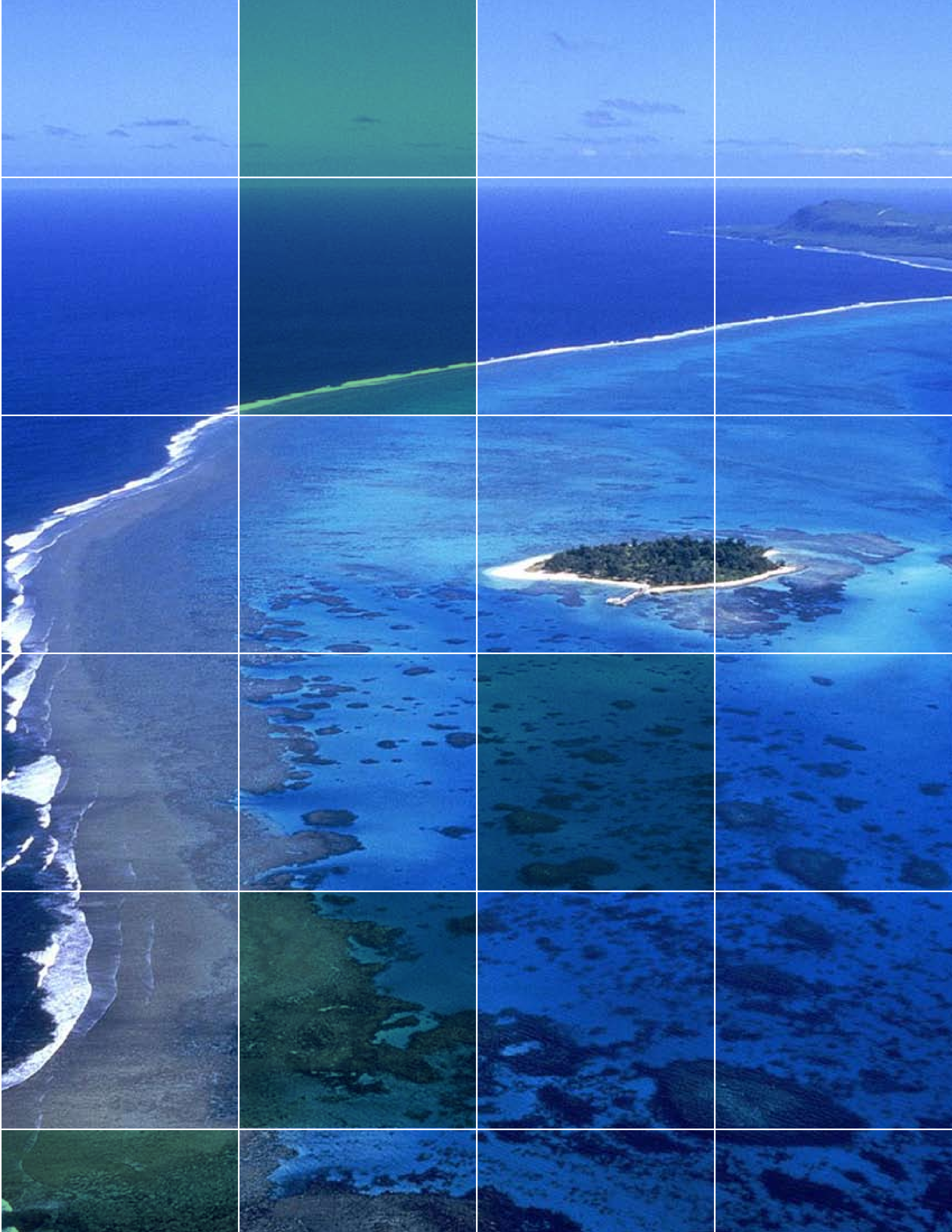
FSMDB

Federated States of Micronesia Development Bank
2008 Annual Report



VISION STATEMENT

The FSM DEVELOPMENT BANK is a key player in the development of the private sector in the Federated States of Micronesia that enjoys the confidence of the national and state leaders, its customers, regulators and stakeholders.

FSMDB services and performance are comparable to the best-managed development financial institutions in the Pacific region.

