

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

Financial Statements

September 30, 2014 and 2013



Candor. Insight. Results.

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

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September 30, 2014 and 2013

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

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## Management's Discussion and Analysis

Fiscal Years Ended September 30, 2014 and 2013

The following represents the 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, 2014 and 2013. Please read it in conjunction with the Trust Fund's financial statements, which follow this section.

### **Summary of Fiscal Year 2014 Financial Highlights**

- The Trust Fund's total fiduciary net position value increased 17.9% to \$380.9 million in fiscal year (FY) 2014 from \$323.1 million in FY2013. The increase was due to a contribution from the United States government of \$26.1 million and net investment income of \$31.9 million.
- The Trust Fund had a dollar-weighted annual rate of return of 8.72% for FY14 compared to 13.47% for FY13 and 14.78% for FY12. Gains in the last three years have helped to offset negative or weak performance in FY08, FY09 and FY11. On a performance basis, net of fees, the Trust Fund gained 9.0% compared to a benchmark of 10.6% and a Foundations Median of 8.5%.<sup>1</sup>
- Given the positive returns, an allocation of \$9.9 million was made to the "C" account for FY2014 bringing the total of that account to \$73.7 million.<sup>2</sup>
- Investment expense amounted to \$2.8 million in FY2014 compared to \$2.6 million in FY2013. Overall investment expense amounted to 0.75% of restricted fiduciary net position for FY2014, down from 0.81% for FY2013. The investment expense changes are in line with the Investment Policy Statement asset allocation changes and accompanying resolutions.
- Administrative expenses increased by 0.7% to \$154,481 for FY2014 from \$153,346 in FY2013. Overall, administrative expenses continue to be a reduced portion of the total fiduciary net position - 0.04% compared to 0.05% for FY13.

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<sup>1</sup> As of 1/1/14, the Total Trust Benchmark is comprised of 25.5% Russell 3000, 25.5% MSCI ACWIxUS Net Dividend, 19.0% fixed income benchmark, 10% NCREIF NFI ODCE, 9.5% S&P 500+3%, and 10.5% T-Bills+3%. The Foundation Performance Universe Median is a performance median of a Mercer pool of foundations, endowments and trust funds.

<sup>2</sup> The C account contains any annual income on the Fund over 6%. The C account shall contain no more than three times the estimated equivalent of the fiscal year 2023 annual grant assistance, including the estimated inflation adjustment provided in the Amended Compact of Free Association (Section 217). After fiscal year 2023, the C account may be drawn on, to the extent it has sufficient funds, to address any shortfall in the B account if income from the A account falls below the previous year's distribution adjusted for inflation. Transfers were made to the C account in fiscal years 2006, 2007, 2010, 2012, 2013 and 2014, the years with over 6% annual income. The A and C accounts are managed collectively and are only separated for accounting purposes.

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

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2014 and 2013

## The Trust Fund for the People of the Federated States of Micronesia Fiduciary Net Position Summary

	<u>September 30,</u>	
	<u>2014</u>	<u>2013</u>
Assets		
Cash and investments	\$ 381,020,231	\$ 322,913,871
Accrued investment income	-	148,184
Due from broker	-	180,119
	<u>381,020,231</u>	<u>323,242,174</u>
Total assets		
Liabilities		
Accrued expenses	<u>119,220</u>	<u>159,038</u>
	<u>119,220</u>	<u>159,038</u>
Total liabilities		
Restricted fiduciary net position	<u>\$ 380,901,011</u>	<u>\$ 323,083,136</u>

### Financial Highlights – Fiduciary Net Position at September 30, 2014

The fair value of the Trust Fund's fiduciary net position was \$380.9 million as of September 30, 2014, compared to \$323.1 million as of September 30, 2013. The 17.9% increase of fiduciary net position of \$57.8 million is attributable to the annual contribution from the Government of the United States that amounted to \$26.1 million and \$31.9 million in net investment income. The gain in investment earnings is attributable to periodic gains in investment assets mainly by interest and dividends of \$12.3 million, unrealized gains of \$13.9 million and realized gains of \$6.7 million. Given the investment gain, a contribution was made to the Trust Fund's "C" account.

At September 30, 2014, the Trust Fund's assets consisted of managed assets (80.8% of the Trust Fund) and non-discretionary assets (19.2%). The managed assets portfolio consisted of domestic equity funds (28.3% of the Trust Fund), international equity funds (26.6%), fixed income securities (19.8%), a managed hedge fund (4.8%), and a managed private equity fund (1.3%). The fixed income portfolio was adjusted with the non-discretionary fixed income funds (emerging market debt and convertible bond funds) liquidated during fiscal year 2014 and the monies transferred to the managed fixed income funds (a core fixed income fund and an opportunistic fixed income fund). The non-discretionary assets portfolio consisted of real estate (9.8%), a hedge fund (4.3%), and private equity investments (5.0%). The asset category percentages are within the ranges set by the Trust Fund's Investment Policy Statement.

Accrued expenses represent amounts payable for accounting, custodial and investment management services incurred during the fiscal year.

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

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2014 and 2013

## Financial Highlights - Fiduciary Net Position at September 30, 2013

The fair value of the Trust Fund's fiduciary net position was \$323.1 million as of September 30, 2013, compared to \$257.3 million as of September 30, 2012. The 25.5% increase of fiduciary net position of \$65.7 million was mainly attributable to the annual contribution from the Government of the United States that amounted to \$25.0 million and \$40.9 million in net investment income. The gain in investment earnings was attributable to periodic gains in investment assets mainly by unrealized gains of \$31.8 million, realized gains of \$5.2 million and dividends of \$4.4 million. Given the investment gain, a contribution was made to the Trust Fund's "C" account.

