

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**YEAR ENDED DECEMBER 31, 2000**

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## **INDEPENDENT AUDITORS' REPORT**

Chairman  
Board of Directors  
Federated States of Micronesia  
Development Bank:

We have audited the accompanying statement of condition of the Federated States of Micronesia Development Bank, a component unit of the National Government of the Federated States of Micronesia, as of December 31, 2000, and the related statements of revenues, expenses and changes in fund equity and cash flows for the year then ended. These financial statements are the responsibility of the Federated States of Micronesia Development Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Federated States of Micronesia Development Bank, as of December 31, 2000, and the results of its operations and its cash flows for the year 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 30, 2001 on our consideration of the Bank's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is stylized and appears to be written in a cursive or semi-cursive script.

March 30, 2001

**FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK**

Statement of Condition  
December 31, 2000  
(With Comparative Totals as of December 31, 1999)

	(Proprietary Fund Type)	Governmental Fund Types (Capital Projects Funds)			Totals (Memorandum Only)	
	FSMDB	IDF	PDLF	YDLF	December 31, 2000	1999
<b><u>ASSETS</u></b>						
Unrestricted assets:						
Cash and equivalents (note 2)	\$ 2,644,924	\$ -	\$ -	\$ -	\$ 2,644,924	\$ 3,418,653
Investments (note 2)	8,828,724	-	-	-	8,828,724	10,308,924
Interest receivable	383,638	-	-	-	383,638	238,253
Accounts receivable	28,627	-	-	-	28,627	36,820
Prepaid expenses	-	-	-	-	-	1,650
Investment at cost (note 3)	662,188	-	-	-	662,188	662,188
Loans receivable, net (notes 4 and 5)	15,006,172	-	-	-	15,006,172	12,772,660
Fixed assets, net (note 6)	91,733	-	-	-	91,733	84,245
Total unrestricted assets	<u>27,646,006</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>27,646,006</u>	<u>27,523,393</u>
Restricted assets:						
Cash and equivalents (note 2)	-	743,233	131,774	6,234	881,241	609,651
Investments (note 2)	-	8,792,931	300,000	120,000	9,212,931	8,909,915
Interest and other receivables	-	137,235	5,992	1,921	145,148	158,073
Interfund receivable	-	388,509	28,510	8,763	425,782	887,236
Loans receivable, net (notes 4 and 5)	-	6,405,746	297,051	46,262	6,749,059	6,582,004
Total restricted assets	<u>-</u>	<u>16,467,654</u>	<u>763,327</u>	<u>183,180</u>	<u>17,414,161</u>	<u>17,146,879</u>
	<u>\$ 27,646,006</u>	<u>\$ 16,467,654</u>	<u>\$ 763,327</u>	<u>\$ 183,180</u>	<u>\$ 45,060,167</u>	<u>\$ 44,670,272</u>
<b><u>LIABILITIES AND FUND EQUITY</u></b>						
Liabilities:						
Accounts payable	\$ 53,795	\$ -	\$ -	\$ -	\$ 53,795	\$ 90,478
Interfund payable	425,782	-	-	-	425,782	887,236
Credit life payable	37,373	-	-	534	37,907	47,772
Loan participations-sold (note 9)	-	-	-	-	-	106,588
Total liabilities	<u>516,950</u>	<u>-</u>	<u>-</u>	<u>534</u>	<u>517,484</u>	<u>1,132,074</u>
Fund equity:						
Contributed capital	28,978,830	-	-	-	28,978,830	28,978,830
Deficit, unreserved	(1,849,774)	-	-	-	(1,849,774)	(2,492,399)
Fund balances:						
Reserved for related assets	-	6,405,746	297,051	46,262	6,749,059	6,582,004
Unreserved	-	10,061,908	466,276	136,384	10,664,568	10,469,763
Total fund equity	<u>27,129,056</u>	<u>16,467,654</u>	<u>763,327</u>	<u>182,646</u>	<u>44,542,683</u>	<u>43,538,198</u>
Commitments and contingencies (note 8)	<u>\$ 27,646,006</u>	<u>\$ 16,467,654</u>	<u>\$ 763,327</u>	<u>\$ 183,180</u>	<u>\$ 45,060,167</u>	<u>\$ 44,670,272</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK**

