

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

Financial Statements

September 30, 2013 and 2012



Trust Fund for the People of the Federated States of Micronesia

Table of Contents

September 30, 2013 and 2012

	<u>Page</u>
Management's Discussions and Analysis	1
Independent Auditors' Report	7
Financial Statements	
Statement of Net Position	9
Statement of Changes in Net Position	10
Notes to Financial Statements	11
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 <i>Government Auditing Standards</i>	28

Trust Fund for the People of the Federated States of Micronesia

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2013 and 2012

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, 2013 and 2012. Please read it in conjunction with the Trust Fund's financial statements, which follow this section.

Summary of Fiscal Year 2013 Financial Highlights

- The total net position value of the Fund increased 25.5% to \$323.1 million in fiscal year 2013 from \$257.3 million in fiscal year 2012. The increase was due to a contribution from the United States government of \$25.0 million and net investment income of \$40.9 million.
- Overall, the Trust Fund had a dollar weighted rate of return of 13.5% - the Trust Fund's third best return since inception in 2004 and continued gains from fiscal year 2012 (14.8%). On a performance basis, net of fees, the Trust Fund gained 13.9% compared to a benchmark of 14.3% and a Foundations Median of 10.2%.¹
- Given the positive returns, an allocation of \$22.6 million was made to the "C" account for fiscal year 2013 bringing the total of that account to \$63.8 million.²
- Investment expense amounted to \$2.6 million in fiscal year 2013 compared to \$2.1 million in fiscal year 2012. Overall investment expense amounted to 0.81% of restricted net position for fiscal year 2013, down from 0.85% for fiscal year 2012. The investment expense changes are in line with the Investment Policy Statement asset allocation changes and accompanying resolutions.
- Administrative expenses decreased by 2.3% to \$153,346 for fiscal year 2013 from \$156,960 in fiscal year 2012. Decreases occurred for the Executive Administrator's fee, accounting fee and miscellaneous expenses. Increases occurred for legal and audit fees.

¹ As of 1/1/13, the Total Trust Benchmark is comprised of 25.5% Russell 3000, 25.5% MSCI ACWIxUS Net Dividend, 2.5% Barclays Capital Aggregate, 10% JPMorgan Emerging Market Bond Index, 6.5% BofA Merrill Lynch All U.S. Convertibles, 10.5% T-Bills+3%, 10% NCREIF NFI ODCE, 9.5% S&P 500+3%.

² 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 and 2013, 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, 2013 and 2012

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

	September 30,	
	2013	2012
Assets		
Cash and investments	\$ 322,913,871	\$ 257,614,686
Accrued investment income	148,184	95,834
Due from broker	180,119	-
Total assets	<u>323,242,174</u>	<u>257,710,520</u>
Liabilities		
Accrued expenses	159,038	87,814
Due to broker	-	276,598
Total liabilities	<u>159,038</u>	<u>364,412</u>
Restricted net position	<u>\$ 323,083,136</u>	<u>\$ 257,346,108</u>

Financial Highlights - Net Position at September 30, 2013

The fair value of the Trust Fund's net position was \$323.1 million as of September 30, 2013, compared to \$257.3 million at September 30, 2012. The 25.5% increase of net position of \$65.7 million is 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 is 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 fiscal year 2013 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.

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, 2013 and 2012

Financial Highlights - Net Position at September 30, 2012

The fair value of the Trust Fund's net position was \$257.3 million as of September 30, 2012, compared to \$198.5 million at September 30, 2011. The increase was attributable to the Government of the United States contribution of \$23.6 million and a net investment income gain of \$35.4 million less administrative expenses for a total of \$35.2 million. At September 30, 2012, the Trust Fund's assets were primarily invested in domestic equity funds, international equity funds, a hedge fund, global private equity funds, fixed income, a domestic real estate fund, convertible bonds and debt securities.

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

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

	Year ended September 30,	
	2013	2012
Contributions	\$ 24,993,360	\$ 23,587,200
Net investment income	40,897,014	35,455,835
Total additions	65,890,374	59,043,035
Administrative expenses	153,346	156,960
Change in net position	65,737,028	58,886,075
Restricted net position, beginning	257,346,108	198,460,033
Restricted net position, ending	\$ 323,083,136	\$ 257,346,108

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

The Government of the United States, the sole contributor to the Trust Fund in fiscal year 2013, 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, and 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.