At September 30, 2013, the Trust Fund's assets consisted of managed assets (65.4% of the Trust Fund) and non-discretionary assets (34.6%). The managed assets portfolio consisted of domestic equity funds (28.6% of the Trust Fund), international equity funds (28.5%) and fixed income securities (2.6%). A managed hedge fund (5.3%) and managed private equity fund (0.4%) were added to the managed asset component of the portfolio during FY2013 and the fixed income fund was split into a core fixed income fund and an opportunistic fixed income fund. The non-discretionary assets portfolio consisted of emerging market debt and convertible bonds (14.3%), real estate (9.4%), a hedge fund (4.7%), and private equity investments (6%). The asset category percentages are within the ranges set by the Trust Fund's Investment Policy Statement.

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

	Year Ended September 30,	
	2014	2013
Contributions	\$ 26,104,960	\$ 24,993,360
Net investment income	31,867,396	40,897,014
Total additions	57,972,356	65,890,374
Administrative expenses	154,481	153,346
Change in fiduciary net position	57,817,875	65,737,028
Restricted fiduciary net position, beginning	323,083,136	257,346,108
Restricted fiduciary net position, ending	\$ 380,901,011	\$ 323,083,136

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

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Management's Discussion and Analysis

Fiscal Years Ended September 30, 2014 and 2013

## **Financial Highlights - Changes in Fiduciary Net Position for Fiscal Year Ended September 30, 2014**

The Government of the United States, the sole contributor to the Trust Fund in FY2014, made a contribution to the Trust Fund on October 21, 2013 in the amount of \$26.1 million. The contribution consisted of the base amount of \$21.6 million, an \$0.8 million increment, plus a cumulative partial inflation adjustment.

The net investment income of \$31.9 million was due to: interest and dividends of \$12.3 million, unrealized gains of \$13.9 million, realized gains of \$6.7 million, interest of \$0.2 million, and a slight loss due to accretion of \$0.02 million and a currency value change of \$0.01 million during the fiscal year ended September 30, 2014, net of investment expenses of \$1.1 million. The gains were experienced mainly in the managed asset portion of the portfolio from the periodic gains in U.S. equities. The non-discretionary assets also contributed to the positive performance but at lower growth rates.

Investment expenses increased by 10.5% compared to FY2013 to \$1,105,359 from \$1,000,276 according to the annual financial statements. For FY2014, the Trust Fund incurred investment advisory fees of \$402,713, custodian fees of \$98,437 and money manager fees of \$604,209. In addition, as occurred in past fiscal years, part or all of money manager fees were deducted from the asset values and not included in the investment adviser's fee and the investment expense category. All investment expenses, inclusive of custodial, investment advisory and all money manager fees, amounted to \$2,849,842 in FY2014 compared to \$2,613,679 in FY2013. The increase was due to 1) the managed asset fee increase to 63 basis points from 58 basis points agreed to in FY2014, and; 2) the increased value of the Trust Fund on which the fees are based, driven by an additional contribution and market appreciation. The overall investment expense amounted to 0.75% of restricted fiduciary net position for the FY2014, down from 0.81% for FY2013.

Administrative expenses amounted to \$154,481, a slight increase of 0.7% over the FY2013 amount of \$153,346. The increase is attributed to slight increases in the executive administrator's fee, accounting fee, audit fee and miscellaneous expenses. Decreases occurred for accounting and legal fees. The percentage of administrative expenses was reduced to 0.04% of restricted fiduciary net position for FY2014 from 0.05% for FY2013, continuing the downward trend of administrative expenses since FY2009.

The U.S. Departments of the Interior, State, Education and Commerce contributed staff time, equipment usage and incidental expenses during the fiscal year ended September 30, 2014. No amounts for these contributions were recorded in the accompanying financial statements.

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

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Management's Discussion and Analysis

Fiscal Years Ended September 30, 2014 and 2013

## **Financial Highlights - Changes in Fiduciary Net Position for Fiscal Year Ended September 30, 2013**

The Government of the United States, the sole contributor to the Trust Fund in FY2013, made a contribution to the Trust Fund on October 4, 2012 in the amount of \$25.0 million. The contribution consisted of the base amount of \$20.8 million, an \$800,000 increment, plus a cumulative partial inflation adjustment.

The net investment income gain of \$40.9 million was due to: unrealized gains of \$31.8 million, realized gains of \$5.2 million, dividends of \$4.4 million, interest of \$0.5 million, a slight loss due to accretion of \$0.05 million, and a currency value change of \$0.01 during the fiscal year ended September 30, 2013, net of investment expenses of \$1 million. The gains were experienced mainly in the managed asset portion of the portfolio from the periodic gains in U.S. and international equities. The non-discretionary assets also contributed to the positive performance but at lower growth rates. The fixed income category had a slight loss due to the conditions of the U.S. bond market.

Investment expenses increased by 35.5% compared to FY2012 to \$1,000,276 from \$737,949 according to the annual financial statements. For FY2013, the Trust Fund incurred investment advisory fees of \$359,658, custodian fees of \$85,449 and money manager fees of \$555,169. In addition, as occurred in past fiscal years, part or all of money manager fees were deducted from the asset values and not included in the investment adviser's fee and the investment expense category. All investment expenses, inclusive of custodial, investment advisory and all money management fees, amounted to \$2.6 million in FY2013 compared to \$2.1 million in FY2012. The increase was due to 1) the managed asset fee increase to 58 basis points from 52 basis points agreed to in FY12 and fully in effect for FY13; 2) the increased value of the Trust Fund on which the fees are based, driven by an additional contribution and market appreciation; and 3) the addition of three more funds to be managed (hedge fund, private equity fund and opportunistic fixed income fund). The overall investment expense amounted to 0.81% of restricted fiduciary net position for the FY2013, down from 0.85% for FY2012.