Statement of Revenues, Expenses and Changes in Fund Equity - Proprietary Fund Type  
Year Ended December 31, 2000  
(With Comparative Totals for the Year Ended December 31, 1999)

	FSMDB	
	2000	1999
Operating revenues:		
Loan interest	\$ 1,588,263	\$ 1,220,321
Investment income	807,004	786,875
Loan fees	75,911	49,102
Miscellaneous	44,278	29,006
Total operating revenues	<u>2,515,456</u>	<u>2,085,304</u>
Operating expenses:		
Provision for doubtful loans	823,197	650,000
Personnel services	743,329	669,275
Rent	129,937	119,284
Contractual services	105,141	131,910
Travel	100,393	105,175
Training	70,873	30,136
Communications	44,340	41,245
Depreciation	35,390	37,799
Supplies	18,001	13,582
Insurance	2,427	2,747
Printing	1,818	2,722
Miscellaneous expenses	126,178	212,348
Total operating expenses	<u>2,201,024</u>	<u>2,016,223</u>
Earnings from operations	<u>314,432</u>	<u>69,081</u>
Nonoperating revenues:		
IDF reimbursement (note 10)	250,000	250,000
Allocations from managed funds	47,143	48,331
Other income	31,050	54,032
Total nonoperating revenues	<u>328,193</u>	<u>352,363</u>
Net earnings	642,625	421,444
Deficit at beginning of year	<u>(2,492,399)</u>	<u>(2,913,843)</u>
Deficit at end of year	<u>(1,849,774)</u>	<u>(2,492,399)</u>
Contributed capital at beginning of year	28,978,830	27,978,830
Additions (note 10)	<u>-</u>	<u>1,000,000</u>
Contributed capital at end of year	<u>28,978,830</u>	<u>28,978,830</u>
Fund equity at end of year	\$ <u>27,129,056</u>	\$ <u>26,486,431</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK**

Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Types  
Year Ended December 31, 2000  
(With Comparative Totals for the Year Ended December 31, 1999)

	Governmental Fund Types (Capital Projects Funds)			Totals	
	IDF	PDLF	YDLF	2000	1999
Operating revenues:					
Investment interest	\$ 559,287	\$ 20,434	\$ 6,684	\$ 586,405	\$ 510,803
Loan interest	244,060	25,967	3,053	273,080	255,807
Miscellaneous	41,193	742	11	41,946	1,888
Total operating revenues	<u>844,540</u>	<u>47,143</u>	<u>9,748</u>	<u>901,431</u>	<u>768,498</u>
Operating expenditures:					
Doubtful loans expense	<u>107,861</u>	<u>111,067</u>	<u>23,500</u>	<u>242,428</u>	<u>77,900</u>
Total operating expenditures	<u>107,861</u>	<u>111,067</u>	<u>23,500</u>	<u>242,428</u>	<u>77,900</u>
Revenues over (under) expenditures	<u>736,679</u>	<u>(63,924)</u>	<u>(13,752)</u>	<u>659,003</u>	<u>690,598</u>
Other uses:					
Investment management fee	(250,000)	-	-	(250,000)	(250,000)
Transfers to FSMDB fund	<u>-</u>	<u>(47,143)</u>	<u>-</u>	<u>(47,143)</u>	<u>(48,331)</u>
Total other uses, net	<u>(250,000)</u>	<u>(47,143)</u>	<u>-</u>	<u>(297,143)</u>	<u>(298,331)</u>
Revenues and other sources over (under) expenditures and other uses	486,679	(111,067)	(13,752)	361,860	392,267
Fund balances at beginning of year	<u>15,980,975</u>	<u>874,394</u>	<u>196,398</u>	<u>17,051,767</u>	<u>16,659,500</u>
Fund balances at end of year	<u>\$ 16,467,654</u>	<u>\$ 763,327</u>	<u>\$ 182,646</u>	<u>\$ 17,413,627</u>	<u>\$ 17,051,767</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK**

Statement of Cash Flows  
Year Ended December 31, 2000  
(With Comparative Totals for the Year Ended December 31, 1999)