Trust Fund for the People of the Federated States of Micronesia

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2013 and 2012

Investment expenses increased by 35.5% compared to fiscal year 2012 to \$1,000,276 from \$737,949 according to the annual financial statements. For fiscal year 2013, 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 fiscal year 2013 compared to \$2.1 million in fiscal year 2012. 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 net position for the fiscal year 2013, down from 0.85% for fiscal year 2012.

Administrative expenses amounted to \$153,346, a decrease of 2.3% over the fiscal year 2012 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 net position for fiscal year 2013 from 0.06% for fiscal year 2012, continuing the downward trend of administrative expenses since fiscal year 2009.

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.

Financial Highlights - Changes in Net Position for Fiscal Year Ended September 30, 2012

The Government of the United States made the only contribution to the Trust Fund in October, 2011 in the amount of \$23.6 million.

The net investment income gain of \$35.4 million was due to: unrealized gains of \$28.8 million, dividends of \$6.3 million, realized gains of \$0.7 million, interest of \$0.3 million, and accretion of \$0.05 million and a slight loss of currency value change during the fiscal year ended September 30, 2012, net of investment expenses of \$737,948. The gains were experienced mainly in the managed asset portion of the portfolio from the periodic gains in U.S. and international public equities. The fixed income and non-discretionary assets also contributed to the positive performance but at lower growth rates.

Investment expenses increased by 14.3% compared to fiscal year 2011 to \$737,949 from \$645,382 according to the annual financial statements. The investment expense increase was partially due to the larger amount of assets managed by the Investment Adviser, Money Managers, and Custodian since their fees are based on the amount of funds managed. In addition, the Investment Adviser fee also slightly increased with the addition of the emerging market equity fund, while the Custodian added a fee to meet regulatory, market and service requirements. Inclusive of all Money Manager fees, investment expenses totaled \$2.2 million.

Administrative expenses amounted to \$156,960, an increase of 6.1% over the fiscal year 2011 amount of \$147,921. The increase is attributed to increases in the executive administrator fee and miscellaneous fees. Decreases are attributed to legal, audit, and accounting fees.

Trust Fund for the People of the Federated States of Micronesia

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2013 and 2012

The U.S. Departments of the Interior and State contributed staff time, equipment usage and incidental expenses during the fiscal year ended September 30, 2012. No amounts for these contributions were recorded in the accompanying financial statements.

Future Prospects Beyond September 30, 2013

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 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 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 13.47% for the fiscal year (FY) compared to a rate of 14.78% for FY12 and -0.57% for FY11. The FY13 return is the third largest percentage annual investment gain experienced since Fund inception in 2004. In terms of performance measurement, the Trust Fund gained 13.9%, net of fees. This gain compares to a 14.3% gain for the Total Trust Benchmark and 10.2% for the Foundations Median.

Portfolio gains were mainly spurred by the performance of domestic and international public equity funds. For managed assets, net of fees, domestic equity investments posted a 21.2% gain (benchmark gain 21.6%) and international equities a 20.4% gain (benchmark 16.5%). The fixed income category had a slight loss of -0.6% gain (benchmark -1.7%). The managed hedge fund and private equity fund were building-up during the year and full annual performance data is not available.

The total non-discretionary asset portfolio, net of fees, was up 5.6%. Gains were made in fixed income investments consisting of convertible and emerging market bond funds (0.8%; benchmark 5.3%), real estate (11.9%; benchmark 13.0%), hedge fund (9.0%; benchmark 3.1%), and private equity (9.3%; benchmark 22.9%). Private equity investments are 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 FY13, an amount of \$22.6 million was allocated to the C account since more than the 6% annual income growth threshold was attained. The C account now amounts to \$63.8 million compared to \$41.2 million in fiscal year 2012. The C account now holds about 77% of the estimated FY23 sector grant amount to be provided to the Federated States of Micronesia through the Amended Compact of Free Association.

Since inception the Trust Fund's average annual net rate of return on investment is 4.9%, net of fees, an improvement over the 3.8% rate at the end of fiscal year 2012. The return rate is below the Total Trust Benchmark of 5.4% and the Foundations Median of 6.3%.

Trust Fund for the People of the Federated States of Micronesia

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2013 and 2012

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 FY13 to FY23, the distribution from the estimated assets would probably provide FY24 revenue equivalent to about 68.5% of the Amended Compact's Section 211 FY23 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 FY13, the average annual rate of return is 4.9%, net of fees.