Administrative expenses amounted to \$153,346, a decrease of 2.3% over the FY2012 amount of \$156,960. The decrease is attributed to decreases in the executive administrator's fee, accounting fee and miscellaneous fees. Increases occurred for legal and audit fees. The percentage of administrative expenses was reduced to 0.05% of restricted fiduciary net position for FY2013 from 0.06% for FY2012, continuing the downward trend of administrative expenses since FY2009.

The U.S. Departments of the Interior, State and Commerce contributed staff time, equipment usage and incidental expenses during the fiscal year ended September 30, 2013. No amounts for these contributions were recorded in the accompanying financial statements.

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

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Management's Discussion and Analysis

Fiscal Years Ended September 30, 2014 and 2013

## **Future Prospects Beyond September 30, 2014**

As stated in Article 3 of the Trust Fund Agreement: *"The purpose of the Fund is to contribute to the economic advancement and long-term budgetary self-reliance of the Federated States of Micronesia ("FSM") by providing an annual source of revenue, after Fiscal Year 2023, for assistance in the sectors described in Section 211 of the Compact, as amended, or other sectors as mutually agreed by the Original Parties, with priorities in education and health care."*

The investment objective as set forth in the Investment Policy Statement of September, 2010, and amended in April 2014 with an effective date of January 2014 states: *"The broad investment objective will be to maximize investment returns, subject to constraints aimed at containing fluctuations in returns over shorter periods within acceptable limits. Over shorter periods, outperformance will be sought relative to the notional return on a benchmark portfolio designed to reflect the risk profile according to which the assets are invested at the time."*

The Trust Fund's dollar weighted rate of return on investment, after discounting for contributions, fees and expenses, was 8.7% for the fiscal year compared to a rate of 13.5% for FY2013 and 14.8% for FY2012. The FY14 return continues gains since FY2010 to help recover from negative or weak performance in FY2008, FY2009 and FY2011 due to the global economic and financial downturn of those years. In terms of performance measurement, the Trust Fund gained 9.0%, net of fees. This gain compares to a 10.6% gain for the Total Trust Benchmark and 8.5% for the Foundations Median.

Portfolio gains were mainly spurred by the performance of domestic public equity funds. For managed assets, net of fees, domestic equity investments posted a 16.1% gain (benchmark gain 17.8%), international equities a 5.3% gain (benchmark 4.8%), the fixed income category a 2.7% gain (benchmark 4.8%), and the managed hedge fund a 6.8% gain (benchmark 3.0%). The managed private equity fund continues to build-up as capital is called and investments are made over the next several years as this asset strategy is in the early stages of the "J-curve" effect.

The total non-discretionary asset portfolio, net of fees, was up 12.2%. Gains were made in real estate (12.1%; benchmark 12.4%), hedge fund (8.2%; benchmark 3.0%), and private equity (19.7%; benchmark 23.3%). The more mature non-discretionary private equity funds continue producing more consistent distributions given the progress of those investments through the "J-curve" effect as distributions outpace capital infusions to these funds.

The positive performance has also affected the ability to place funds in the C account. For FY2014, an amount of \$9.9 million was allocated to the C account since more than the 6% annual income growth threshold was attained. The C account now amounts to \$73.7 million compared to \$63.8 million in FY2013. The C account now holds about 93.2% of the estimated FY23 sector grant amount to be provided to the FSM through the Amended Compact of Free Association.

Since inception, the Trust Fund's average annual net rate of return on investment is 5.3%, net of fees, an improvement over the 4.9% rate at the end of FY2013. The return rate is below the Total Trust Benchmark of 5.9% and the Foundations Median of 6.5%.

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

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### Management's Discussion and Analysis

Fiscal Years Ended September 30, 2014 and 2013

An analysis by the Investment Adviser estimates that, assuming a 6% payout from the Trust Fund, if the Trust Fund manages an average 5% return annually from FY2014 to FY2023, the distribution from the estimated assets would probably provide FY2024 revenue equivalent to about 72.7% of the Amended Compact's Section 211 FY2023 sector grant level with the partial inflation adjustment. There would also be a build-up of the C account but not to the maximum level permitted under the Trust Fund Agreement. As of FY2014, the average annual rate of return is 5.3%, net of fees.

If the Trust Fund were to achieve an average 8% return annually, the Trust Fund would probably provide in FY2024 an amount equivalent to 89.9% of FY2023 sector grant assistance with the partial inflation adjustment. There would also be a build-up of the C account but not to the maximum level permitted under the Trust Fund Agreement. The Trust Fund has achieved 8% or more return in five fiscal years: 2007, 2010, 2012, 2013 and 2014.

If the Trust Fund were to achieve an average 10% return annually, the Fund would probably provide FY2024 revenue equivalent to about 103.6% of partially inflation adjusted FY2023 sector grant assistance. However, it is unlikely that post 2023 distributions would provide for future inflation adjustments beyond the FY2023 amount. The C account would achieve the maximum level permitted under the Trust Fund Agreement prior to FY2023. However, there is a low probability to achieve such growth annually.

Any growth projections are estimates, subject to fluctuation based on actual market performance. This also extends to future fiscal planning. As intended in the Amended Compact, Trust Fund payments will be a post-2023 "source of revenue" to supplement other financial resources of the FSM government.

## **Independent Auditors' Report**

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Trust Fund for the People of the Federated States of Micronesia (a District of Columbia not for profit corporation), which comprise the statement of fiduciary net position as of September 30, 2014 and 2013, and the related statement of changes in fiduciary net position for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Trust Fund for the People of the Federated States of Micronesia as of September 30, 2014 and 2013, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 7, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2015, on our consideration of 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* in considering Trust Fund for the People of the Federated States of Micronesia's internal control over financial reporting and compliance.