	(Proprietary Fund Type) FSMDB	
	<u>2000</u>	<u>1999</u>
Increase (decrease) in cash and equivalents		
Cash flows from operating activities:		
Operating income	\$ 314,432	\$ 69,081
Adjustments to reconcile operating income to net cash used for operating activities:		
Depreciation	35,390	37,799
Provision for doubtful loans	823,197	650,000
Other income and allocations	<u>328,193</u>	<u>357,444</u>
	<u>1,501,212</u>	<u>1,114,324</u>
Changes in working capital:		
Interest receivable	(145,385)	13,851
Accounts receivable	8,193	7,275
Prepaid expenses	1,650	350
Loans receivable	(3,056,709)	(1,868,718)
Accounts payable and other liabilities	(46,548)	(128,293)
Interfund payables	<u>(366,876)</u>	<u>(462,687)</u>
	<u>(3,605,675)</u>	<u>(2,438,222)</u>
Net cash used for operating financing activities	<u>(2,104,463)</u>	<u>(1,323,898)</u>
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	<u>(42,878)</u>	<u>(42,094)</u>
Net cash used for capital and related financing activities	<u>(42,878)</u>	<u>(42,094)</u>
Cash flows from noncapital financing activities:		
Loan participations sold	(106,588)	(24,364)
Contributed capital received	<u>-</u>	<u>1,000,000</u>
Net cash (used for) provided by noncapital financing activities	<u>(106,588)</u>	<u>975,636</u>
Cash flows from investing activities:		
Decrease in investments	<u>1,480,200</u>	<u>33,152</u>
Net cash provided by investing activities	<u>1,480,200</u>	<u>33,152</u>
Net decrease in cash and equivalents	(773,729)	(357,204)
Cash and equivalents at beginning of year	<u>3,418,653</u>	<u>3,775,857</u>
Cash and equivalents at end of year	\$ <u><u>2,644,924</u></u>	\$ <u><u>3,418,653</u></u>

See accompanying notes to financial statements.

# **FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK**

Notes to Financial Statements  
December 31, 2000

## **(1) Summary of Significant Accounting Policies**

### **Reporting Entities**

The Federated States of Micronesia Development Bank (FSMDB) was created in 1979 by Public Law 1-37 of the First Congress of the Federated States of Micronesia. The FSM Development Bank began its operations on October 1, 1980. The FSMDB was reorganized in January 1994 by Public Law 8-47 of the Eighth Congress of the Federated States of Micronesia. The purpose of the FSM Development Bank is to provide loans for economic development of the FSM. Such loans may otherwise be too risky for the commercial banks to underwrite. Additionally, the FSMDB's repayment terms tend to be longer than those offered by commercial banks.

The Investment Development Fund (IDF) was established by Public Law 5-122 in January 1989. The purpose of the IDF is to finance projects which will (1) have their operations primarily located within the FSM; (2) improve the balance of payments position of the FSM; (3) increase the value of visible and invisible exports or result in import substitutions; (4) demonstrate positive economic returns; (5) contribute to the furtherance of close economic relations with the USA.

The Pohnpei Development Loan Fund (PDLF) and the Yap Development Loan Fund (YDLF) are administered by the Bank in a Trust capacity. All loan decisions are made by executives of the respective state governments.

The FSMDB is a component unit (a discretely presented proprietary fund type) of the FSM National Government. The financial statements in this report do not represent the financial position, results of operations or cash flows of the FSM National Government as a whole. The financial statements of the FSMDB are not obligations of the FSM National Government unless specifically authorized by the FSM National Government. To date, no such authorizations have been made.

The Bank has opted to establish itself more in line with a corporate model. The Bank, through this process, hopes to be able to attract additional capital through non-FSM sources. To that end, the Bank as of December 31, 2000, has issued 2,897,883 shares to the FSM National Government (98.6%), Kosrae State (.3%) and Chuuk State (1.1%).

### **Fund Structure and Basis of Accounting**

The accounts of the FSMDB are organized as a discretely presented component unit - proprietary fund of the FSM National Government. Proprietary funds are used by governmental units to account for operations that are financed and operated in a manner similar to a private business. This accounting is appropriate when costs of providing goods or services to the general public are to be financed primarily through user charges or where the periodic determination of net income is appropriate for accountability purposes. The accrual basis of accounting is utilized by proprietary funds. Under the accrual basis, revenues are recorded when earned, and expenses are recorded at the time the liabilities are incurred.

