Financial Statements

September 30, 2011 and 2010



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Management's Discussion and Analysis Fiscal Years Ended September 30, 2011 and 2010

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, 2011 and 2010. Please read it in conjunction with the Trust Fund's financial statements, which follow this section.

Summary of FY11 Financial Highlights

- The total Net Asset Value of the Fund increased 12% to \$198.5 million in FY11 from \$177.2 million in FY10. The increase was due mainly to increased contributions. The Fund experienced an investment loss of \$339,312 primarily due to declining international equity markets.
- Overall, the Fund, after discounting for contributions, achieved zero growth gross of fees and a 0.4% loss net of fees. This compares to a -0.2% loss for the Total Trust Benchmark.¹
- The poor performance of domestic and international equities was balanced by positive performance of the non-discretionary component of the portfolio (35% of all Fund assets), consisting of emerging market debt, convertible bonds, a real estate fund, a hedge fund, and private equity investments.
- An annual contribution of \$22.4 million was received from the United States for FY11. FY10 contributions amounted to \$21.5 million.
- No transfer was made to the "C" account for FY11 since there was an investment loss. The "C" account remains at \$20.2 million from FY10.
- Investment expenses were substantially reduced by 31.3% to \$645,382 in FY11 from \$939,224 in FY10. The reduction is attributed to a new contract and fee structure with the newly contracted custodian and with the investment adviser in September 2010.
- Administrative expenses also decreased by 3.1% to \$147,921 in FY11 from \$152,679 in FY10. The decrease can be attributed to reduced legal, audit, and miscellaneous administrative fees.

¹ The Total Trust Benchmark is comprised of 28% Russell 3000, 29% MCSI EAFE (net dividend), 10% Barclays Capital Aggregate, 8.5% JPMorgan Emerging Market Bond Index, 5% BofA Merrill Lynch All US Convertibles, 5% T-Bills +3%, 7.5% NCREIF NFI ODCE and 7% S&P 500 +3%.

Management's Discussion and Analysis Fiscal Years Ended September 30, 2011 and 2010

	Septerr	ber 30,
	2011	2010
Assets Cash and investments Accrued investment income Prepaid expenses	\$ 198,742,509 88,507 	\$ 177,263,672 87,172 22,000
Total assets	198,831,016	177,372,844
Liabilities Accrued expenses Due to broker	69,998 300,985	171,145 3,337
Total liabilities	370,983	174,482
Restricted net assets	\$ 198,460,033	\$ 177,198,362

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

Financial Highlights - Net Assets at September 30, 2011

The fair value of the Trust Fund's net assets was \$198.5 million as of September 30, 2011, compared to \$177.2 million at September 30, 2010. The 12.0 percent increase of net assets of \$21.3 million is solely attributable to the annual contribution from the Government of the United States that amounted to \$22.4 million. Given the poor performance of U.S. and foreign equity markets, the Trust Fund experienced an investment loss of \$339,312. After adding the cost of investment fees of \$645,382 and administrative expenses of \$147,921, the net investment loss increases to \$1.1 million. Given the investment loss, no transfer was made to the Trust Fund's "C" account.

At September 30, 2011, the Trust Fund's assets consisted of managed assets (65 percent of the Trust Fund) and non-discretionary assets (35 percent). The managed assets portfolio consisted of domestic equity mutual funds (27.1 percent of the Trust Fund), international equities (27.3 percent) and fixed income securities (10.1 percent). The non-discretionary assets portfolio consisted of emerging market debt and convertible bonds (12.8 percent), alternative investments in real estate (8.5 percent), a hedge fund (4.5 percent), and private equity investments (9.5 percent). The percentages are within those 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.

Management's Discussion and Analysis Fiscal Years Ended September 30, 2011 and 2010

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 was attributable to the Government of the United States 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 funds, international equity 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.

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

	Year ended September 30,				
	2011	2010			
Contributions Net investment income (loss)	\$ 22,394,286 (984,694)	\$ 21,518,180 17,757,642			
Total additions	21,409,592	39,275,822			
Administrative expenses	147,921	152,679			
Change in net assets	21,261,671	39,123,143			
Restricted net assets, beginning	177,198,362	138,075,219			
Restricted net assets, ending	\$ 198,460,033	\$ 177,198,362			

Financial Highlights - Changes in Net Assets for Fiscal Year Ended September 30, 2011

The Government of the United States made the only contribution to the Trust Fund on October 14, 2010 in the amount of \$22.4 million. The contribution consisted of the base amount of \$18.4 million, an \$800,000 increment, plus a cumulative partial inflation adjustment.