MISSION STATEMENT

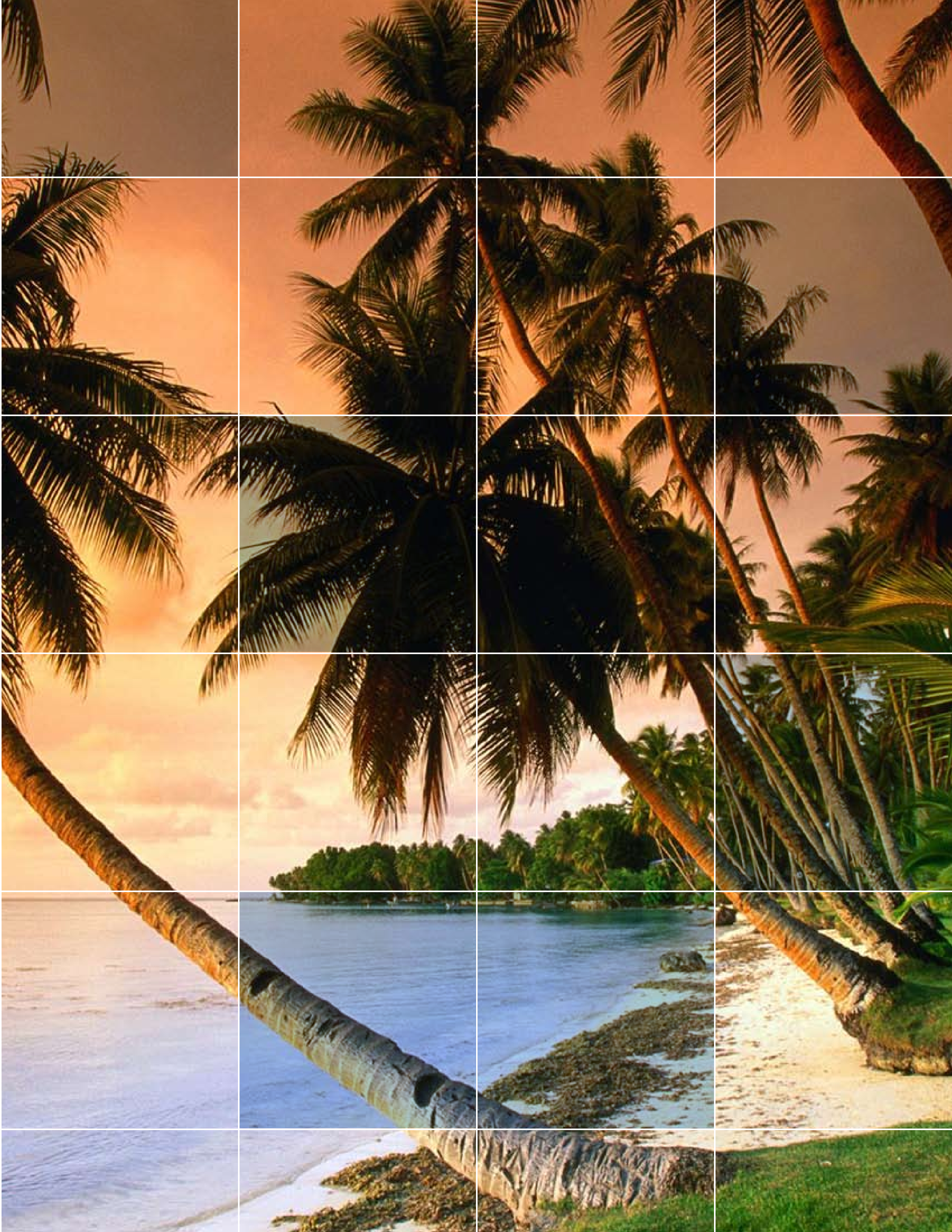
FSM Development Bank actively promotes the growth of micro, small and medium enterprises in the Federated States of Micronesia and supports programs designed to help business achieve greater efficiency in their operations.

The policies of the FSMDB are constantly aligned with the overall socio-economic goals of the nation and it continues to coordinate closely with the governments and community leaders in defining its strategic directions.

FSMDB processes are designed to deliver efficient and timely services to its customers, and ensure effective exchange of information at all levels of the organization.

The FSMDB organization is characterized by a high level of teamwork and morale. FSMDB supports its people with appropriate equipment and technology, ensures that its compensation and reward program are competitive within the industry, and implements a conscious program for the continuous professional growth and personal development of its people.

FSMDB maintain a consistently healthy and growing financial portfolio and continues to earn the respect and support of the general public, the various governments, donor agencies and the international financial community.



CONTENTS

DEAR SHAREHOLDERS

On behalf of the Board of Directors, we are pleased to submit FSMDB's (bank) 2008 annual report.

2008 was a difficult year for the bank. The bank's investments in the U.S. equity market dramatically dropped in value as a result of what was considered to be the worst financial crisis since the great depression of the 1930's. Because of the decline in the value of its investments and despite improved revenue generated from operations, the bank reported a net loss of $1.6 million for the year ending December 31, 2008.