*Baker Tilly Viechow Krause, LLP*

Philadelphia, Pennsylvania  
March 25, 2015

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

## Statement of Fiduciary Net Position

September 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
<b>Assets</b>		
Cash equivalents	\$ 143,046	\$ 1,149,362
Investments, at fair value	<u>380,877,185</u>	<u>321,764,509</u>
	381,020,231	322,913,871
Accrued investment income	-	148,184
Due from broker	<u>-</u>	<u>180,119</u>
Total assets	<u>\$ 381,020,231</u>	<u>\$ 323,242,174</u>
<b>Liabilities and Restricted Fiduciary Net Position</b>		
<b>Liabilities</b>		
Accrued expenses	<u>\$ 119,220</u>	<u>\$ 159,038</u>
Total liabilities	119,220	159,038
<b>Restricted Fiduciary Net Position</b>	<u>380,901,011</u>	<u>323,083,136</u>
Total liabilities and restricted fiduciary net position	<u>\$ 381,020,231</u>	<u>\$ 323,242,174</u>

See notes to financial statements

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

### Statement of Changes in Fiduciary Net Position Years Ended September 2014 and 2013

	<u>2014</u>	<u>2013</u>
<b>Additions</b>		
Contributions:		
Government of the United States of America	\$ 26,104,960	\$ 24,993,360
Investment income:		
Interest and dividends	12,348,471	4,886,086
Net increase in the fair value of investments	<u>20,624,284</u>	<u>37,011,204</u>
Gross investment income	32,972,755	41,897,290
Less: investment expenses	<u>1,105,359</u>	<u>1,000,276</u>
Net investment income	<u>31,867,396</u>	<u>40,897,014</u>
Total additions	<u>57,972,356</u>	<u>65,890,374</u>
<b>Deduction</b>		
Administrative expenses	<u>154,481</u>	<u>153,346</u>
Change in fiduciary net position	57,817,875	65,737,028
<b>Restricted Fiduciary Net Position, Beginning</b>	<u>323,083,136</u>	<u>257,346,108</u>
<b>Restricted Fiduciary Net Position, Ending</b>	<u><u>\$ 380,901,011</u></u>	<u><u>\$ 323,083,136</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, 2014 and 2013

## 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 (“FSM”) 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 FSM 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

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 FSM 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 FSM by providing an annual source of revenue, after fiscal year 2023, for assistance in education, health care, the environment, public sector capacity building, private sector development, and public infrastructure described in Section 211 of the Compact, as amended, or other sectors as mutually agreed by the FSM and United States Governments, 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, as amended. “Subsequent Contributors” are any government, international organization, financial institution, or other entity or person who grants, not lends, funds into the Trust Fund, not including the Original Parties. Subsequent Contributors may contribute to the Trust Fund if first approved by all Joint Trust Fund Committee (“Committee”) voting members. 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 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 primary accountability for fiscal matters. 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.

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

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Notes to Financial Statements  
September 30, 2014 and 2013

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 FSMs' 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 fiduciary net position and the statement of changes in fiduciary net position are private purpose trust fund financial statements. They report information on all of the Trust Fund's assets, liabilities, fiduciary net position, 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 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 fiduciary net position. The Trust Fund's fiduciary net position is restricted for future use after fiscal year 2023.

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

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Notes to Financial Statements  
September 30, 2014 and 2013

## **Credit Risk, Custodial Credit Risk, Concentration of Credit Risk and Interest Rate Risk**

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, the Trust Fund has assessed the credit risk, concentration of credit risk, and the interest rate risk applicable to its cash and cash equivalents, and investments. The Trust Fund's policy is to report cash equivalents at cost which approximates fair value. Cash equivalents consist of money market investments in the custodian, State Street Bank and Trust Company's SSgA Money Market Fund. This portfolio invests in short term, highly liquid certificates of deposit and notes issued by international banks and finance companies, and repurchase agreements with domestic banks collateralized by debt securities issued or guaranteed by the U.S. government or its agencies. Investments in money market funds are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the funds seek to preserve the value of the investment at \$1.00 per share, it is possible to lose money investing in this type of fund. Custodial credit risk for cash and cash equivalents is the risk that in the event of a bank failure, the Trust Fund's deposits may not be returned to it. The Trust Fund does not have a deposit policy for custodial credit risk.

The Trust Fund does not have any concentrations of credit risk. See Note 3 for a discussion of credit risk and interest rate risk.

## **Investments**

Investments are reported at fair value unless a legal contract exists which guarantees a higher value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Open-ended mutual funds are valued at net asset value, generally based on quoted market values of the underlying marketable securities. The fair value of private equities and investments in hedge funds are based on management's valuation of estimates and assumptions from information and representations provided by the respective general partners, in the absence of readily ascertainable market values. Real estate assets are reported at fair value utilizing an income approach to valuation. Investment income consists of interest, dividends and net investment gains or losses resulting from changes in the fair value of investments. Accrued expenses may include amounts due to brokers for purchases of securities as of the fiscal year end which have not settled, and for which payment has not yet been transferred from the broker.

