global equity common trust funds, global private equity funds, domestic real estate funds, and domestic common stocks.

Accrued expenses represent amounts payable for legal expenses, investment expenses, and other professional services incurred during the fiscal year which are unpaid at September 30.

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

| | Year ended September 30, | |
|----------------------------------|---------------------------------|----------------|
| | 2010 | 2009 |
| Contributions | \$ 21,518,180 | \$ 20,911,560 |
| Net investment income (loss) | 17,757,642 | (218,069) |
| Total additions | 39,275,822 | 20,693,491 |
| Administrative expenses | 152,679 | 133,960 |
| Change in net assets | 39,123,143 | 20,559,531 |
| Restricted net assets, beginning | 138,075,219 | 117,515,688 |
| Restricted net assets, ending | \$ 177,198,362 | \$ 138,075,219 |

Financial Highlights - Changes in Net Assets for Fiscal Year Ended September 30, 2010

On October 2, 2009, the Government of the United States made a contribution of \$21.5 million. Net investment income calculated as a weighted return on invested assets, net of investment expenses of \$939,224 for fiscal year ended September 30, 2010, is approximately 10.46%.

Investment advisory fees charged by asset managers range from 40 to 150 basis points of average assets under management. The Trust Fund has retained a professional investment advisory firm. The terms of the cancellable agreement provide for compensation of \$125,000 annually, to be billed quarterly and indexed to the U.S. Consumer Product Index. The Trust Fund incurred \$138,989 of fees to the investment advisory firm in fiscal year 2010; 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, 2010. No amounts have been recorded in the accompanying financial statements.

Trust Fund for the People of the Federated States of Micronesia

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2010 and 2009

Financial Highlights - Changes in Net Assets for Fiscal Year Ended September 30, 2009

On October 6, 2008, the Government of the United States made a contribution of \$20.9 million. Net investment loss calculated as a weighted return on invested assets, net of investment expenses of \$1,049,150 for fiscal year ended September 30, 2009, is approximately (0.26)%.

Investment advisory fees charged by asset managers range from 40 to 150 basis points of average assets under management. The Trust Fund has retained a professional investment advisory firm. The terms of the cancellable agreement provide for compensation of \$125,000 annually, to be billed quarterly and indexed to the U.S. Consumer Product Index. The Trust Fund incurred \$150,790 of fees to the investment advisory firm in fiscal year 2009; 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, 2009. No amounts have been recorded in the accompanying financial statements.

Independent Auditors' Report

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

We have audited the accompanying statement 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, 2010 and 2009, and the related statement of changes in net assets for the years then ended. These financial statements are the responsibility of Trust Fund for the People of the Federated States of Micronesia's management. 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 audits 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 assets, liabilities, and net assets of the Trust Fund for the People of the Federated States of Micronesia as of September 30, 2010 and 2009, and the changes in its 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 March 25, 2011, 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, is not a required part of the basic financial statements but is 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.



Malvern, Pennsylvania
March 25, 2011

Trust Fund for the People of the Federated States of Micronesia

Statement of Net Assets
September 30, 2010 and 2009

| | <u>2010</u> | <u>2009</u> |
|--|------------------------------|------------------------------|
| Assets | | |
| Cash equivalents | \$ 358,587 | \$ 5,566,461 |
| Investments, at fair value | <u>176,905,085</u> | <u>132,678,889</u> |
| | 177,263,672 | 138,245,350 |
| Accrued investment income | 87,172 | 4,834 |
| Prepaid expenses | <u>22,000</u> | <u>-</u> |
| Total assets | <u><u>\$ 177,372,844</u></u> | <u><u>\$ 138,250,184</u></u> |
| Liabilities and Restricted Net Assets | | |
| Liabilities | | |
| Accrued expenses | \$ 171,145 | \$ 174,965 |
| Due to broker | <u>3,337</u> | <u>-</u> |
| Total liabilities | <u>174,482</u> | <u>174,965</u> |
| Restricted Net Assets | <u>177,198,362</u> | <u>138,075,219</u> |
| Total liabilities and restricted net assets | <u><u>\$ 177,372,844</u></u> | <u><u>\$ 138,250,184</u></u> |