The FSM economy pretty much came to a halt in the latter half of the year as businesses and households in the FSM alike felt the adverse impact caused by the economic downturn in the industrialized nations. These events happening in places thousands of miles away, affected daily lives in the FSM most notably the high cost of fuel. The dramatic increase in fuel prices, where in some cases as much as three to four times, curtailed economic activities in the FSM. Businesses faced increased costs of doing business and households faced increased prices in essential goods and services. The net impact, we believed, resulted in the economy contracting mainly due to a decline in the demand for goods and services due to high prices. These likely scenarios perhaps contributed and could provide some explanation to the bank's unfavorable operational results in 2008.

Despite the bank's unfavorable operational results, key areas in the its operations showed favorable trend at year end 2008 such as:

- Fueled by stockholder's equity, assets continue to show a favorable trend with nominal growth at an average rate of 1.8% since 2004.
- Liabilities increased in 2008 by over $2 million, but remained within acceptable level at 6% of total assets at year end 2008.
- Stockholder's equity (net assets) was 94% of total assets as of December 31, 2008. At this level, the bank is adequately positioned to sustain future growth and absorb unexpected losses.
- Revenues, inclusive of non-operating revenues, resulting from the bank's operations, particularly loan interest income, improved and maintained a positive trend. Had it not been for the drop in the value of the investment portfolio, the bank could have reported a gain rather than a loss.
- General and administrative expenses have been consistently maintained well within budget for the last five years averaging about 76% of total operating revenues.
- The loan portfolio has remained rela-

tively stable with minimal growth in the last five years. The interest income trend from the loan portfolio on the other hand, has been positive. The real rate of return on the loan portfolio surpassed the year's target of 8.0% to end 2008 with 8.4%, a significant improvement from 7.3% reported for 2007.

- Delinquency remained high but improving. The bank ended the year 2008 with a default ratio of 27% as compared to 33% for the previous year. The trend is positive and encouraging.

Contributions from the bank's principal shareholder – the FSM National Government is unlikely in the near future. The need to mobilize funds elsewhere to fund the bank's lending programs is seemingly imminent. The bank's debt position, therefore, is likely to increase as we continue to pursue funding sources for the bank's lending programs. It is highly probable that these sources will likely come in the form of loans.

THE $2 MILLION DOLLAR LOAN WITH THE CHINA EXPORT AND IMPORT BANK WAS FULLY DRAWN AND RE-LENT IN 2008. 27 PROJECTS WERE FUNDED WITH THIS SOURCE. WE ARE NEAR TO CLOSING A $466 THOUSAND LOAN FROM THE RURAL DEVELOPMENT OFFICE UNDER THE U.S. DEPARTMENT OF AGRICULTURE. THIS SOURCE IS EXPECTED TO BECOME AVAILABLE FOR ON-LENDING IN 2009. STILL IN THE DISCUSSION STAGE, WE ARE PURSUING A $5 MILLION LINE OF CREDIT FROM THE EUROPEAN INVESTMENT BANK.

The bank began extending line of credit and housing loans in 2008. These are the newest addition to the bank's services. Also during the year, the bank modified its sector classification to accurately reflect the specific industries it lends. The sectors are now classified in eight industry categories as follows: 1) Agriculture/Fishery/Forestry, 2) Manufacturing, 3) Real Estate, 4) Wholesale/Retail, 5) Construction/Mining, 6) Tourism, 7) Services and 8) Transportation.

53 loans were approved in 2008 with a total value of $4.6 million dollars. With the modified sector classification, the 2008 approvals in terms of percentages were as follows: Agriculture/Fishery/Forestry - 1%; Manufacturing – 2%; Real Estate – 8%; Services – 4%; Transportation – 30%; Construction/Mining – 25%; and Tourism – 24%.

We anticipate economic conditions to improve in 2009. More lending, particularly short term working capital financing, is expected to pick up in the construction industry as more and more infrastructure projects under the compact is coming to realization. We also expect the housing loan program to augment the bank's loan portfolio.

In closing, we wish to acknowledge and extend our sincere gratitude and appreciation for your continued support and confidence in the FSMDB. We further extend the same to our esteem colleagues, the members of the Board of Directors, for their unwavering commitments and valuable insights that they have contributed throughout the years toward the advancement of this institution We wish to also thank our employees for their hard work and their firm commitments to put our words into actions. And finally, we thank our customers for their continued loyalty and confidence in the FSMDB. We thank you for giving us the opportunity to serve you. It is our hope that you will continue to allow us to serve you while extending opportunities to other aspiring entrepreneurs. As always, we shall remain your partner in business.