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

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Notes to Financial Statements  
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The investment policy adopted by the Trust Fund Committee on September 15, 2010 and amended through December 17, 2013 requires the Trust Fund to allocate its managed investment portfolios among domestic and foreign equity and fixed income securities. All or a portion of the Trust Fund may be invested in exchange traded funds (ETFs), mutual funds, real estate investment trusts (REITs), separate accounts and common trust funds (commingled vehicles), hedge funds, private equity funds, and other pooled investment vehicles (pooled vehicles). A common trust fund is similar to an open-ended investment company or mutual fund, but participation is limited to investors with trust accounts. Commingled and pooled vehicles that invest exclusively in marketable fixed income securities are considered to be fixed income securities for the purpose of compliance with the Trust Fund's investment policy. The fair values of ETFs, mutual funds, and common trust funds are generally determined by the fair value of the underlying marketable equity and debt securities owned, which are principally common stocks and bonds, respectively. Publicly traded ETFs, mutual funds, and similar vehicles may trade at prices above or below the fair values of the underlying investments held; therefore the fair value of such investments may differ from the sum of the fair values of the underlying investments owned. The core fixed income portfolios may be invested in debt securities issued by the U.S. government and government agencies, foreign governments, domestic and international corporate securities, including asset-backed and mortgage-backed obligations. The fixed income portfolio may invest in convertible and high yield debt securities; however the average quality of the fixed income portfolio must be rated "investment grade" by at least one nationally recognized rating agency at the time of purchase. The Trust Fund's fixed income investment objective is for each portfolio to achieve total return similar to a relevant index, such as Barclays Capital Aggregate Index and the Bank of America Merrill Lynch Global High Yield Index.

The Trust Fund's equity investment objective is for its various portfolios to achieve total returns similar to their benchmark equity indices. Benchmark indices include the Russell 3000, the S&P 500 and the MSCI EAFE.

Private equity funds are a form of pooled investment vehicle, typically limited partnerships controlled by a private equity firm that acts as general partner. The general partner seeks to obtain specific dollar commitments from qualified institutional and accredited investors to invest capital in the fund as limited partners. The passive limited partners fund pro rata portions of their commitments when the general partner has identified an appropriate opportunity, which may be venture capital in the form of equity securities, convertible debt securities, or real estate for which no active markets exist. Venture capital is often used to finance new products and technologies, expand working capital, make acquisitions, or finance leveraged buyouts. A typical private equity fund could make between 15 and 25 separate investments over a ten-year life, with no single investment exceeding 10% of the total capital commitment. 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 manager of the private equity fund and is based upon the Trust Fund's percentage ownership of the underlying investments. Investments in private equity funds generally tend to be illiquid for significant periods of time.

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

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Notes to Financial Statements  
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Hedge funds are a form of pooled investment vehicle, generally a limited partnership or a foreign (off-shore) investment corporation, that seeks to maximize absolute returns whose offering memorandum allows for the fund to take both long and short positions, use leverage and derivatives, and invest in many markets. Hedge funds often take large risks using a broad range of speculative strategies, including investing in unconventional and illiquid investments. The fair value of the Trust Fund's investment in a hedge fund is determined by the hedge fund manager and is based upon the Trust Fund's percentage ownership of the underlying investments.

Commingled separate accounts invested in real estate and related assets are carried at fair value of the underlying investments. The fair value of separate account investments in real property real estate partnerships are generally determined based on independent appraisals obtained no less frequently than annually. The fair value of separate account investments in real estate partnerships are generally determined based upon the equity method of accounting, and the fair value of underlying investments in real estate loans and mortgages are generally determined through the use of cash flow forecasting or other models by management of the insurance company that manages the separate account.

Derivatives, options and future contracts are permitted investments for the purpose of reducing risk and efficient portfolio management. Derivatives, options and futures may not be used for speculative purposes.

## **Restricted Fiduciary Net Position**

Restricted fiduciary net position consists of the "A", "B", and "C" Accounts as described below and are subject to legal, regulatory, budgetary, or other restrictions in accordance with the Compact.

1. The "A" Account:
  - a. The "A" Account, which was 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.

The balance of the "A" Account as of September 30, 2014 and 2013 was \$307,228,648 and \$259,306,473, respectively.

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

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Notes to Financial Statements  
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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 FSM and for special needs agreed to by the Committee.

The "C" Account is maintained as a memorandum account within the Trust Fund, and is not separately invested.

Additions to the "C" Account during the years ended September 30, 2014 and 2013 were \$9,895,700 and \$22,592,935, respectively. The balance of the "C" Account as of September 30, 2014 and 2013 was \$73,672,363 and \$63,776,663.
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 FSM, 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.
5. The Committee may disburse to the Government of the FSM 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 FSM in fiscal year 2023, plus an inflation adjustment; and

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

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Notes to Financial Statements  
September 30, 2014 and 2013

- 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 FSM 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 FSM 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 FSM 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.

## **Recently Adopted Accounting Pronouncements**

In March 2012, GASB issued Statement No. 65, Items Previously Reported as Assets and Liabilities, effective for periods beginning after December 15, 2012. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

In March 2012, GASB issued Statement No. 66, Technical Corrections - 2012, an amendment of GASB Statements No. 10 and No. 62, effective for periods beginning after December 15, 2012. The objective of this Statement is to improve accounting and financial reporting by state and local governmental entities by resolving conflicting guidance that resulted from the issuance of two pronouncements: Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, and No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.

The implementation of GASB No. 65 and GASB No. 66 did not have a material effect on the financial statements of the Trust Fund.

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

Notes to Financial Statements  
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## Upcoming Accounting Pronouncements

In February, 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*, effective for periods beginning after June 15, 2015. This Statement addresses accounting and financial reporting issues related to fair value measurements by defining fair value and providing guidance for determining a fair value measurement for financial reporting purposes. Guidance is also provided for applying fair value to certain investments and disclosures related to all fair value measurements.

The Trust Fund is currently evaluating the effects the above upcoming accounting pronouncement might have on its financial statements.

## 2. Contributions

The Government of the United States will 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.