See notes to financial statements

Trust Fund for the People of the Federated States of Micronesia

Statement of Changes in Net Assets
Years Ended September 30, 2010 and 2009

| | <u>2010</u> | <u>2009</u> |
|--|------------------------------|------------------------------|
| Additions | | |
| Contributions: | | |
| Government of the United States of America | \$ 21,518,180 | \$ 20,911,560 |
| Investment income: | | |
| Interest and dividends | 2,996,061 | 3,711,947 |
| Net increase (decrease) in the fair value of investments | <u>15,700,805</u> | <u>(2,880,866)</u> |
| Total investment earnings | 18,696,866 | 831,081 |
| Less: investment expenses | <u>939,224</u> | <u>1,049,150</u> |
| Net investment income (loss) | <u>17,757,642</u> | <u>(218,069)</u> |
| Total additions | <u>39,275,822</u> | <u>20,693,491</u> |
| Deduction | | |
| Administrative expenses | <u>152,679</u> | <u>133,960</u> |
| Change in net assets | 39,123,143 | 20,559,531 |
| Restricted Net Assets, Beginning | <u>138,075,219</u> | <u>117,515,688</u> |
| Restricted Net Assets, Ending | <u><u>\$ 177,198,362</u></u> | <u><u>\$ 138,075,219</u></u> |

See notes to financial statements

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

1. Summary of Significant Accounting Policies

Overview of the Trust Fund:

Compact

The Compact of Free Association Between the Governments of the United States of America (United States) and the Federated States of Micronesia and the Republic of 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. 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 through fiscal year 2023. After fiscal year 2023, the Trust Fund will provide an annual source of revenue 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 Trust 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 Trust 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, two voting members appointed by and for the Government of 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

Notes to Financial Statements
September 30, 2010 and 2009

1. Summary of Significant Accounting Policies (Continued)

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

Tax Exempt Status

As provided by the Compact, the Trust Fund is exempt from U.S. federal income tax.

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. The Trust Fund's 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 or 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's 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.

The Trust 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 statements of net assets. The Trust Fund's net assets are restricted for future use after fiscal year 2023.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

1. Summary of Significant Accounting Policies (Continued)

Cash Equivalents

The Committee considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents. The Trust Fund's policy is to report cash equivalents at cost, which approximates fair value.

Investments

During January 2010, the Trust Fund began investing in regular and convertible debt securities which are managed by a third party. These securities are reported at their fair values based upon quoted market values. The Trust Fund's investment strategy as it relates to fixed income is to achieve a total return similar to the range of convertible securities comprising the Bank of America Merrill Lynch All US Convertibles Index.

During January 2009, the Trust Fund began investing in small and mid cap stocks which are managed by a third party. These marketable equity securities are reported at their fair values based upon quoted market values. The Trust Fund's long-term investment objective is to achieve a total return similar to the range of stocks comprising the Russell 2500 Index.

As of September 30, 2010 and 2009, the Trust Fund held investments in common trust funds. Common Trust Funds are reported at fair value of the underlying investment securities based upon quoted market values unless a contract guarantees a higher value. A common trust fund is similar to an open-ended investment company or mutual fund, but participation is limited to those with trust accounts. As of September 30, 2010 and 2009, the common trust funds were not rated by a nationally recognized statistical rating organization. Investment income consists of interest, dividends and net investment gains or losses resulting from changes in the fair value of investments.

Hedge fund represents an investment in an investment company, organized for the primary purpose of developing and actively managing a portfolio of non-traditional portfolio managers. Substantially all of the fund's assets are invested in a master fund through a "master-feeder" structure, whereby the fund's fair value is directly related to its investment in the master fund. The fair value of Trust Fund's investment in the hedge fund is determined by the fund manager and is based upon Trust Fund's percentage ownership of the underlying investments.