If the Trust Fund were to achieve an average 8% return annually, the Trust Fund would probably provide FY24 an amount equivalent to 86.2% of FY23 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 Fund has achieved 8% or more return in four fiscal years: 2007, 2010, 2012 and 2013.

If the Trust Fund were to achieve an average 10% return annually, the Fund would probably provide FY24 revenue equivalent to about 100.4% of partially inflation adjusted FY23 sector grant assistance. However, it is unlikely that post 2023 distributions would provide for future inflation adjustments beyond the FY23 amount. The C account would achieve the maximum level permitted under the Trust Fund Agreement prior to FY23. However, there is a low probability to achieve such growth annually.

Any growth projections are estimates, subject to fluctuation based on actual market performance. Cautionary advice 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 Federated States of Micronesia 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 net position as of September 30, 2013 and 2012, and the related statement of changes in 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.

Auditor's 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, 2013 and 2012, 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 6, 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 August 29, 2014, 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.



Wilmington, Delaware
August 29, 2014

Trust Fund for the People of the Federated States of Micronesia

Statement of Net Position
September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Assets		
Cash equivalents	\$ 1,149,362	\$ 981,858
Investments, at fair value	<u>321,764,509</u>	<u>256,632,828</u>
	322,913,871	257,614,686
Accrued investment income	148,184	95,834
Due from broker	<u>180,119</u>	<u>-</u>
Total assets	<u><u>\$ 323,242,174</u></u>	<u><u>\$ 257,710,520</u></u>
Liabilities and Restricted Net Position		
Liabilities		
Accrued expenses	\$ 159,038	\$ 87,814
Due to broker	<u>-</u>	<u>276,598</u>
Total liabilities	<u>159,038</u>	<u>364,412</u>
Restricted Net Position	<u>323,083,136</u>	<u>257,346,108</u>
Total liabilities and restricted net position	<u><u>\$ 323,242,174</u></u>	<u><u>\$ 257,710,520</u></u>

See notes to financial statements

Trust Fund for the People of the Federated States of Micronesia

Statement of Changes in Net Position Years Ended September 2013 and 2012

	<u>2013</u>	<u>2012</u>
Additions		
Contributions:		
Government of the United States of America	\$ 24,993,360	\$ 23,587,200
Investment income:		
Interest and dividends	4,886,086	6,684,643
Net increase in the fair value of investments	<u>37,011,204</u>	<u>29,509,141</u>
Gross investment income	41,897,290	36,193,784
Less: investment expenses	<u>1,000,276</u>	<u>737,949</u>
Net investment income	<u>40,897,014</u>	<u>35,455,835</u>
Total additions	<u>65,890,374</u>	<u>59,043,035</u>
Deduction		
Administrative expenses	<u>153,346</u>	<u>156,960</u>
Change in net position	65,737,028	58,886,075
Restricted Net Position, Beginning	<u>257,346,108</u>	<u>198,460,033</u>
Restricted Net Position, Ending	<u>\$ 323,083,136</u>	<u>\$ 257,346,108</u>

See notes to financial statements

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

1. Summary of Significant Accounting Policies

Overview of the Trust Fund:

Compact

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

Trust Fund

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

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

The composition of the Committee consists of three voting members from the United States appointed by the Government of the United States, which include the Chairman of the Joint Trust Fund Committee, 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.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

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

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

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements

September 30, 2013 and 2012

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 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. Amounts due from broker represent 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.

The investment policy adopted by the Trust Fund Committee on September 15, 2010 and amended through January 1, 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. 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

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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 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 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.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

Derivatives, options and futures 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 Net Position

Restricted net position consists 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 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, 2013 and 2012 was \$259,306,473 and \$216,162,380, 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

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

- 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.

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, 2013 and 2012 were \$22,592,935 and \$20,966,806, respectively. The balance of the "C" Account as of September 30, 2013 and 2012 was \$63,776,663 and \$41,183,728.

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.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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 June 2011, GASB issued Statement No. 63, *Financial reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective for periods beginning after December 15, 2011. The Statement provides financial reporting guidance for deferred outflows of resources and deferred inflow of resources. Deferred outflows is defined as the consumption of net assets that is applicable to a future reporting period and deferred inflows is defined as the acquisition of net assets that is applicable to a future reporting period. GASB No. 63 also amends the net asset reporting requirement by incorporating deferred outflows of resources and deferred inflow of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The Trust Fund's adoption of GASB No. 63 in 2013 resulted in a change in the presentation of the statement of net assets to what is now referred to as the statements of net position and the term "net assets" was changed to "net position" throughout the financial statements. The implementation of GASB No. 63 did not have a material effect on the financial statements of the Trust Fund.