The accounts of the IDF, PDLF and YDLF are accounted for as governmental fund types (capital projects funds) as the amounts are to be reported on the respective entities' financial statements (the FSM National Government, Pohnpei State and Yap State, respectively).

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Notes to Financial Statements  
December 31, 2000

(1) Summary of Significant Accounting Policies, Continued

Fund Structure and Basis of Accounting, Continued

Governmental funds are accounted for on a current financial resources measurement focus. With this measurement, only current assets and current liabilities are presented on the balance sheet. Long-term assets, such as loans, are recorded as reserves for related assets in fund balances. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses). The modified accrual basis of accounting is used by all governmental fund types. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). Expenditures are generally recorded at the time liabilities are incurred.

The accounting policies of the Bank conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. The Government Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting", requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Bank has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is based on the loans receivable of the Bank and does not take into account the outstanding balances of the managed funds. The allowance is maintained at a level adequate to absorb probable losses. Management determines the adequacy of the allowance based upon reviews of individual loans, recent loss experience, current economic conditions, the risk characteristics of the loans and other pertinent factors. Loans deemed uncollectible are charged to the allowance. Provisions for losses and recoveries on loans previously charged off are added to the allowance.

Loans for managed funds (PDLF and YDLF) do not carry a provision for loan losses. The loans are reserved in fund balance as a reserve for related assets. Loans are written off directly against income based on discussions with the owners of the managed funds.

Fixed Assets

Fixed assets are stated at cost, less accumulated depreciation. Depreciation is based on the straight-line method over the estimated useful lives of the respective assets. All of the assets have an estimated useful life of three years.

Interest Income on Loans

Interest on loans is accrued and credited to income based on the principal amount outstanding. The accrual of interest on loans is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due. Upon such discontinuance, all unpaid accrued interest is reversed.



**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Notes to Financial Statements  
December 31, 2000

(1) Summary of Significant Accounting Policies, Continued

Cash and Equivalents

For the purposes of the statement of financial condition and the statement of cash flows, cash and equivalents are defined as cash in bank checking and savings accounts, money market funds, and commercial paper with original maturities of three months or less from the date of acquisition. The Bank does not require collateralization of its cash in excess of FDIC limits; therefore, any amounts in excess of those limits are uncollateralized.

Totals - Memorandum Only

The "Totals-Memorandum Only" column represents an aggregate of the individual financial statements. The total column is presented only for information purposes and does not represent consolidated financial information.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the FSM Development Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and loan guarantees. Such financial instruments are recorded in the financial statements when they become payable.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(2) Deposits and Investments

FSM National Government statutes permit the FSMDB to invest in shares, stocks, mortgages, bonds, obligations, securities and investments of all kinds. IDF funds must be invested in short-term, readily marketable, investment grade nonconvertible bonds, guaranteed investment contracts issued by an insurance company with over \$1 billion in assets, or shares in a money market, open-ended, mutual fund.

Deposits with financial institutions at December 31, 2000, are categorized by risk as follows:

Amount insured or collateralized	\$ 300,000
Uninsured or uncollateralized	<u>3,226,165</u>
Total Deposits	\$ <u>3,526,165</u>

Management's confidence in the financial strength of their banking institutions was the basis of the decision to not require collateralization. No losses as a result of this practice were incurred for the year ended December 31, 2000.

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Notes to Financial Statements  
December 31, 2000

**(2) Deposits and Investments, Continued**

GASB Statement No. 3 requires government entities to categorize investments in the following categories to give an indication of the level of risk assumed by the entity at year end.

- Category 1 - Securities insured or registered and held by the FSMDB or IDF or its agent in the FSMDB's or IDF's name.
- Category 2 - Securities uninsured and unregistered and held by a party other than the FSMDB or IDF or its agent, in the FSMDB's or IDF's name.
- Category 3 - Securities uninsured and unregistered and held by a party other than the FSMDB or IDF and not in the FSMDB's or IDF's name.