Private equity funds and real estate fund invest in equities, convertible debt securities, and real estate for which no active markets exist. The fair values of the underlying investments held by each private equity fund are generally determined by management of the equity investee or as determined by the general partner or management of the private equity funds. Real estate fund consists of an investment in an open-ended commingled insurance company separate account whose investments consist primarily of real estate investments either directly owned or through partnership interests, mortgages and other loans. The fair values of the underlying investments generally are determined by management of the insurance company separate account.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

1. Summary of Significant Accounting Policies (Continued)

Portfolio Securities on Loan

The Trust Fund invests in certain common trust funds that participate in a securities lending program (Lending Funds) managed by State Street Bank (Agent). Securities held by the Lending Funds are loaned by State Street Bank, as agent, to certain brokers and other financial institutions (borrowers). The borrowers provide cash, securities, or letters of credit as collateral against loans in an amount at least equal to 100% of the fair value of the loaned securities. The borrowers are required to maintain the collateral at not less than 100% of the fair value of the loaned securities. The Agent indemnifies the Lending Funds for replacement of any loaned securities (or, in certain circumstances, return of equivalent cash value) due to borrower default on a security loan. The Trust Fund bears the risk of loss with respect to the investment of collateral. Collateral is typically invested in high quality short-term fixed income securities that are AAA rated and are substantially similar to those of a registered money market fund.

At September 30, 2010 and 2009, the fair value of the Trust Fund's investment in Lending Funds is \$35,288,574 and \$30,938,767, respectively. The Lending Funds restrict amounts of full or partial redemptions, the Trust Fund may withdraw between 2% to 4% per month (depending on the Lending Fund) of the value of its investment in a particular Lending Fund.

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 Trust 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, 2010 and 2009, were \$156,981,440 and \$125,361,962, respectively.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

1. Summary of Significant Accounting Policies (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 Trust 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.

At September 30, 2010, the "C" Account had not yet been funded. Additions to the "C" Account during the years ended September 30, 2010 and 2009 were \$7,503,665 and \$-0-, respectively. The actual amount that will ultimately be transferred to the "C" Account will be determined by the Joint Trust Fund Committee based on actual cumulative investment performance through the date of the transfer. Nominal amounts included in the "C" Account as of September 30, 2010 and 2009 were \$20,216,922 and \$12,713,257, 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, 2010 and 2009

1. Summary of Significant Accounting Policies (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 commingled with the Trust Fund and must 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 Trust Fund corpus and are not under the control of the Joint Trust Fund Committee. 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 generally 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.

Reclassification of Prior Year Amounts

Certain amounts from the prior year have been reclassified to conform to the current year presentation and did not affect the changes in total net assets or total net assets.

2. Contributions

The Government of 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, 2010 and 2009

2. Contributions (Continued)

The Government of the United States contribution to the Trust Fund was 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 Government of 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 Government of the Federated States of Micronesia contribution.

Contributions to the Trust Fund's "A" Account from inception are as follows:

| <u>Date</u> | <u>Contribution (Millions)</u> | <u>Contributor</u> |
|--|------------------------------------|-----------------------------------|
| October 1, 2004 | \$ 30.3 | Federated States of Micronesia |
| October 5, 2004 | 32.2 | United States |
| October 6, 2005 | 16.4 | United States |
| October 6, 2006 | 17.7 | United States |
| October 9, 2007 | 19.0 | United States |
| October 6, 2008 | 20.9 | United States |
| October 2, 2009 | 21.5 | United States |
| | <u>158.0</u> | |
| Total contributions from inception through fiscal year 2010 | <u>\$ 158.0</u> | |

Past received and future scheduled contributions to the Trust Fund "A" Account by the Government of the United States during the Trust Fund period are as follows:

| <u>Fiscal Year</u> | <u>Contribution (Millions)</u> |
|--------------------|------------------------------------|
| 2004 | \$ 16.0 |
| 2005 | 16.2 |
| 2006 | 16.4 |
| 2007 | 17.7 |
| 2008 | 19.0 |
| 2009 | 20.9 |
| 2010 | 21.5 |
| 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, 2010 and 2009

2. Contributions (Continued)

The amounts of scheduled contributions as shown are subject to an inflation adjustment for each United States fiscal year by the percent that equals two-thirds of the percent change in the United States Gross Domestic Product Implicit Price Deflator, or 5 percent, whichever is less in any one year, using the beginning of fiscal period 2004 as a base.