Upcoming 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 Trust Fund is currently evaluating the effects the above upcoming accounting pronouncements 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.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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	Contribution (Millions)	Contributor
October 1, 2004	\$ 30.3	Federated States of Micronesia
October 5, 2004	32.2	United States
October 6, 2005	16.4	United States
October 6, 2006	17.7	United States
October 9, 2007	19.0	United States
October 6, 2008	20.9	United States
October 2, 2009	21.5	United States
October 14, 2010	22.4	United States
October 14, 2011	23.6	United States
October 4, 2012	25.0	United States
	<u>229.0</u>	
Total contributions from inception through fiscal year 2013	<u>\$ 229.0</u>	

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

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	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

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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 2013 and 2012, the Trust Fund realized net gains from the sale of investments of \$5,252,538 and \$744,530, 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, 2013 and 2012 was \$37,011,204 and \$29,509,140, respectively. These amounts take into account all changes in fair value that occurred during the years ended September 30, 2013 and 2012 including approximately \$4,100 and \$9,000, respectively, of foreign currency transaction losses. The cumulative net unrealized gain on investments held at September 30, 2013 and 2012 was \$49,497,769 and \$17,734,995, respectively.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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

Investment Class	Cost 9/30/13	Fair Value				Ending Fair Value 9/30/13	Change in Fair Value
		Beginning Fair Value 10/1/12	Purchases	Sales	Subtotal		
(In Thousands)							
2013							
Equity:							
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
Hedge Funds:							
Mutual funds (Cayman) – global fund of funds	28,330	9,524	19,830	-	29,354	32,390	3,036
Fixed Income:							
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 (US & Cayman) – emerging market debt	29,651	18,654	22,303	12,103	28,854	26,612	(2,242)
Private Real Estate:							
Commingled separate account – domestic real estate	28,387	18,688	28,804	19,474	28,018	30,255	2,237
Cash:							
Cash equivalents	1,149	979	58,196	58,028	1,147	1,149	2
Total	\$ 273,416	\$ 257,615	\$ 175,068	\$ 146,780	\$ 285,903	\$ 322,914	\$ 37,011

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

Investment Class	Cost 9/30/12	Fair Value				Ending Fair Value 9/30/12	Change in Fair Value
		Beginning Fair Value 10/1/11	Purchases	Sales	Subtotal		
2012							
Equity:							
Equity securities – domestic common and preferred stocks	\$ -	\$ 391	\$ -	\$ 350	\$ 41	\$ -	\$ (41)
Common trust funds and mutual funds – domestic equity	63,966	53,782	10,845	3,714	60,913	76,965	16,052
Mutual fund – international equity	78,525	54,282	25,553	10,319	69,516	76,936	7,420
Private equity funds - global	14,983	18,892	779	1,388	18,283	19,673	1,390
Hedge Fund:							
Mutual fund (Cayman) – global fund of funds	8,500	8,929	-	-	8,929	9,524	595
Fixed Income:							
Debentures and Convertible bonds – domestic	9,437	9,018	5,249	5,034	9,233	10,044	811
Mutual fund – domestic debt	25,345	19,968	5,305	223	25,050	26,152	1,102
Mutual fund (Cayman) – emerging market debt	18,945	16,121	18,945	16,714	18,352	18,654	302
Private Real Estate:							
Commingled separate account – domestic real estate	19,197	16,980	-	179	16,801	18,688	1,887
Cash:							
Cash equivalents	982	379	32,289	31,680	988	979	(9)
Total	\$ 239,880	\$ 198,742	\$ 98,965	\$ 69,601	\$ 228,106	\$ 257,615	\$ 29,509

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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 January 2013 per resolution FSM 2013-1 "Asset Allocation for Private Equity Investment". 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.

Direct investments in bonds at September 30, 2013 and 2012 are as follows:

	Fair Value			Range of Interest Yield to Maturity	Average Credit Rating	
	Domestic Corporate Bonds	Domestic Corporate Convertible Bonds	Total		Moody's	Standard & Poor's
2013						
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>			
2012						
Due in one year or less	\$ -	\$ 726,202	\$ 726,202	(159.00)% to 2.09 %	A1/Baa1	A+/BB
Due after one year through five years	138,337	4,835,163	4,973,500	(23.47)% to 6.99 %	Baa2/Caa1	A/CCC
Due after five years through ten years	555,301	415,919	971,220	(1.92)% to 8.56 %	Baa3/Caa1	BB+/B-
Due after ten years	25,125	3,348,513	3,373,638	(.76)% to 8.14 %	A3/B3	A-/CCC+
Total	<u>\$ 718,763</u>	<u>\$ 9,325,797</u>	<u>\$ 10,044,560</u>			

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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 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 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.