The net investment income loss of \$984,694 was due to a loss of unrealized gains (-\$5.6 million) which was offset by interest earnings (\$314,982), accretion (\$72,123), dividends (\$3.6 million), and realized gains (\$1.2 million) during the fiscal year ended September 30, 2011, net of investment expenses of \$645,382. The loss was minimized by the diversity of the portfolio between the managed assets and non-discretionary assets. The poor performance of the U.S. and international equity markets and related Trust Fund assets were somewhat offset by the more positive performance of the fixed income and non-discretionary assets.

Management's Discussion and Analysis Fiscal Years Ended September 30, 2011 and 2010

Investment expenses were significantly reduced by 31 percent to the FY11 amount of \$645,382 from the FY10 amount of \$939,224. The investment expense reduction is due to the fee structures entered into with a newly contracted custodian in September 2010. For the fiscal year ended September 30, 2011, the Trust Fund incurred investment advisory firm fees of \$162,496, custodian fees of \$59,312 and money manager fees of \$423,575.

Administrative expenses amounted to \$147,921, a decrease of 3.1 percent over the 2010 amount of \$152,679. The decrease can be attributed to reduced legal, audit, and miscellaneous administrative fees. Accounting and Executive Administrator fees slightly rose.

The U.S. Department of the Interior and U.S. Department of State contributed staff time, equipment usage and incidental expenses during the fiscal year ended September 30, 2011. No amounts have been recorded in the accompanying financial statements.

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

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, was approximately 10.46%.

Investment advisory fees charged by asset managers ranged from 40 to 150 basis points of average assets under management. The Trust Fund retains 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 from the investment advisory firm in fiscal year 2010; this amount was included in investment expenses.

The U.S. Department of the Interior and U.S. Department of State 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.

Future Prospects Beyond Financial September 30, 2011

As stated in the Trust Fund Agreement between the United States and the Federated States of Micronesia, the purpose of the Trust Fund is *"contribute to the economic advancement and long-term budgetary self-reliance of the Federated States of Micronesia by providing an annual source of revenue, after Fiscal Year 2023, for assistance in 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 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."

Management's Discussion and Analysis Fiscal Years Ended September 30, 2011 and 2010

The Trust Fund's effective yield, after discounting for contributions, was -0.57 percent for the year compared to a yield of 10.46 percent in 2010. In terms of performance measurement (not discounting for fees and expenses), the Trust Fund had zero growth and a -.4 percent loss net of fees. This loss compares to a -0.2 percent loss for the Total Trust Benchmark and a 1.2 percent gain for the Foundations Median.

For managed assets, gross of fees, domestic equity investments posted a -0.2 percent loss (benchmark 0.5 percent) and international equities a -11.2 percent loss (benchmark -9.4).

The total non-discretionary assets portfolio, gross of fees, was up 11.9 percent. Gains were made in fixed income investments (2.1 percent; benchmark 0 percent), real estate (23.3 percent; benchmark 18.3 percent), hedge fund (2.6 percent; benchmark 3.1 percent), and private equity (19.1 percent; benchmark 4.1 percent).

The gains in the non-discretionary portfolio of the Trust Fund helped to offset the losses of the equity driven managed assets.

The weak performance has also affected the ability to place funds in the C account.² For FY11 no funds were allocated to the C account since the 6 percent threshold was not attained and it remains at \$20.2 million- the same as in FY10.

An analysis by the investment adviser estimates that if the Fund manages an average 5% return annually from FY12 to FY23, the distribution from the estimated assets should provide FY24 revenue equivalent to approximately 85% of the nominal FY23 grant level without a partial inflation adjustment.

If the Fund were to achieve an average 8% return annually, the Fund would probably provide FY24 revenue equivalent to nominal FY23 grant assistance without an inflation adjustment. There would also be a build-up of the C account but probably not to the maximum level permitted under the Trust Fund Agreement. The Fund has only achieved 8% or more return in two years-FY07 and FY10.