Investments as of December 31, 2000, are carried at cost, which approximates market value, and are comprised of the following:

	<u>FSMDB</u>	<u>IDF</u>	<u>PDLF</u>	<u>YDLF</u>
U.S. Government obligations	\$ 7,685,000	\$ 8,850,000	\$ -	\$ -
Time certificates of deposit with original maturities of greater than ninety days	1,200,000	-	300,000	120,000
Investment premiums and discounts	<u>(56,276)</u>	<u>(57,069)</u>	<u>-</u>	<u>-</u>
	<u>\$ 8,828,724</u>	<u>\$ 8,792,931</u>	<u>\$ 300,000</u>	<u>\$ 120,000</u>

The difference between book and market values is not material. Management is of the opinion that it has the intent and ability to hold all of the securities to maturity and, therefore, no losses will be incurred. The investments held by the FSMDB and IDF have been classified as category 1 investments in accordance with the GASB Statement No. 3 as all investments are held in the name of FSMDB or IDF by Merrill Lynch, Inc.

**(3) Investment at Cost**

An investment in Bank of the FSM is carried at the lower of cost or market and is classified as an available for sale security. The FSMDB owns 100,000 shares (approximately 11%) of the stock outstanding. Prior to the year ending December 31, 1993, the stock in the Bank of the FSM was accounted for using the equity method which is required by APB Opinion No. 18 for an investor with shareholdings between 20% and 50% and exercising significant influence over the investee. Subsequent to that time, the FSMDB has elected to carry the investment at cost, which was the carrying value at cost on the date the number of shares held by the FSMDB became less than 20% of the outstanding shares. Since the shares are not readily tradeable and the book value of the shares exceed the carrying value, management does not believe that carrying the shares at cost represents a material difference from market value.

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Notes to Financial Statements  
December 31, 2000

**(4) Loans Receivable**

Loans receivable are reported net of the allowance for doubtful loans. The following is a schedule of loans receivable and the respective allowances as of December 31, 2000:

	<u>Loan Balance</u>	<u>Allowance</u>	<u>Net Amount</u>
FSMDB	\$ 19,938,920	\$ (4,932,748)	\$ 15,006,172
State Development Funds (Pohnpei and Yap)	343,313	-	343,313
IDF	<u>8,059,566</u>	<u>(1,653,820)</u>	<u>6,405,746</u>
	\$ <u>28,341,799</u>	\$ <u>(6,586,568)</u>	\$ <u>21,755,231</u>

Maturities of the above principal balances of these loans will be as follows:

Fully matured and others	\$ 777,537
1 - 6 months	370,360
7 - 18 months	1,025,345
19 months - 3 years	8,413,374
After 3 years	<u>17,755,183</u>
	\$ <u>28,341,799</u>

**(5) Allowance For Doubtful Accounts**

An analysis of the change in the allowance for doubtful loans is as follows:

	<u>FSMDB</u>	<u>IDF</u>
Balance - December 31, 1999	\$ 4,688,540	\$ 12,007,886
Loans charged off	(886,511)	(10,461,927)
Provision for doubtful loans	957,764	107,861
Loan recoveries for previously charged off loans and other adjustments	<u>172,955</u>	<u>-</u>
Balance - December 31, 2000	\$ <u>4,932,748</u>	\$ <u>1,653,820</u>

**(6) Fixed Assets**

A summary of fixed assets as of December 31, 2000, is as follows:

	<u>FSMDB</u>
Office furniture, fixtures and equipment	\$ 156,115
Home furniture, fixtures and equipment	39,084
Vehicles	152,459
Computers and software	<u>243,950</u>
Total	591,608
Less accumulated depreciation	<u>(499,875)</u>
Net fixed assets	\$ <u>91,733</u>

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Notes to Financial Statements  
December 31, 2000

**(7) Related Party Transactions**

As of December 31, 2000, the Bank has twenty-eight loans totaling \$3,101,416 to employees and spouses of employees of the Bank of which six loans totaling \$2,955,113 are considered to be normal bank project loans. These loans are made under the same terms and conditions as exist with other borrowers. Officers and Board members are not eligible to borrow from the Bank.