As of September 30, 2012, 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, 2012. 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, 2012. At September 30, 2012, the weighted average maturity of the bonds comprising MIM COFI is 6.45 years. The bonds held by AEMDF vary in credit quality with an average overall rating of "Baa1/Ba2" as rated by Moody's as of September 30, 2012. High yield debt receiving a credit rating below "A" comprises approximately 87% of the AEMDF fixed income portfolio as rated by Moody's at September 30, 2012. At September 30, 2012, the weighted average maturity of the bonds comprising AEMDF is 10.87 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 31% 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, 2013.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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 9/30/13
2013			
Managed Assets			
Domestic Equity:	25.5 %	20.5 - 30.5 %	28.5 %
US Large Cap	18.0		20.8
US Small/Medium Cap	7.5		7.7
Non-US 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
Non-Discretionary Assets			
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
	100.0 %		100.0 %

Investment Class	% of Strategic Target Allocation	% of Fund Tactical Range	% of Allocation at 9/30/12
2012			
Equity:			
Domestic	27.0 %	22.0 - 32.0 %	29.9 %
International	28.0	23.0 - 33.0	29.9
Global Private Equity	9.0	4.0 - 14.0	7.6
Hedge Fund:			
Global Multi Strategy	5.0	0.0 - 10.0	3.7
Fixed Income:			
Domestic	10.0	5.0 - 15.0	10.1
Domestic Convertible Bonds	5.0	0.0 - 10.0	3.9
International	8.5	3.5 - 13.5	7.2
Private Real Estate	7.5	2.5 - 12.5	7.3
Cash and Cash Equivalents	0.0	0.0 - 3.0	0.4
	100.0 %		100.0 %

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 16.7% and 11.3% of invested assets at September 30, 2013 and 2012, respectively.

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

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

<u>Currency</u>	<u>\$USD Fair Value of Investments in Foreign Issuers Total</u>
2013	(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
	<u>\$ 88,446</u>

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

Currency	\$USD Fair Value of Investments in Foreign Issuers Total
2012	(In Thousands)
Australian Dollar	\$ 1,909
Brazilian Real	2,074
British Pound	11,214
Canadian Dollar	573
Cayman Island Dollar	1,098
Chilean Peso	319
Chinese Yuan	1,035
Columbian Peso	226
Czech Koruna	40
Danish Krone	1,972
European Euro	19,597
Hong Kong Dollar	1,352
Hungarian Forint	13
Indian Rupee	772
Indonesian Rupiah	786
Israeli New Shekel	382
Japanese Yen	12,661
Kazakhstani Tenge	142
Malaysian Ringgit	952
Mauritian Rupee	64
Mexican Peso	1,926
New Zealand Dollar	127
Norwegian Krone	1,463
Peruvian Nuevo Sol	67
Philippine Peso	106
Polish Zloty	870
Russian Ruble	591
Singapore Dollar	954
South African Rand	973
South Korean Won	1,738
Swedish Krona	2,227
Swiss Franc	5,663
Taiwan New Dollar	1,346
Thai Baht	544
Turkish Lira	309
Other	1,636
	<u>\$ 77,721</u>

Trust Fund for the People of the Federated States of Micronesia

Notes to Financial Statements
September 30, 2013 and 2012

4. Commitments

At September 30, 2013 and 2012, 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, 2013 and 2012 were as follows:

<u>Currency</u>	<u>Capital Commitments</u>	<u>Capital Contributions</u>	<u>Unfunded Capital Commitments</u>
2013			
Hedge fund and Private equity funds	<u>\$ 60,368,220</u>	<u>\$ 22,695,221</u>	<u>\$ 37,672,999</u>
2012			
Hedge fund and Private equity funds	<u>\$ 25,126,001</u>	<u>\$ 19,630,764</u>	<u>\$ 5,495,237</u>

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 net position as of September 30, 2013 and 2012, and the related statement of changes in net position for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated August 29, 2014.

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.

ParenteBeard LLC

Wilmington, Delaware
August 29, 2014