Contributions to the "D" Account are not reflected in the accompanying financial statements. As described in Note 1, the "D" Account was set up to allow for additional income to the Trust Fund from unanticipated sources. These contributions may not be commingled with assets of the Trust Fund and are required to have a separate account number. The Government of the Federated States of Micronesia has access to funds in this account for unanticipated shortfalls or other purposes. Funds in the "D" Account are not part of the corpus of the Trust Fund for the People of the Federated States of Micronesia.

3. Investments

During 2010 and 2009, the Trust Fund realized net gains from the sale of investments of \$1,709,598 and \$1,110,995, respectively. The calculation of net realized investment gains is independent of the calculation of the net increase (decrease) in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net increase (decrease) in the fair value of investments during the fiscal years ended September 30, 2010 and 2009 was \$15,700,805 and \$(2,880,866), respectively. This amount takes into account all changes in fair value that occurred during the year. The cumulative net unrealized loss on investments held at September 30, 2010 and 2009 was \$5,441,943 and \$19,433,151, respectively.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

3. Investments (Continued)

The cost and fair values of cash equivalents and related activity for the years ended September 30 are as follows:

| Investment Class | Cost 9/30/10 | Fair Value | | | | Ending Fair Value 9/30/10 | Change in Fair Value |
|--|-------------------|------------------------------|------------------|------------------|-------------------|---------------------------|----------------------|
| | | Beginning Fair Value 10/1/09 | Purchases | Sales | Subtotal | | |
| (In Thousands) | | | | | | | |
| 2010 | | | | | | | |
| Cash equivalents | \$ 359 | \$ 5,566 | \$ 32,640 | \$ 37,847 | \$ 359 | \$ 359 | \$ - |
| Domestic debt securities | 8,555 | - | 11,161 | 2,746 | 8,415 | 8,871 | 456 |
| Domestic equity securities | 8,931 | 10,584 | 2,506 | 2,389 | 10,701 | 12,015 | 1,314 |
| Domestic common trust funds-equity | 39,862 | 32,645 | 665 | - | 33,310 | 36,250 | 2,940 |
| Global common trust funds-equity | 57,176 | 45,062 | 4,344 | 837 | 48,569 | 53,591 | 5,022 |
| Global common trust funds-fixed income | 19,841 | 18,017 | 958 | 89 | 18,886 | 20,244 | 1,358 |
| Global common trust funds-emerging market debt | 14,768 | 9,966 | 4,649 | 293 | 14,322 | 16,070 | 1,748 |
| Global hedge fund | 8,500 | - | 8,500 | - | 8,500 | 8,810 | 310 |
| Global private equity funds | 14,409 | 10,652 | 2,570 | 396 | 12,826 | 14,922 | 2,096 |
| Domestic real estate fund | 10,304 | 5,753 | - | 78 | 5,675 | 6,132 | 457 |
| Total | <u>\$ 182,705</u> | <u>\$ 138,245</u> | <u>\$ 67,993</u> | <u>\$ 44,675</u> | <u>\$ 161,563</u> | <u>\$ 177,264</u> | <u>\$ 15,701</u> |

| Investment Class | Cost 9/30/09 | Fair Value | | | | Ending Fair Value 9/30/09 | Change in Fair Value |
|--|-------------------|------------------------------|------------------|------------------|-------------------|---------------------------|----------------------|
| | | Beginning Fair Value 10/1/08 | Purchases | Sales | Subtotal | | |
| (In Thousands) | | | | | | | |
| 2009 | | | | | | | |
| Cash equivalents | \$ 5,566 | \$ 813 | \$ 30,091 | \$ 25,353 | \$ 5,551 | \$ 5,566 | \$ 15 |
| Domestic equity securities | 8,156 | - | 9,748 | 1,798 | 7,950 | 10,584 | 2,634 |
| Domestic common trust funds-equity | 39,197 | 34,857 | 684 | - | 35,541 | 32,645 | (2,896) |
| Global common trust funds-equity | 52,976 | 35,150 | 6,838 | 1,140 | 40,848 | 45,062 | 4,214 |
| Global common trust funds-fixed income | 18,974 | 17,053 | 998 | 61 | 17,990 | 18,017 | 27 |
| Global common trust funds-emerging market debt | 10,118 | 9,504 | 262 | - | 9,766 | 9,966 | 200 |
| Global private equity funds | 12,248 | 10,390 | 2,730 | 85 | 13,035 | 10,652 | (2,383) |
| Domestic real estate fund | 10,443 | 10,061 | 462 | 78 | 10,445 | 5,753 | (4,692) |
| Total | <u>\$ 157,678</u> | <u>\$ 117,828</u> | <u>\$ 51,813</u> | <u>\$ 28,515</u> | <u>\$ 141,126</u> | <u>\$ 138,245</u> | <u>\$ (2,881)</u> |