Sincerely,

Anna Mendiola,
President/CEO

Ihlen Joseph,
Chairman - Board of Directors

ABOUT THE BANK

The Federated States of Micronesia Development Bank (FSMDB) is a subcomponent unit of the National Government of the Federated States of Micronesia (FSM). It was chartered in 1979 by the First Congress of the Federated States of Micronesia. The bank opened in 1980 but did not start actual lending until 1982. In 1994, the enabling law that created the bank was amended to reorganize the structure of the bank to reflect that of a normal corporation. The bank, however, maintained its subcomponent status.

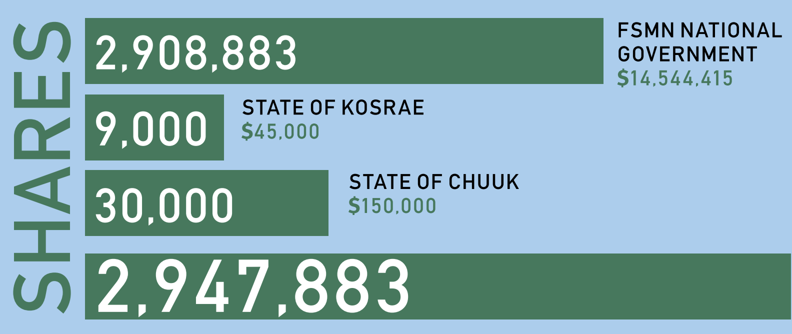
Within the same amendment, the bank is authorized to engage in all banking functions. To date the bank remains primarily engaged in providing financing to viable commercial oriented endeavors within the Federated States of Micronesia. Its primary mandate in general is to help develop and strengthen the private sector to ultimately help advance the economic development of the FSM. The ban had just recently added home loans as an additional service to the people of the FSM.

The bank's main office is located in Pohnpei, the capital of the FSM. It has branch offices in all the four islands that make up the FSM – Pohnpei, Chuuk, Kosrae and Yap. The United States Dollar (USD) is the official currency of the FSM. All the financial reports and transactions presented in this report are in USD.

SHAREHOLDERS

The FSM National Government is presently the principal shareholder of the bank. It owns 98.7% of the outstanding shares. The States of Chuuk and Kosrae each own 1.0% and 0.3% of the bank's outstanding shares respectively. The States of Pohnpei and Yap are not shareholders but they are given representation on the Bank's Board of Directors as a courtesy.

The Bank's fiscal year runs on a calendar year basis. The shareholder meets annually normally during the second Quarter of the Bank's fiscal year.



TOTAL SHARES OUTSTANDING

$14,739,415

BOARD OF DIRECTORS

Because of the need to operate the bank in a commercial manner, a board was created to oversee the affairs of the Bank. The board is comprised of seven members. Six of them are elected by the shareholders. The FSM National Government is represented with two seats on the board. The four states are each accorded a seat more or less as a courtesy. The seventh member is the President and Chief Executive Officer (CEO), who serves as the Ex-Officio to the board. Despite the ownership make-up, all of the Board members have equal voting rights. Aside from the Ex-Officio, all Board members serve a term of 3 years on a staggering basis. Regular Board meetings are held four times a year on a calendar quarterly basis. Special meetings can be held at the discretion of the Board.

The composition and representation of the board as of December 31, 2008 were as follows:

Name	Position	Representation
Ihlen Joseph	Chairman	FSM National Government
Hilary Tacheliol	Vice Chairman	Yap State
Ramon Falcam	Member	FSM National Government
John Sohl	Member	Pohnpei State
Wilson Waguk	Member	Kosrae State
Sisionio Welly	Member	Chuuk State
Anna Meniola	Ex-Officio	President/CEO FSMDB

Ihlen Joseph
Chairman
FSM National Government

Hilary Tacheliol
Vice Chairman
Yap State

Ramon Falcam
Member
FSM National Government

John Sohl
Member
Pohnpei State

Wilson Waguk
Member
Kosrae State

Sisionio Welly
Member
Chuuk State

Anna Mendiola
Ex-Officio
President/CEO FSMDB

MANAGEMENT AND STAFF

Reporting to the board is a management team comprised of a President/Chief Executive Officer, a Senior Vice President, a Chief Financial Officer and a Senior Lending Officer. These four positions are the senior officers of the bank. Assisting the senior management and the board on legal and compliance matters, the bank employs an In-House Legal Counsel and an Internal Auditor respectively. The branch offices each have a Branch Manager who supervises the daily operations of the branches. In total, the bank employed 35 people at year end 2008.