If the Fund were to achieve an average 10% return annually, the Fund would probably provide FY24 revenue equivalent to partially inflation adjusted FY23 grant assistance. However, this would not allow for future inflation adjustments beyond the FY23 amount. There would also be a build-up of the C account but not to the maximum level permitted under the Trust Fund Agreement. However, achieving such annual average growth is not expected.

The Trust Fund Committee has taken actions in FY11 to help attract other contributions to the Trust Fund.

² The C account contains any annual income on the Fund over 6 percent. The C account shall contain no more than three times the estimated equivalent of the FY23 annual grant assistance, including the estimated inflation adjustment provided in the amended Compact of Free Association (Section 218). After FY23 the C account may be drawn on, to the extent it has sufficient funds, to address any shortfall if Fund income from the previous year falls below the previous year's distribution adjusted for inflation. Transfers were made to the C account in FY06, FY07 and FY10- the years with over 6 percent annual income.



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, 2011 and 2010, 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, 2011 and 2010, 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 22, 2012, 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 5, 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.

Parente Beard LLC

Malvern, Pennsylvania March 22, 2012

Statement of Net Assets September 30, 2011 and 2010

	2011	2010
Assets		
Cash equivalents Investments, at fair value	\$	\$
	198,742,509	177,263,672
Accrued investment income Prepaid expenses	88,507	87,172 22,000
Total assets	\$ 198,831,016	\$ 177,372,844
Liabilities and Restricted Net Assets		
Liabilities Accrued expenses Due to broker	\$	\$
Total liabilities	370,983	174,482
Restricted Net Assets	198,460,033	177,198,362
Total liabilities and restricted net assets	\$ 198,831,016	\$ 177,372,844

See notes to financial statements

Statement of Changes in Net Assets Year Ended September 2011 and 2010

	2011	2010
Additions Contributions: Government of the United States of America	\$ 22,394,286	\$ 21,518,180
Investment income: Interest and dividends Net increase (decrease) in the fair value of investments	4,006,987 (4,346,299)	2,996,061 15,700,805
Gross investment income (loss)	(339,312)	18,696,866
Less: investment expenses	645,382	939,224
Net investment income (loss)	(984,694)	17,757,642
Total additions	21,409,592	39,275,822
Deduction Administrative expenses	147,921	152,679
Change in net assets	21,261,671	39,123,143
Restricted Net Assets, Beginning	177,198,362	138,075,219
Restricted Net Assets, Ending	\$ 198,460,033	\$ 177,198,362

See notes to financial statements

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 nonvoting 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.

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 Government 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.

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

Investments are reported at fair value unless a legal contract exists which guarantees a higher value. Investment income consists of interest, dividends and net investment gains or losses resulting from changes in the fair value of investments. Amounts due to broker represent purchases of securities as of the fiscal year end which have not settled, and for which payment has not yet been transferred to the broker. Investment income consists of interest, dividends and net investment gains or losses resulting from changes in the fair value of investment income consists of interest, dividends and net investment gains or losses resulting from changes in the fair value of investments.

The investment policy adopted by the Trust Fund Committee on September 15, 2010 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, 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. Equity securities issued by ETFs, mutual funds, REITs, 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 All US Convertibles 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 general partner or manager of the private equity fund and is based upon Trust Fund's percentage ownership of the underlying investments. Investments in private equity funds generally tend to be illiquid for significant periods of time.

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 speculative strategies, including investing in unconventional and illiquid investments. The fair value of Trust Fund's investment in a hedge fund is determined by the hedge fund manager and is based upon 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 value of separate account investments in real estate partnerships are generally determined based the equity method of accounting, and the fair value of underlying investments 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.

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.

The balance of the "A" Account as of September 30, 2011 and 2010 was \$178,243,111 and \$156,981,440, respectively.

- 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.

Additions to the "C" Account during the years ended September 30, 2011 and 2010 were \$-0- and \$7,503,665, respectively. The balance of the "C" Account as of September 30, 2011 and 2010 was \$20,216,922.

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.

- 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.