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

3. Investments (Continued)

The Trust Fund has an investment policy (revised effective September 15, 2010) which has been established to reflect the growth objectives and risk tolerance of the Committee. It is anticipated investment risk will be limited by appropriate diversification between and within asset classes. Asset allocations are targets and will be dictated by current and anticipated market conditions. Tactical ranges anticipate fluctuation and provide flexibility for the investment manager's portfolio to vary within the range without the need for immediate rebalancing. The Trust Fund does not make investments in any one issuer that would represent 5 percent or more of any one issue or total investments.

Investments in marketable debt securities at September 30, 2010 are as follows:

| | Fair Value | | | Range of Interest Yield to Maturity | Average Credit Rating | |
|--|--------------------------|--------------------------------------|---------------------|-------------------------------------|-----------------------|-------------------|
| | Domestic Corporate Bonds | Domestic Corporate Convertible Bonds | Total | | Moody's | Standard & Poor's |
| Due in one year or less | \$ - | \$ 117,300 | \$ 117,300 | (2.29)% to 1.84 % | Not Rated | BBB |
| Due after one year through five years | 361,225 | 3,760,442 | 4,121,667 | (5.63)% to 10.37 % | Ba3/Caa3 | BBB-/CCC+ |
| Due after five years through ten years | 207,188 | - | 207,188 | 6.5% to 7.93 % | B2/Caa1 | B/B- |
| Due after ten years | - | 4,424,534 | 4,424,534 | (1.91)% to 6.65 % | Baa2-Caa1 | BBB/CCC |
| Total | <u>\$ 568,413</u> | <u>\$ 8,302,276</u> | <u>\$ 8,870,689</u> | | | |

The Trust Fund's investment policy permits investments in the following types of marketable and non-marketable fixed income investments: debentures, high yield bonds, convertible bonds, non-convertible corporate debt, synthetic convertible securities, non-convertible preferred stocks and other equity securities with characteristics of debt securities. The Trust Fund's investment policy considers investments in debt securities held by its common trust funds, investment companies, and mutual funds to be investment in debt. The Trust Fund's investment policy limits its investment in corporate debt securities to a maximum of 5% in any single issuer. The Trust Fund's investment policy does not require debt securities to be held to maturity and imposes no restrictions on trading of debt securities. As a means of managing its exposure to losses from rising market interest rates or deterioration of credit quality, the Trust Fund may trade or liquidate its positions in debt securities. Approximately 24% of the domestic corporate convertible bonds were not rated by either Moody's or Standards & Poor's as of September 30, 2010 due to the issuance of ratings by the rating agencies.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

3. Investments (Continued)

The Trust Fund's allocation to investment classes as of September 30 is as follows:

| Investment Class | % of Strategic Target Allocation | % of Fund Tactical Range | % of Allocation at 9/30/10 |
|----------------------------|--|-----------------------------|-------------------------------|
| 2010 | | | |
| Equity: | | | |
| Domestic Small/Mid Cap | 7.0 % | 5.0 - 9.0 % | 12.7 % |
| Domestic Large Cap | 21.0 | 18.0 - 24.0 | 14.4 |
| International | 29.0 | 24.0 - 34.0 | 30.2 |
| Global Private Equity | 7.0 | 2.0 - 12.0 | 8.4 |
| Hedge Funds/Alternative | 5.0 | 0.0 - 10.0 | 5.0 |
| Debt: | | | |
| Fixed Income | 10.0 | 5.0 - 15.0 | 11.5 |
| Convertible Bonds | 5.0 | 0.0 - 10.0 | 5.0 |
| Emerging Markets | 8.5 | 3.5 - 13.5 | 9.1 |
| Real Estate - Private | 7.5 | 2.5 - 12.5 | 3.5 |
| Cash | 0.0 | 0.0 - 3.0 | 0.2 |
| Investment Class | % of Strategic Target Allocation | % of Fund Tactical Range | % of Allocation at 9/30/09 |
| 2009 | | | |
| Equity: | | | |
| Domestic All Cap | 24.0 % | 0.0 - 24.0 % | 12.4 % |
| Domestic Small Cap | 0.0 | 0.0 - 5.0 | 6.9 |
| Domestic Large Cap | 0.0 | 0.0 - 15.0 | 12.0 |
| Non-US - Developed Markets | 18.0 | 15.0 - 18.0 | 15.4 |
| Non-US - Emerging Markets | 8.5 | 7.5 - 8.5 | 3.7 |
| Non-US - Small Cap | 0.0 | 0.0 - 3.0 | 6.0 |
| Private Equity | 16.0 | 12.5 - 16.0 | 7.7 |
| Debt: | | | |
| Fixed Income Aggregate | 17.5 | 0.0 - 17.5 | 13.0 |
| Emerging Markets | 8.5 | 7.5 - 8.5 | 14.7 |
| Real Estate - Private | 7.5 | 7.5 - 19.5 | 4.2 |
| Cash | 0.0 | 0.0 - 4.0 | 4.0 |

The Trust Fund's exposure to foreign currency risk is derived from its investment in common trust funds and private equity funds that hold investments in securities of foreign issuers. The underlying investments expose the Trust Fund to foreign currencies.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

3. Investments (Continued)

The Trust Fund's exposure to foreign currencies at September 30 is as follows:

| Currency | \$USD Fair Value of Investments in Foreign Issuers | | |
|-----------------------------|--|----------------------|-----------|
| | Common Trust Funds | Private Equity Funds | Total |
| 2010 | (In Thousands) | | |
| Argentina Peso | \$ 784 | \$ - | \$ 784 |
| Australian Dollar | 1,757 | - | 1,757 |
| Brazilian Real | 4,860 | - | 4,860 |
| British Pound | 8,406 | - | 8,406 |
| Canadian Dollar | 428 | - | 428 |
| Cayman Island Dollar | 1,832 | - | 1,832 |
| Chilean Peso | 346 | - | 346 |
| Chinese Yuan | 1,482 | - | 1,482 |
| Columbian Peso | 603 | - | 603 |
| Danish Krone | 581 | - | 581 |
| European Euro | 9,736 | 3,064 | 12,800 |
| Hong Kong Dollar | 1,888 | - | 1,888 |
| Hungarian Forint | 497 | - | 497 |
| Indian Rupee | 2,672 | - | 2,672 |
| Indonesian Rupiah | 1,870 | - | 1,870 |
| Israeli New Shekel | 398 | - | 398 |
| Japanese Yen | 7,969 | - | 7,969 |
| Kazakhstani Tenge | 620 | - | 620 |
| Malaysian Ringgit | 443 | - | 443 |
| Mexican Peso | 2,442 | - | 2,442 |
| New Zealand Dollar | 45 | - | 45 |
| Norwegian Krone | 312 | - | 312 |
| Peruvian Nuevo Sol | 339 | - | 339 |
| Philippine Peso | 1,299 | - | 1,299 |
| Polish Zloty | 305 | - | 305 |
| Russian Ruble | 1,643 | - | 1,643 |
| Singapore Dollar | 2,150 | - | 2,150 |
| South African Rand | 1,313 | - | 1,313 |
| South Korean Won | 1,224 | - | 1,224 |
| Sri Lanka Rupee | 168 | - | 168 |
| Swedish Krona | 1,107 | - | 1,107 |
| Swiss Franc | 3,138 | - | 3,138 |
| Taiwan New Dollar | 714 | - | 714 |
| Thai Baht | 1,255 | - | 1,255 |
| Turkish Lira | 1,701 | - | 1,701 |
| Ukraine Hryvnia | 665 | - | 665 |
| United Arab Emirates Dirham | 699 | - | 699 |
| Uruguayan Peso | 477 | - | 477 |
| Venezuelan Bolivar | 791 | - | 791 |
| Other emerging countries | 704 | - | 704 |
| | \$ 69,663 | \$ 3,064 | \$ 72,727 |