The composition of the bank's senior management team as of December 31, 2008 were as follows:

Name	Position	E-MAIL
Anna Mendiola	President/CEO	annam@fsmdb.fm
Stevenson Joseph	Senior Vice President	stevej@fsmdb.fm
Sihna Lawrence	Chief Financial Officer	sihnal@fsmdb.fm
Peter Aldis	Senior Loan Officer	petera@fsmdb.fm
Nora Sigrah	Legal Counsel	noras@fsmdb.fm
Internal Auditor	Vacant	

Anna Mendiola
President / CEO

Stevenson Joseph
Senior Vice President

Sihna Lawrence
Chief Financial Officer

Peter Aldis
Senior Loan Officer

Norah Sigrah
Legal Counsel

CORPORATE OFFICE STAFF

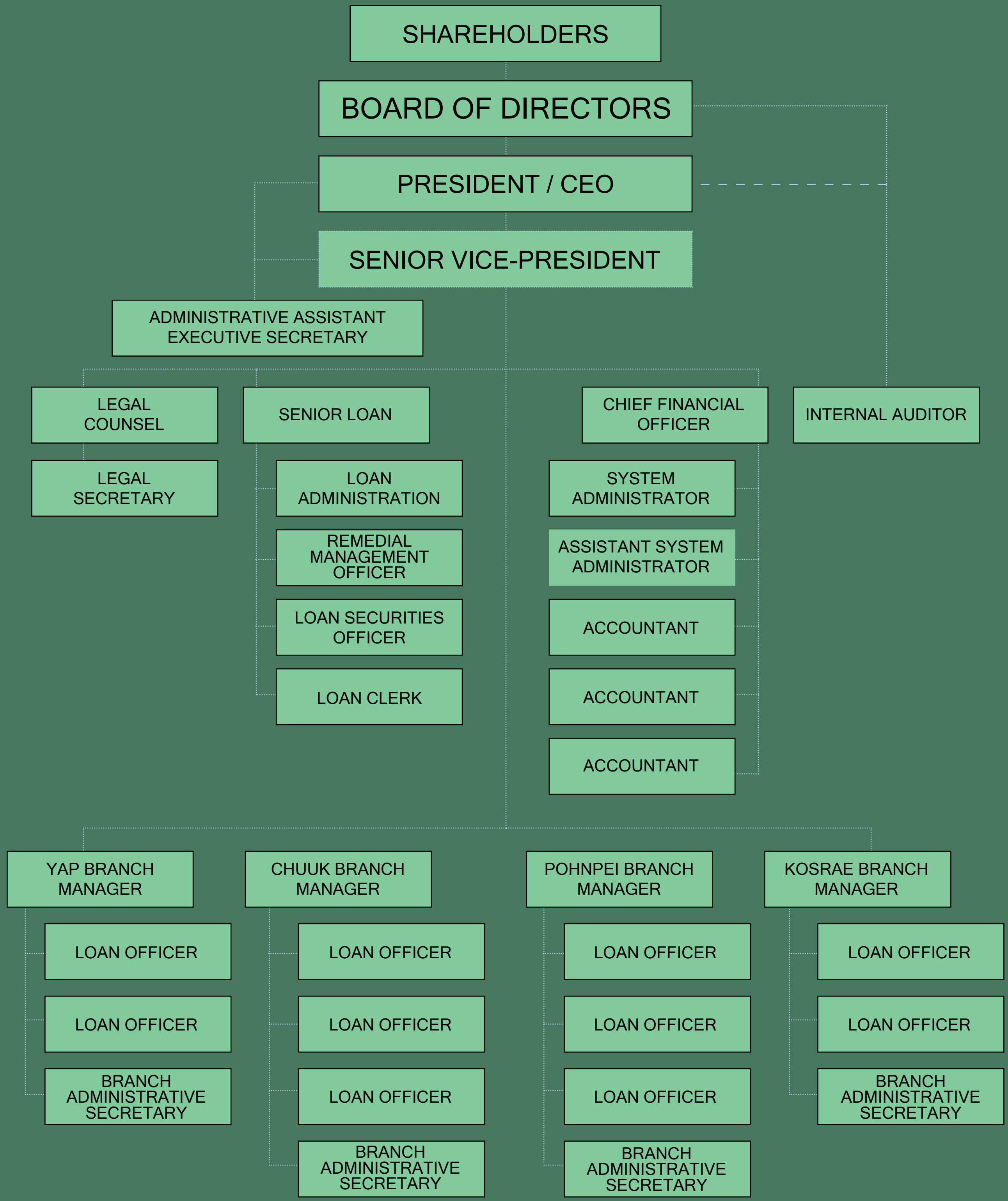
POHNPEI BRANCH

CHUUK BRANCH

YAP BRANCH

KOSRAE BRANCH

ORGANIZATIONAL CHART



MANAGEMENT REPORT

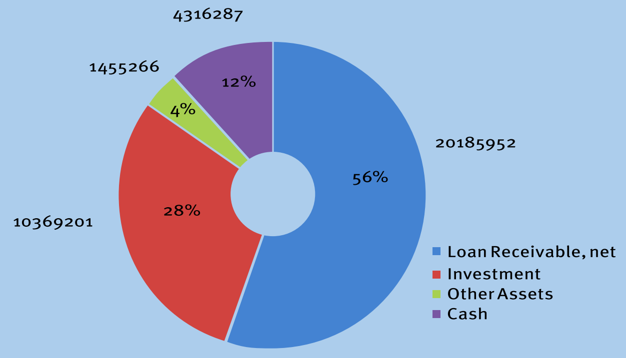
Assets continue to grow at a nominal rate. The bank ended 2008 with $36.3 million in total assets, up by a percent from $35.8 million reported for 2007. Steady growth in the bank's assets has been evident since 2004 at a nominal rate of 1.8% a year.

Total assets were largely comprised of the loan portfolio, the investment portfolio and cash at year end 2008. Collectively, these three components alone made up 96% of the bank's total assets as of December 31, 2008. The remaining 4% lumped together as other assets, included shares in the Bank of FSM, interest receivables, fixed assets, and receivables from administered funds, accounts receivables and pre-paid expenses.