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 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 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:

Date	 ntribution Millions)	Contributor
		Federated States of
October 1, 2004	\$ 30.3	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
October 1, 2010	 22.4	United States
Total contributions from inception through fiscal year 2011	\$ 180.4	

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:

Fiscal Year	Contribution (Millions)
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	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

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 2011 and 2010, the Trust Fund realized net gains from the sale of investments of \$1,246,658 and \$1,709,598, 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 during the fiscal years ended September 30, 2011 and 2010 was \$(4,346,299) and \$15,700,805, 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, 2011 and 2010 was \$11,034,900 and \$5,441,943, respectively.

Notes to Financial Statements September 30, 2011 and 2010

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

			Fair Value											
Investment Class		Cost 9/30/11		jinning Fair lue 10/1/10		Purchases		Sales		Subtotal	E	nding Fair Value 9/30/11		Change in Fair Value
2011						(In Thous	ands)						
2011														
Equity: Equity securities – domestic common and preferred stocks Common trust funds and mutual funds –	\$	442	\$	12,015	\$	298	\$	12,226	\$	87	\$	391	\$	304
domestic equity Mutual fund –		56,292		36,250		61,098		42,672		54,676		53,782		(894)
international equity		63,559		53,591		74,441		65,881		62,151		54,283		(7,868)
Private equity funds - global		15,513		14,922		1,641		544		16,019		18,892		2,873
Hedge Fund: Mutual fund (Cayman) – global fund of funds		8,500		8,810		-		-		8,810		8,929		119
Fixed Income: Convertible bonds – domestic Commingled separate		9,080		8,871		5,675		5,560		8,986		9,018		32
account – global debt Mutual fund –		-		20,244		-		20,391		(147)		-		147
domestic debt Mutual fund (Cayman) –		20,262		-		23,812		3,487		20,325		19,968		(357)
emerging market debt		16,363		16,070		36,735		36,243		16,562		16,121		(441)
Private Real Estate: Commingled separate account – domestic real estate		19,388		6,132		9,200		91		15,241		16,980		1,739
Cash: Cash														
equivalents	_	379		359		34,020		34,000		379		379		
Total	\$	209,778	\$	177,264	\$	246,920	\$	221,095	\$	203,089	\$	198,743	\$	(4,346)

Notes to Financial Statements September 30, 2011 and 2010

			Fair Value											
Investment Class		Cost 9/30/10		jinning Fair lue 10/1/09		Purchases	ondo)	Sales		Subtotal		nding Fair Value 9/30/10		Change in Fair Value
2010						(In Thous	ands							
Equity: Equity securities – domestic common and preferred stocks Common trust funds –	\$	8,931	\$	10,584	\$	2,506	\$	2,389	\$	10,701	\$	12,015	\$	1,314
domestic equity Common trust		39,862		32,645		665		-		33,310		36,250		2,940
funds – global equity Private equity		57,176		45,062		4,344		837		48,569		53,591		5,022
funds - global		14,409		10,652		2,570		396		12,826		14,922		2,096
Hedge Fund: Mutual fund (Cayman) – global fund of funds		8,500		-		8,500		-		8,500		8,810		310
Fixed Income: Convertible bonds - domestic Commingled separate		8,555		-		11,161		2,746		8,415		8,871		456
account – global debt Mutual fund (Cayman) –		19,841		18,017		958		89		18,886		20,244		1,358
emerging market debt		14,768		9,966		4,649		293		14,322		16,070		1,748
Private Real Estate: Commingled separate account – domestic real estate		10,304		5,753		-		78		5,675		6,132		457
Cash:	•		¢		¢	00.015	•		<u>,</u>		•		¢	
Cash equivalents	\$	359	\$	5,566	\$	32,640	\$	37,847	\$	359	\$	359	\$	-
Total	\$	182,705	\$	138,245	\$	67,993	\$	44,675	\$	161,563	\$	177,264	\$	15,701

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.