The Government of the United States' contribution to the Trust Fund was conditioned on the Government of the FSM contributing at least \$30 million to the Trust Fund prior to September 30, 2004. Any funds received by the Government of the FSM 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 FSM 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	FSM
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
October 14, 2010	22.4	United States
October 14, 2011	23.6	United States
October 4, 2012	25.0	United States
October 21, 2013	26.1	United States
Total contributions from inception through fiscal year 2014	<u>\$ 255.1</u>	

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

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Notes to Financial Statements  
September 30, 2014 and 2013

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	22.4
2012	24.0
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

The amounts of scheduled contributions as shown above 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. As of the end of FY2014, the FSM government has not established a "D" Account.

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

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Notes to Financial Statements  
September 30, 2014 and 2013

## **3. Investments**

During 2014 and 2013, the Trust Fund realized net gains from the sale of investments of \$6,728,971 and \$5,252,538, respectively. The calculation of net realized investment gains is independent of the calculation of the net increase 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 in the fair value of investments during the fiscal years ended September 30, 2014 and 2013 was \$20,624,284 and \$37,011,204, respectively. These amounts take into account all changes in fair value of invested assets (including purchases and sales) that occurred during the years ended September 30, 2014 and 2013, including approximately \$8,300 and \$4,100, respectively, of foreign currency transaction losses. The cumulative net unrealized gain on investments held at September 30, 2014 and 2013 was \$63,402,497 and \$49,497,769, respectively.

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

Notes to Financial Statements  
September 30, 2014 and 2013

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

Investment Class	Cost 9/30/14	Fair Value				Ending Fair Value 9/30/14	Change in Fair Value
		Beginning Fair Value 10/1/13	Purchases	Sales	Subtotal		
(In Thousands)							
<b>2014</b>							
<b>Equity:</b>							
Common trust funds and mutual funds - domestic equity	\$ 75,840	\$ 92,133	\$ 22,288	\$ 18,143	\$ 96,278	\$ 107,611	\$ 11,333
Mutual funds - international equity	91,485	91,753	18,727	7,610	102,870	101,405	(1,465)
Private equity funds - global	14,067	21,571	4,524	5,259	20,836	24,260	3,424
<b>Hedge Funds:</b>							
Mutual funds (Cayman) - global fund of funds	28,330	32,390	-	-	32,390	34,865	2,475
<b>Fixed Income:</b>							
Debentures and Convertible bonds - domestic	-	18,615	4,278	23,695	(802)	-	802
Mutual fund - domestic debt	75,414	8,436	67,088	328	75,196	75,402	206
Mutual funds (U.S. & Cayman) - emerging market debt	-	26,612	775	28,108	(721)	-	721
<b>Private Real Estate:</b>							
Commingled separate account - domestic real estate	\$ 32,339	\$ 30,255	\$ 4,267	\$ 316	\$ 34,206	\$ 37,334	\$ 3,128
<b>Cash:</b>							
Cash equivalents	143	1,149	92,233	93,239	143	143	-
<b>Total</b>	<b>\$ 317,618</b>	<b>\$ 322,914</b>	<b>\$ 214,180</b>	<b>\$ 176,698</b>	<b>\$ 360,396</b>	<b>\$ 381,020</b>	<b>\$ 20,624</b>

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

Notes to Financial Statements  
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Investment Class	Cost 9/30/13	Fair Value				Ending Fair Value 9/30/13	Change in Fair Value
		Beginning Fair Value 10/1/12	Purchases	Sales	Subtotal		
(In Thousands)							
<b>2013</b>							
<b>Equity:</b>							
Common trust funds and mutual funds - domestic equity	\$ 66,107	\$ 76,965	\$ 12,097	\$ 12,479	\$ 76,583	\$ 92,133	\$ 15,550
Mutual funds - international equity	79,426	76,936	5,445	5,307	77,074	91,753	14,679
Private equity funds - global	14,427	19,673	2,124	2,942	18,855	21,571	2,716
<b>Hedge Funds:</b>							
Mutual funds (Cayman) - global fund of funds	28,330	9,524	19,830	-	29,354	32,390	3,036
<b>Fixed Income:</b>							
Debentures and Convertible bonds - domestic	17,276	10,044	17,435	10,300	17,179	18,615	1,436
Mutual fund - domestic debt	8,663	26,152	8,834	26,147	8,839	8,436	(403)
Mutual funds (U.S. & Cayman) - emerging market debt	29,651	18,654	22,303	12,103	28,854	26,612	(2,242)
<b>Private Real Estate:</b>							
Commingled separate account - domestic real estate	\$ 28,387	\$ 18,688	\$ 28,804	\$ 19,474	\$ 28,018	\$ 30,255	\$ 2,237
<b>Cash:</b>							
Cash equivalents	1,149	979	58,196	58,028	1,147	1,149	2
Total	<u>\$ 273,416</u>	<u>\$ 257,615</u>	<u>\$ 175,068</u>	<u>\$ 146,780</u>	<u>\$ 285,903</u>	<u>\$ 322,914</u>	<u>\$ 37,011</u>

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

Notes to Financial Statements  
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The Trust Fund has an investment policy which has been established to reflect the growth objectives and risk tolerance of the Committee. The Trust Fund's investment policy was revised effective December 2013 per resolution FSM 2014-1 *Fixed Income Asset Category Adjustment*. Asset allocations are targets and will be dictated by current and anticipated market conditions, and may be amended by the Trust Fund Committee from time to time. 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's allocation by investment classes as of September 30 is as follows:

Investment Class	2014		% of Fund Tactical Range	% of Allocation at 9/30/14
	% of Strategic Target Allocation			
<b>Managed Assets</b>				
Domestic Equity:	25.5	%	20.5 - 30.5 %	28.3 %
U.S. Large Cap	18.0			20.5
U.S. Small/Medium Cap	7.5			7.8
Non-U.S. Equity	25.5		20.5 - 30.5	26.6
Fixed Income:	19.0		14.0 - 24.0	19.8
Cored Fixed Income	2.5			2.7
Opportunistic Fixed Income	16.5			17.1
Private Market	0.0		0.0 - 10.0	1.3
Hedge Funds	5.5		3.0 - 8.0	4.8
<b>Non-Discretionary Assets</b>				
Private Market	9.5		0.0 - 10.0	5.1
Private Real Estate	10.0		5.0 - 15.0	9.8
Hedge Fund	5.0		2.5 - 7.5	4.3
Cash and Cash Equivalents	0.0		0.0 - 3.0	0.0
	<u>100.0</u>	%		<u>100.0</u> %

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

Notes to Financial Statements  
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Investment Class	2013		% of Allocation at 9/30/13
	% of Strategic Target Allocation	% of Fund Tactical Range	
<b>Managed Assets</b>			
Domestic Equity:	25.5	%	28.5
U.S. Large Cap	18.0		20.8
U.S. Small/Medium Cap	7.5		7.7
Non-U.S. Equity	25.5	20.5 - 30.5	28.4
Fixed Income	2.5	0.0 - 5.0	2.6
Private Market	0.0	0.0 - 10.0	0.4
Hedge Funds	5.5	3.0 - 8.0	5.3
<b>Non-Discretionary Assets</b>			
Emerging Market Debt	10.0	5.0 - 15.0	8.2
Convertible Bonds	6.5	4.0 - 9.0	5.8
Private Market	9.5	0.0 - 10.0	6.3
Private Real Estate	10.0	5.0 - 15.0	9.4
Hedge Fund	5.0	2.5 - 7.5	4.7
Cash and Cash Equivalents	0.0	0.0 - 3.0	0.4
	<u>100.0</u>	%	<u>100.0</u> %

As of September 30, 2014, the Trust Fund's fixed income allocation consists of a Mercer Investment Management Opportunistic Fixed Income mutual fund ("MIM OFI") and a Mercer Investment Management Core Fixed Income Fund ("MIM CFI"); the performance of these funds is expected to closely replicate the performance of 50% of the JP Morgan Government Bond Index Emerging Market Global Diversified Index / 50% Bank of America/Merrill Lynch Global High Yield and the Barclays Capital U.S. Aggregate Bond Index, respectively. The bonds held by MIM CFI vary in credit quality with an average overall rating of "Aa2" as rated by Moody's as of September 30, 2014. High yield debt receiving a credit rating below "A" comprises approximately 22.5% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2014. At September 30, 2014, the weighted average maturity of the bonds comprising MIM CFI is 7.62 years. The bonds held by MIM OFI vary in credit quality with an average overall rating of "BB" as rated by Moody's as of September 30, 2014. High yield debt receiving a credit rating below "A" comprises approximately 83.2% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2014. At September 30, 2014, the weighted average maturity of the bonds comprising MIM OFI is 3.39 years.

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

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Notes to Financial Statements  
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As of September 30, 2013, the Trust Fund's fixed income allocation consists of a Mercer Investment Management Opportunistic Fixed Income mutual fund ("MIM OFI"), a Mercer Investment Management Core Fixed Income Fund ("MIM CFI") and an Ashmore Emerging Markets Debt Fund, a Cayman Islands exempted company mutual fund (AEMDF); the performance of these funds is expected to closely replicate the performance of 50% of the JP Morgan Government Bond Index Emerging Market Global Diversified Index / 50% Bank of America/Merrill Lynch Global High Yield, the Barclays Capital U.S. Aggregate Bond Index, and the JP Morgan Emerging Market Bond Index, respectively. The bonds held by MIM OFI vary in credit quality with an average overall rating of "BB" as rated by Moody's as of September 30, 2013. High yield debt receiving a credit rating below "A" comprises approximately 87.5% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2013. At September 30, 2013, the weighted average maturity of the bonds comprising MIM OFI is 6.89 years. The bonds held by MIM CFI vary in credit quality with an average overall rating of "Aa2" as rated by Moody's as of September 30, 2013. High yield debt receiving a credit rating below "A" comprises approximately 22.9% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2013. At September 30, 2013, the weighted average maturity of the bonds comprising MIM CFI is 7.00 years. The bonds held by AEMDF vary in credit quality with an average overall rating of "Ba1/BB+" as rated by Moody's as of September 30, 2013. High yield debt receiving a credit rating below "A" comprises approximately 84.8% of the AEMDF fixed income portfolio as rated by Moody's at September 30, 2013. At September 30, 2013, the weighted average maturity of the bonds comprising AEMDF is 9.80 years.

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 common trust funds, investment companies, ETFs, separate accounts, and mutual funds to be fixed income investments. 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 fixed income investments.

As a result of Resolution FSM 2014-1, the Trust Fund Committee resolved to liquidate holdings in Shenkman Capital Management (a convertible bond fund) and Ashmore Investment Management (an emerging market debt fund), and transferred the resulting funds to the Mercer Core Fixed Income Fund and the Mercer Opportunistic Fixed Income Fund.