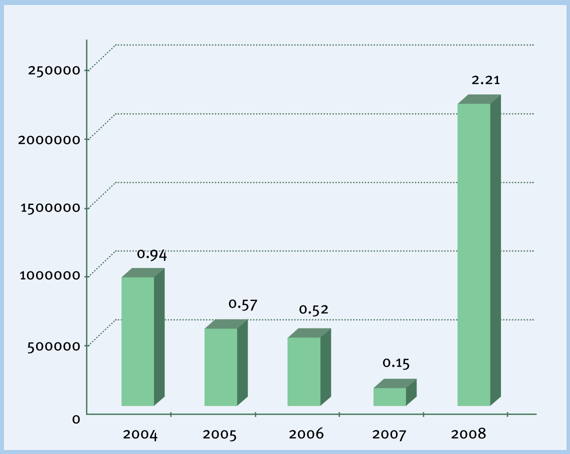
Liabilities totaled $2.2 million at year end 2008. This was a substantial increase from $146,657 that was posted at year end 2007. The increase resulted from a $2 million loan from the China Export and Import Bank.

The bank's debt position is likely to increase in the forthcoming years as it continues to seek funding to support its lending programs. Funds are likely to come in the form of loans.

The bank's total debt was 6% of total assets as of December 31, 2008.



Asset Components
As of December 31, 2008

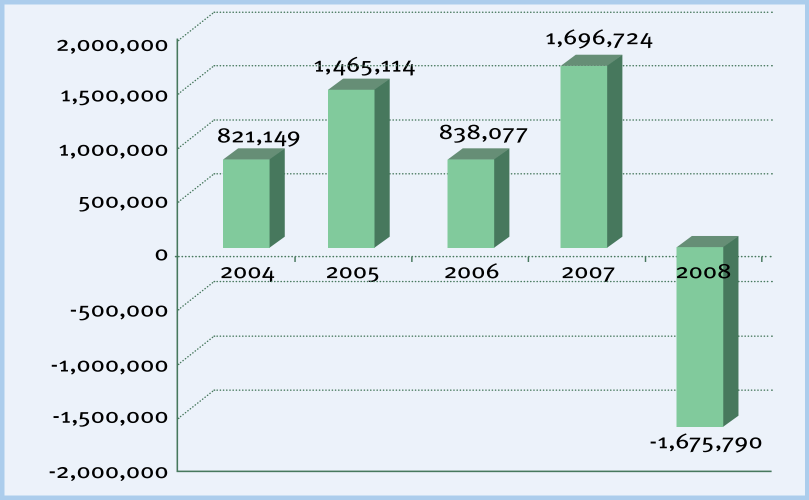


Liability Trend

Stockholder's equity (Net Assets) position declined by 5% due to the loss in the investment portfolio but remained at a favorable level at 94% of total assets as of December 31, 2008.

Net Assets (Equity)

Revenues derived from the bank's operations in 2008 were insufficient to offset the decline in the value of the bank's investment portfolio in the U.S. equity market. As a result, the bank reported a net loss of $1.6 million for the year ending December 31, 2008.