	Fair Value								Average Credit Rating			
2011	_	Oomestic Corporate Bonds		Domestic Corporate Convertible Bonds		Total	Range of Interest Yield to Maturity	Moody's	Standard & Poor's			
Due in one year or less	\$	-	\$	740,101	\$	740,101	(0.94)% to5.59 %	B2/Caa3	BB/CCC			
Due after one year through five years	Ψ	176,187	Ψ	3,699,963	Ψ	3,876,150	(0.04) % to (11.04)% to 15.32 %	A1/Caa1	AA-/CCC			
Due after five years through ten years		358,500		576,581		935,081	3.78% to 10.47 %	B1/Caa1	BB/CCC+			
Due after ten years		-		3,466,819		3,466,819	0.01% to 14.64 %	A3/Baa3	A-/CCC+			
Total	\$	534,687	\$	8,483,464	\$	9,018,151						
2010												
Due in one year or less Due after one year through	\$	-	\$	117,300	\$	117,300	(2.29)% to 1.84 %	Not Rated	BBB			
five years Due after five years through		361,225		3,760,442		4,121,667	(5.63)% to 10.37 %	Ba3/Caa3	BBB-/CCC+			
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	\$	568,413	\$	8,302,276	\$	8,870,689						

Direct investments in bonds at September 30, 2011 and 2010 are as follows:

As of September 30, 2011, the Trust Fund's fixed income allocation consists of a Mercer Investment Management Core Opportunistic Fixed Income mutual fund (MIM COFI) 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 the Barclays Capital U.S. Aggregate Bond Index and the JP Morgan Emerging Market Bond Index, respectively. The bonds held by MIM COFI vary in credit quality with an average overall rating of "Aa2" as rated by Moody's as of September 30, 2011. High yield debt receiving a credit rating below "A" comprises approximately 18% of the MIM COFI fixed income portfolio as rated by Moody's at September 30, 2011. At September 30, 2011, the weighted average maturity of the bonds comprising MIM COFI is 7.28 years. The bonds held by Moody's as of September 30, 2011. High yield debt receiving a credit quality with an average overall rating of "Baa1/Ba2" as rated by Moody's as of September 30, 2011, the weighted average maturity of the bonds comprising a credit rating below "A" comprises approximately 82% of the AEMDF fixed income portfolio as rated by Moody's at September 30, 2011. At September 30, 2011. At September 30, 2011, the weighted average maturity of the bonds comprises approximately below "A" comprises approximately 82% of the AEMDF fixed income portfolio as rated by Moody's at September 30, 2011, the weighted average maturity of the bonds comprising AEMDF is 10.03 years.

As of September 30, 2010, the Trust Fund's fixed income allocation consisted of AEMDF and Aberdeen Core Plus Fixed Income Fund LLC, a limited liability company managed by Aberdeen Asset Management, Inc. (ACPFIF). The bonds held by ACPFIF vary in credit quality with an average overall rating of "A+" as rated by Standard and Poor's as of September 30, 2010. Bond issues receiving a credit rating below "A" comprised less than 30% of the fixed income portfolio as rated by Standard and Poor's at September 30, 2010. At September 30, 2010, the weighted average maturity of the bonds comprising ACPFIF was 7.02 years. The bonds held by AEMDF vary in credit quality with an average overall rating of "Baa1/Ba3" as rated by Moody's as of September 30, 2010. High yield debt receiving a credit rating below "A" comprised approximately 80% of the AEMDF fixed income portfolio as rated by Moody's at September 30, 2010. At September 30, 2010, the weighted average maturity of the bonds comprised income portfolio as rated by Moody's at September 30, 2010. At September 30, 2010, the weighted average maturity of the bonds comprised income portfolio as rated by Moody's at September 30, 2010. At September 30, 2010, the weighted average maturity of the bonds comprising AEMDF was 11.22 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. Approximately 72% of the Trust Fund's direct investments in domestic corporate convertible bonds were not rated by either Moody's or Standards & Poor's as of September 30, 2011.