**(8) Commitments and Contingencies**

The Bank is contingently liable on loan guarantees to the Bank of the FSM, Bank of Hawaii, and Bank of Guam, ranging from 50% to 90% of the outstanding loan balances for commercial projects within the FSM. Outstanding loan balances on the guarantees as of December 31, 2000, are as follows:

<u>Type of Project</u>	<u>Amount</u>
Commercial	\$ 553,877
Real estate	<u>314,766</u>
	\$ <u>868,643</u>

The FSMDB and PDLF have made loan commitments in the amounts of \$2,586,394 and \$2,067, respectively, at December 31, 2000. These are loans approved but undisbursed as of December 31, 2000.

**(9) Loan Participation - Sold**

Certain loans have been sold to the Pacific Islands Development Bank. The Bank has guaranteed repayment of these loans. The outstanding principal balance of these loans was \$106,588 at December 31, 1999, which was all paid off in fiscal year 2000.

**(10) Contribution From The FSM National Government**

The FSM Development Bank receives periodic subsidies of its operations from appropriations received from the Congress of the FSM. During the year ended December 31, 2000, the Bank did not receive such subsidies, but the Bank was reimbursed for expenses incurred in administering the IDF program from the IDF Private Sub Account for \$250,000.

Additionally, the Bank received \$1,000,000 of contributed capital additions during the year ended December 31, 1999, from the FSM National Government.



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Board of Directors  
Federated States of Micronesia Development Bank:

We have audited the financial statements of the Federated States of Micronesia Development Bank, as of December 31, 2000, and for the year then ended, and have issued our report thereon dated March 30, 2001. 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.

**Compliance**

As part of obtaining reasonable assurance about whether the Federated States of Micronesia Development Bank's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

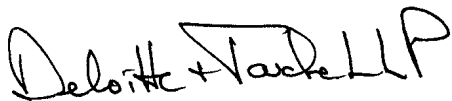
**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Federated States of Micronesia Development Bank's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect the Federated States of Micronesia Development Bank's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2000-1 through 2000-3.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our

consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended for the information of Board of Directors and management of the Federated States of Micronesia Development Bank, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Nauck LLP". The signature is written in a cursive, stylized font.

March 30, 2001



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER  
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

The Board of Directors  
Federated States of Micronesia Development Bank:

Compliance

We have audited the compliance of the Federated States of Micronesia Development Bank with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its one major federal program for the year ended December 31, 2000. Federated States of Micronesia Development Bank's major federal program is identified in the Schedule of Expenditures of Federal Awards (page 15). Compliance with the requirements of laws, regulations, contracts and grants applicable to its one major federal program is the responsibility of Federated States of Micronesia Development Bank's management. Our responsibility is to express an opinion on Federated States of Micronesia Development Bank's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Federated States of Micronesia Development Bank's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Federated States of Micronesia Development Bank's compliance with those requirements.

In our opinion, the Federated States of Micronesia Development Bank complied, in all material respects, with the requirements referred to above that are applicable to its one major federal financial assistance program for the year ended December 31, 2000.

Internal Control Over Compliance

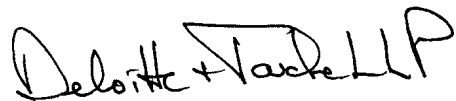
The management of the Federated States of Micronesia Development Bank is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing the audit, we considered the Federated States of Micronesia Development Bank's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

#### Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Federated States of Micronesia Development Bank, as of and for the year ended December 31, 2000, and have issued our report thereon dated March 30, 2001. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of the management of the Federated States of Micronesia Development Bank. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended for the information of Board of Directors and management of the Federated States of Micronesia Development Bank, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Tachell LLP". The signature is written in a cursive, stylized font.

March 30, 2001



# FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

## Schedule of Expenditures of Federal Awards Year Ended December 31, 2000 CFDA #15.875 - Department of the Interior

The Bank receives funds in a subrecipient capacity through the FSM National Government. The loan portfolio established through Section 111 of the Compact of Free Association and the loan portfolio established through Section 211 of the Compact of Free Association were selected for detailed compliance testing in accordance with applicable OMB Circular A-133 requirements. The following sets forth these contributions, by Sections, which are administered by the Bank.