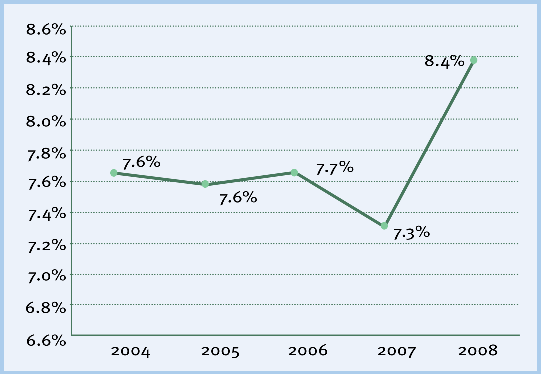


Net Profit/Loss Trend

MANAGEMENT REPORT

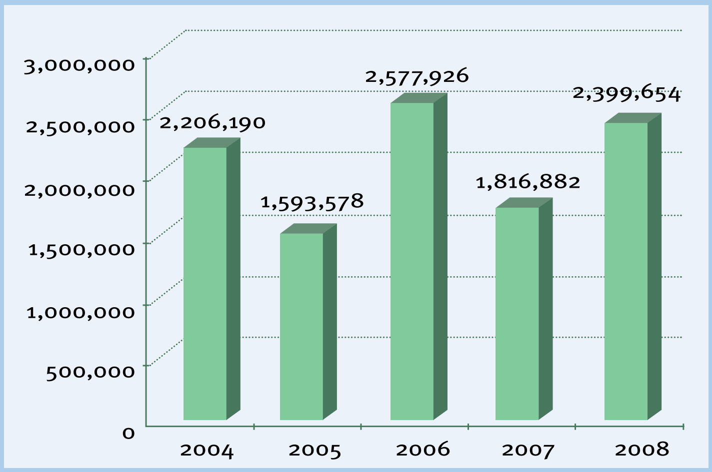
Interest income, although not yet sufficient to alleviate expenses, continues to demonstrate a positive trend. Particularly this year, the rate of return for the loan portfolio registered at 8.4%, surpassing the 2008 target and 2007 result of 8.0% and 7.3% respectively. The trend is encouraging.

Loan Interest Income Trend



Rate of Return - Loan Portfolio Trend

Expenses on the other hand remained within budget but increased from $1.8 million in 2007 to $2.4 million in 2008. The increase was largely attributed to higher provisioning for loan losses in 2008.



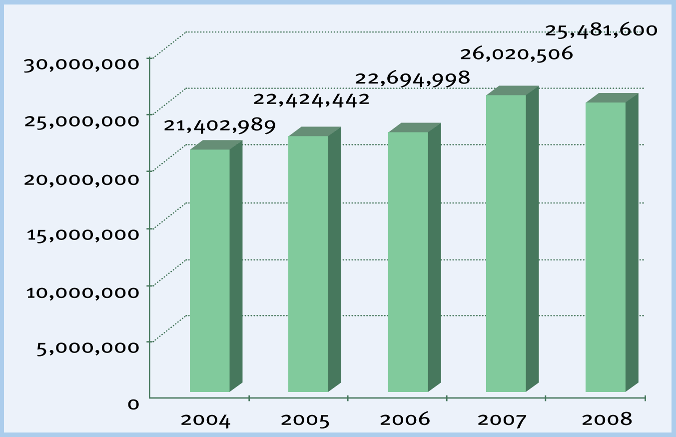
Total Expenditures Trend

The bank's earnings had been quite strong since 2004 and have all been retained, which can explain the rapid growth seen in its Net Asset position.

Asset Trend

Loan Report

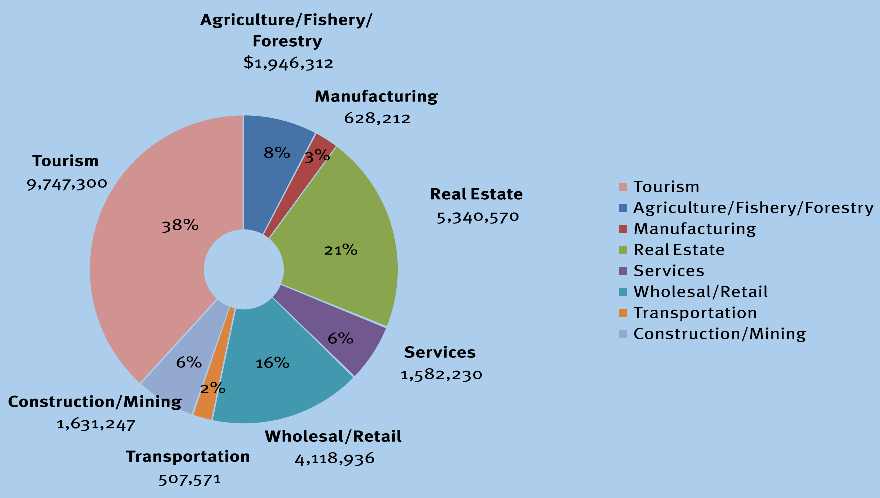
The loan portfolio exhibited growth since 2004 but showed a slight drop from $26 million as of December 31, 2007 to $25.5 million as of December 31, 2008.