Notes to Financial Statements September 30, 2011 and 2010

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

Investment Class	% of Strategic Target Allocation	% of Fund Tactical Range	% of Allocation at 9/30/11			
2011						
Equity:						
Domestic Small/Mid Cap	7.0 %	5.0 - 9.0 %	6.7 %			
Domestic Large Cap	21.0	18.0 - 24.0	20.6			
International	29.0	24.0 - 34.0	27.3			
Global Private Equity	7.0	2.0 - 12.0	9.5			
Hedge Fund:						
Global Multi Strategy	5.0	0.0 - 10.0	4.5			
Fixed Income:						
Domestic	10.0	5.0 - 15.0	10.1			
Domestic Convertible Bonds	5.0	0.0 - 10.0	4.5			
International	8.5	3.5 - 13.5	8.1			
Private Real Estate	7.5	2.5 - 12.5	8.5			
Cash and Cash Equivalents	0.0	0.0 - 3.0	0.2			
	100.00 %		100.00 %			

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 Fund:					
Global Multi Strategy	5.0	0.0 - 10.0	5.0		
Fixed Income:					
Domestic	10.0	5.0 - 15.0	11.5		
Domestic Convertible Bonds	5.0	0.0 - 10.0	5.0		
Global	8.5	3.5 - 13.5	9.1		
Private Real Estate	7.5	2.5 - 12.5	3.5		
Cash and Cash Equivalents	0.0	0.0 - 3.0	0.2		
	100.00 %		100.00 %		

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 is not available for the Trust Fund's investment in the Hedge Fund and its investments in Global Private Equity Funds, which comprise 12% of invested assets at September 30, 2011 and 2010.

Notes to Financial Statements September 30, 2011 and 2010

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

Currency	\$USD Fair Value of Investments in Foreign Issuers Total
2011	(In Thousands)
Angolan Kwanza	\$ 49
Argentina Peso	477
Australian Dollar	1,791
Bahraini Dinar	12
Barbados Dollar	28
Belarusian Ruble	47
Bosnian Convertible Mark	6
Brazilian Real	3,118
British Pound	9,716
Canadian Dollar	651
Cayman Island Dollar	552
Chilean Peso	277
Chinese Yuan	1,284
Columbian Peso	602
Croatian Dinar	72
Czech Koruna	40
Danish Krone	434
Dominican Republic Peso	53
Egyptian Pound	167
European Euro Gabon Franc de la Communaute'	16,994
financiere' africaine	121
Georgian Lari	63
Ghana Cedi	37
Hong Kong Dollar	434
Hungarian Forint	185
Indian Rupee	963
Indonesian Rupiah	1,294
Iraqi Dinar	198
Israeli New Shekel	658
Jamaican Dollar	107
Japanese Yen	13,516
Jordanian Dinar	68
Kazakhstani Tenge	819
Kuwaiti Dinar	17
Lebanese Pound	187
Lithuanian Litas	209
Malaysian Ringgit	267
Mexican Peso	1,709
Moroccan Dirham	79
New Zealand Dollar	163
Nigerian Naira	83
Norwegian Krone	814

Pakistani Rupee	142
Panamanian Balboa	238
Paraguayan Guarani	13
Peruvian Nuevo Sol	258
Philippine Peso	898
Polish Zloty	176
Qatari Riyal	154
Russian Ruble	1,435
Salvadorian Colon	177
Saudi Riyal	45
Senegalese Franc de la Communaute'	
financiere' africaine	40
Serbian Dinar	42
Singapore Dollar	1,562
South African Rand	916
South Korean Won	1,193
Sri Lanka Rupee	72
Swedish Krona	1,194
Swiss Franc	3,474
Taiwan New Dollar	651
Thai Baht	145
Trinidad and Tobago Dollar	50
Tunisian Dollar	11
Turkish Lira	860
Ukraine Hryvnia	594
United Arab Emirates Dirham	836
Uruguayan Peso	436
Venezuelan Bolivar	556
Vietnam Dong	66
	\$ 74,595

Notes to Financial Statements September 30, 2011 and 2010

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

\$ 72,727

4. Commitments

At September 30, 2011 and 2010, 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, 2011 and 2010 were as follows:

Currency	Capital Commitments	Capital Contributions	Unfunded Capital Commitments
2011			
Private equity funds	\$ 25,319,342	\$ 18,353,810	\$ 6,965,532
2010			
Private equity funds	\$ 25,406,504	\$ 16,405,043	\$ 9,001,461



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, 2011 and the related statement of changes in net assets for the year then ended, and have issued our report thereon dated March 22, 2012. 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

Management of Trust fund is responsible for establishing and maintaining effective 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.

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.

Parente Beard LLC

Malvern, Pennsylvania March 22, 2012