Section 211 Compact Capital	Total funding received through December 31, 2000	\$ <u>23,700,000</u>
Section 111 IDF Funds	Total funding available through December 31, 1999	\$ 15,980,975
	Amount of revenues under expenditures and other sources during year ended December 31, 2000	<u>(259,331)</u>
	Fund balance as of December 31, 2000	\$ <u>15,721,644</u>

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Schedule of Findings and Questioned Costs  
Year Ended December 31, 2000

**Part I - Summary of Auditors' Results**

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, none of which are considered to be material weaknesses.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were not identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by OMB Circular A-133.
7. The Organization's major program is:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Compact of Free Association	15.875

8. No Type B programs as those terms are defined in OMB Circular A-133 are administered by the Organization.
9. The Organization did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

**Part II - Financial Statement Findings Section**

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
2000-1	Undisbursed Loans	\$ -	17
2000-2	Fixed Assets Subsidiary Schedule	\$ -	18
2000-3	Investment Schedules	\$ -	19

**Part III - Federal Award Findings and Questioned Cost Section**

No matters are reportable.

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Schedule of Findings and Questioned Costs  
Year Ended December 31, 2000

Undisbursed Loans

Finding No. 2000-1

Criteria: FSM Development Bank maintains a policy whereby a borrower is to take availments of the loan ninety days after the loan is approved and all proper documentation is secured.

Condition: During testing of undisbursed loan amounts, it was noted that three loans (D3F-2045, D3B-2225 and D3E-2300) were approved during fiscal year 2000 but had no disbursements by the end of the year or soon thereafter. There were also several other small loans (approximately 25) which were approved and had no disbursements. This appears to be in violation of FSMDB's loan policy.

Cause: It appears that several of these loan borrowers encountered problems with their respective projects.

Effect: No financial statement impact results from this condition; however, the Bank is reserving funds for these loans when such could be used for other purposes.

Prior Year Status: This finding was also noted in our schedule of findings and questioned costs for the fiscal year ended December 31, 1999.

Recommendation: The Bank should follow up on these loans and consider canceling such (especially the older ones as noted above) as the funds reserved for these loans could be used for other borrowers. The Bank should also review these loans as they appear to contradict the Bank's availment policy. If the borrower has a valid reason for no availments being taken, such should be documented and management may want to consider increasing the availment period for these specific borrowers in order to adhere to the availment policy.

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Schedule of Findings and Questioned Costs  
Year Ended December 31, 2000

Fixed Assets Subsidiary Ledger

Finding No. 2000-2

Criteria: The Bank should maintain a subsidiary fixed assets register which reconciles to the general ledger.

Condition: During fixed assets additions testing, it was noted that the detail schedule provided by FSMDB for additions, disposals and accumulated depreciation did not reconcile to the general ledger by an immaterial amount (adjustment not considered necessary).

Cause: The cause of this condition is unknown.

Effect: The effect of this condition is that the fixed assets account may be misstated if the subsidiary detail ledgers are not reconciled to the general ledger.

Prior year status: This was also a finding in our schedule of findings and questioned costs for fiscal year ended December 31, 1999.

Recommendation: Fixed assets subsidiary ledgers should be maintained and periodically reconciled with the general ledger to ensure that such ties out and that the balances can be adequately supported.

**FEDERATED STATES OF MICRONESIA  
DEVELOPMENT BANK**

Schedule of Findings and Questioned Costs  
Year Ended December 31, 2000

Investment Schedule

Finding No. 2000-3

Criteria: Detail supporting schedules should be prepared for certain account balances.

Condition: While performing detail tests over the investment accounts it was noted that detail schedules for accrued interest receivables were not prepared. However we were able to perform detail tests over these accounts using other schedules.

Cause: The cause of this condition is unknown.

Effect: There is no material impact on the financial statements as a result of this condition, however not having completed schedules for these accounts may mean that such are not properly recorded.

Recommendation: Detailed supporting schedules should be prepared for accrued interest receivables, which include the description of investment, the principal amount, date of purchase, due date, effective date, date interest last paid, number of days to fiscal year end, days to maturity, amount receivable and amount of income to ensure that such is properly recorded and substantiated.

**FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK**

Schedule of Prior Year Audit Findings  
Year Ended December 31, 2000

Prior year audit findings are included in the Schedule of Findings and Questioned Costs (pages 17-19).