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

3. Investments (Continued)

| Currency | \$USD Fair Value of Investments in Foreign Issuers | | |
|-------------------------------------|--|----------------------|--------|
| | Common Trust Funds | Private Equity Funds | Total |
| 2009 | (In Thousands) | | |
| Angola New Kwanza | \$ 41 | \$ - | \$ 41 |
| Argentina Peso | 415 | - | 415 |
| Australian Dollar | 1,778 | - | 1,778 |
| Bermudian Dollar | 324 | - | 324 |
| Bosnia-Herzegovina Convertible Mark | 5 | - | 5 |
| Brazilian Real | 2,750 | - | 2,750 |
| British Pound | 7,694 | - | 7,694 |
| Cambodian Riel | 57 | - | 57 |
| Canadian Dollar | 616 | - | 616 |
| Cayman Island Dollar | 1,218 | - | 1,218 |
| CFA Franc | 12 | - | 12 |
| Chilean Peso | 274 | - | 274 |
| Chinese Yuan | 307 | - | 307 |
| Columbian Peso | 437 | - | 437 |
| Croatian Kuna | 33 | - | 33 |
| Danish Krone | 253 | - | 253 |
| European Euro | 10,532 | 2,073 | 12,605 |
| Georgian Lari | 77 | - | 77 |
| Ghana Cedi | 31 | - | 31 |
| Hong Kong Dollar | 1,524 | - | 1,524 |
| Hungarian Forint | 310 | - | 310 |
| Indian Rupee | 1,363 | - | 1,363 |
| Indonesian Rupiah | 1,097 | - | 1,097 |
| Iraqi Dinar | 145 | - | 145 |
| Israeli New Shekel | 437 | - | 437 |
| Japanese Yen | 7,954 | - | 7,954 |
| Kazakhstani Tenge | 353 | - | 353 |
| Luxembourg Franc | 131 | - | 131 |
| Malaysian Ringgit | 386 | - | 386 |
| Mexican Peso | 1,435 | - | 1,435 |
| Mongolian Tugrik | 23 | - | 23 |
| New Zealand Dollar | 107 | - | 107 |
| Nigerian Naira | 89 | - | 89 |
| North Korean Won | 37 | - | 37 |
| Norwegian Krone | 223 | - | 223 |
| Omani Rial | 4 | - | 4 |
| Pakistani Rupee | 89 | - | 89 |
| Panamanian Balboa | 177 | - | 177 |
| Papua New Guinean Kina | 82 | - | 82 |
| Peruvian Nuevo Sol | 226 | - | 226 |
| Philippine Peso | 1,005 | - | 1,005 |

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2010 and 2009

3. Investments (Continued)

| Currency | \$USD Fair Value of Investments in Foreign Issuers | | |
|-----------------------------|--|----------------------|-----------|
| | Common Trust Funds | Private Equity Funds | Total |
| 2009 (Continued) | (In Thousands) | | |
| Polish Zloty | \$ 57 | \$ - | \$ 57 |
| Russian Ruble | 1,328 | - | 1,328 |
| Singapore Dollar | 1,201 | - | 1,201 |
| South African Rand | 721 | - | 721 |
| South Korean Won | 906 | - | 906 |
| Sri Lanka Rupee | 71 | - | 71 |
| Swedish Krona | 1,112 | - | 1,112 |
| Swiss Franc | 2,986 | - | 2,986 |
| Taiwan New Dollar | 487 | - | 487 |
| Thai Baht | 776 | - | 776 |
| Trinidad and Tobago Dollar | 44 | - | 44 |
| Tunisian Dollar | 13 | - | 13 |
| Turkish Lira | 1,119 | - | 1,119 |
| Ukraine Hryvnia | 209 | - | 209 |
| United Arab Emirates Dirham | 222 | - | 222 |
| Uruguayan Peso | 309 | - | 309 |
| Venezuelan Bolivar | 432 | - | 432 |
| Vietnamese Dong | 10 | - | 10 |
| | \$ 56,054 | \$ 2,073 | \$ 58,127 |