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

Notes to Financial Statements  
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Direct investments in bonds at September 30, 2013 are as follows:

	2013					
	Fair Value			Average Credit Rating		
	Domestic Corporate Bonds	Domestic Corporate Convertible Bonds	Total	Range of Interest Yield to Maturity	Moody's	Standard & Poor's
Due in one year or less	\$ -	\$ 2,688,440	\$ 2,688,440	(40.16)% to 1.94 %	Baa2/Caa1	A/CCC
Due after one year through five years	289,100	7,263,164	7,552,264	(51.95)% to 7.62 %	Aa3/Caa1	A+/CCC
Due after five years through ten years	1,052,244	1,308,032	2,360,276	(2.44)% to 7.57 %	Ba2/Caa1	BB-/B-
Due after ten years	-	6,014,334	6,014,334	(0.07)% to 2.84 %	A3/B2	A-/B
Total	<u>\$ 1,341,344</u>	<u>\$ 17,273,970</u>	<u>\$ 18,615,314</u>			

The Trust Fund's investment in hedge funds includes ownership of the Mercer Hedge Fund Series A ("Mercer Hedge Fund") and the Blackstone Partners Offshore Fund Ltd. Mercer Hedge Funds Investors SPC, who incorporated the Mercer Hedge Fund, and the Blackstone Partners Offshore Fund Ltd. are registered under the Mutual Funds Law of the Cayman Islands. The fair value of the Trust Fund's position in the hedge fund pools are equivalent to the value of the pool shares.

The Trust Fund also holds investments in private equity funds – global and commingled separate account – domestic real estate, which have been legally formed as partnerships under Delaware law. Such investments include the Trust Fund's interest in HarbourVest Partners VIII – Buyout Fund, L.P., HarbourVest Partners VIII – Mezzanine and Distressed Debt Fund L.P., HarbourVest Partners VIII – Venture Fund L.P., HarbourVest International Private Equity Partners V – Partnership Fund L.P., Portfolio Advisors Private Equity Fund IV, L.P., and PRISA LP. The fair value of the Trust Fund's position in the private equity funds and commingled separate account are equivalent to the value of the pool shares.

The Trust Fund's exposure to foreign currency risk is derived from its investments in commingled and pooled investment vehicles that hold investments in securities of foreign issuers. The underlying investments expose the Trust Fund to foreign currencies.

Foreign currency exposure data is not available for the Trust Fund's investment in the Hedge Funds and its investments in Global Private Equity Funds, which comprise 15.5% and 16.7% of invested assets at September 30, 2014 and 2013, respectively.

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

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

2014	
Currency	\$USD Fair Value of Investments in Foreign Issuers Total (In Thousands)
Australian Dollar	\$ 2,163
Bermudian Dollar	1,208
Brazilian Real	7,668
British Pound	13,658
Canadian Dollar	720
Cayman Island Dollar	1,432
Chilean Peso	376
Chinese Yuan	2,508
Columbian Peso	1,692
Czech Koruna	133
Danish Krone	2,498
European Euro	26,155
Hong Kong Dollar	1,751
Hungarian Forint	1,484
Indian Rupee	3,302
Indonesian Rupiah	3,789
Japanese Yen	16,032
Malaysian Ringgit	4,612
Mexican Peso	2,870
New Romanian Leu	723
New Zealand Dollar	346
Nigerian Naira	28
Norwegian Krone	1,347
Panamanian Balboa	26
Peruvian Nuevo Sol	357
Philippine Peso	66
Polish Zloty	1,888
Russian Ruble	3,209
Singapore Dollar	1,589
South African Rand	5,155
South Korean Won	2,842
Swedish Krona	1,768
Swiss Franc	6,099
Taiwan New Dollar	2,835
Thai Baht	1,970
Turkish Lira	4,293
Total	<u>\$ 128,592</u>

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

Notes to Financial Statements  
September 30, 2014 and 2013

2013	
Currency	\$USD Fair Value of Investments in Foreign Issuers Total (In Thousands)
Australian Dollar	\$ 2,294
Bermudian Dollar	897
Brazilian Real	2,045
British Pound	14,038
Canadian Dollar	521
Cayman Island Dollar	1,007
Chilean Peso	346
Chinese Yuan	1,809
Columbian Peso	126
Czech Koruna	107
Danish Krone	902
European Euro	20,543
Hong Kong Dollar	1,879
Hungarian Forint	38
Indian Rupee	1,963
Indonesian Rupiah	715
Israeli New Shekel	212
Japanese Yen	17,729
Malaysian Ringgit	845
Mexican Peso	1,994
New Romanian Leu	1
New Zealand Dollar	257
Norwegian Krone	1,310
Peruvian Nuevo Sol	27
Philippine Peso	121
Polish Zloty	276
Russian Ruble	910
Singapore Dollar	432
South African Rand	1,117
South Korean Won	2,533
Swedish Krona	2,939
Swiss Franc	5,745
Taiwan New Dollar	1,679
Thai Baht	835
Turkish Lira	254
Total	<u>\$ 88,446</u>

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

Notes to Financial Statements  
September 30, 2014 and 2013

## 4. Commitments

At September 30, 2014 and 2013, the Trust Fund had capital funding commitments relating to its investments in hedge fund and private equity funds. Capital commitments, capital contributions, and unfunded capital commitments at September 30, 2014 and 2013 were as follows:

2014			
Currency	Capital Commitments	Capital Contributions	Unfunded Capital Commitments
Hedge fund and Private equity funds	\$ 66,044,514	\$ 27,622,223	\$ 38,422,291

**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, 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, the financial statements of Trust Fund for the People of the Federated States of Micronesia (a District of Columbia not for profit corporation), which comprise the statement of fiduciary net position as of September 30, 2014 and 2013, and the related statement of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated March 25, 2015.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Trust Fund for the People of the Federated States of Micronesia's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Trust Fund for the People of the Federated States of Micronesia's internal control. Accordingly, we do not express an opinion on the effectiveness of the Trust Fund for the People of the Federated States of Micronesia's internal control.

*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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a 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. 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.

Our consideration of 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## **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 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*.

## **Restriction on Use**

This report is intended solely for the information and use of the Joint Trust Fund Committee, its respective governments, and the Trust Fund for the People of the Federated States of Micronesia's management and is not intended to be and should not be used by anyone other than these specified parties.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Baker Tilly Viechow Krause, LLP*

Philadelphia, Pennsylvania  
March 25, 2015