4. Commitments

At September 30, 2010 and 2009, the Trust Fund had capital funding commitments relating to its investments in private equity funds. Capital commitments, capital contributions, and unfunded capital commitments at September 30, 2010 and 2009 were as follows:

| Currency | Capital Commitments | Capital Contributions | Unfunded Capital Commitments |
|----------------------|---------------------|-----------------------|------------------------------|
| 2010 | | | |
| Private equity funds | \$ 25,406,504 | \$ 16,405,043 | \$ 9,001,461 |
| 2009 | | | |
| Private equity funds | \$ 25,771,480 | \$ 13,804,605 | \$ 11,966,875 |

Independent Auditors' 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

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

We have audited the accompanying statement of net assets of Trust Fund for the People of the Federated States of Micronesia (a District of Columbia not for profit corporation herein after referred to as Trust Fund) as of September 30, 2010 and the related statement of changes in net assets for the year then ended, and have issued our report thereon dated March 25, 2011. 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 Trust Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Trust Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Trust Fund's internal control over financial reporting.

A deficiency in internal control 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 material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described below that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We consider the following deficiency to be a significant deficiency in internal control:

Condition:

The Trust Fund is not capable of preparing full disclosure financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP), including Government Accounting Standards (GAS) promulgated by the Government Accounting Standards Board.

Criteria:

The financial statement audit is performed in accordance with generally accepted auditing standards and requires the auditor to issue an opinion on whether the financial statements are presented in accordance with GAAP, including all financial statement disclosures required by GAAP and GAS.

Cause of Condition:

Although the Joint Trust Fund Committee has retained a contract accounting service to maintain certain accounting records and prepare basic accounting statements, the scope of the contract accounting services engagement does not include preparation of the annual full disclosure financial statements in accordance with GAAP.

Currently, the contract accounting services maintains an accrual basis general ledger, prepares accrual basis financial statements, and calculates the annual income allocation to the "C" Account. However, as of the 2010 audit, neither the contract accounting service nor another third party has been engaged a) to summarize the investment activity and track the cost basis of the investments and b) to compile the foreign currency exposure by individual investment for disclosure in the financial statements.

Effect of Condition:

Full disclosure financial statements were not available during the audit process. As a result, financial statement disclosures were prepared by the independent auditor and reviewed and approved by the Joint Trust Fund Committee.

Recommendation:

We recommend that the Joint Trust Fund Committee arrange for the preparation of accrual basis, full disclosure financial statements in accordance with U.S. generally accepted accounting principles (including government accounting principles) prior to the commencement of the 2011 annual audit. Effective implementation of this recommendation will facilitate the audit process and will allow the audit to be completed closer to the fiscal year end of the Trust Fund.

Management's Views and Planned Corrective Action:

The Trust Fund Committee concurs with this recommendation and has agreed to implement corrective action as soon as practicable. The Committee has commenced discussions with its investment custodian, its contract accounting service, and its investment advisor to determine if the parties, either individually or collectively, can provide the information for full disclosure financial statements as of the 2011 audit. The contract accounting service began tracking investment cost basis in the subsidiary ledger effective October 1, 2010.

Evaluation of Management's Comments and Planned Corrective Action:

The independent auditor has reviewed the Joint Trust Fund Committee's corrective action plan and believes it to be a viable course of action. The timely availability of annual full disclosure financial statements prior to the scheduled commencement of the annual audit is critical to the Trust Fund's ability to comply with the reporting provisions of the Compact Subsidiary Agreement, which require the audited financial statements to be included with the Trust Fund's Annual Report. The Annual Report is due six months following the end of the Trust Fund's fiscal year.

This significant deficiency was considered in determining the nature, timing, and extent of the audit tests applied in our audit of the Trust Fund's financial statements as of and for the year ended September 30, 2010, and this communication does not affect our report on those financial statements dated March 25, 2011. We have not considered internal control since the date of our report.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Trust Fund'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 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 Governments of the United States of America and the Federated States of Micronesia and is not intended to be and should not be used by anyone other than these specified parties.

The image shows a handwritten signature in cursive script that reads "ParenteBeard LLC". The signature is written in black ink and is positioned in the lower-left area of the page.

Malvern, Pennsylvania
March 25, 2011