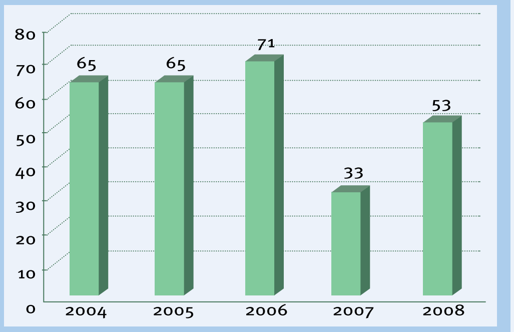
Gross Outstanding Loans Trend

MANAGEMENT REPORT

During the year, the bank modified its sector classification to accurately reflect the specific industries it lends. The sectors are now classified in eight industry categories as follows: 1) Agriculture/Fishery/Forestry, 2) Manufacturing, 3) Real Estate, 4) Wholesale/Retail, 5) Construction/Mining, 6) Tourism, 7) Services and 8) Transportation.



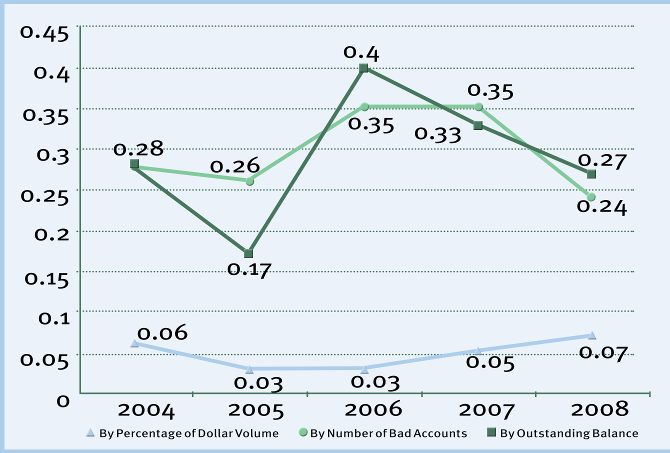
53 loans were approved in 2008 with a total value of $4.6 million dollars. Compared to the 2007 results, the number of loans improved from 33 but the dollar amount decreased from $6.7 million. The impact of the global economic downturn in the FSM is believed to have contributed to the low lending results in 2008.



Loan Approval by number

Loan Approvals by Amount ($) Trend

The bank measures the quality of its portfolio on three fronts: 1) by number of accounts, 2) by payments in arrears and 3) by outstanding balance. The following chart depicts the delinquency trend since 2004 for all three fronts. As illustrated, loan delinquency by number of accounts and outstanding balance both improved in 2008. The former went from 35% in 2007 to 24% in 2008, while the latter went from 33% in 2007 to 24% in 2008. On the other hand, delinquency by payments in arrears increased from 5% in 2007 to 7% in 2008.



Loan Delinquency Trend

The bank began extending line of credits and home loan in 2008. The former is believed to have contributed to higher than expected IRR of 8.4% reported for the year as compared to the 7.3% for 2007. As of December 31, 2008 the bank had extended total of 14 lines of credit valued more than $2 million. There were no home loan approvals in 2008.

Funding Sources Update

The Bank's funding source for its lending activities is primarily derived from loan collections. On an average, the bank recovers about $4 million a year in loan principal.

Capital contribution from Shareholders, particularly from the FSM National Government appears grim. Therefore, the bank has taken steps to mobilize funds from other sources. As of December 31, 2008 the bank had:

- Fully drawn and on-lent the $2 million loan from the China Export and Import Bank. This source funded 27 projects in 2008.
- Entered into a loan agreement with the U.S. Department of Agriculture through its Rural Economic Community Development Services (RECDS) for $466 thousand.
- Discussed and will continue to pursue a $5 million line of credit with the European Investment Bank.

The bank's strategic goal is to lend out $9 million a year in order for it to be self-sustaining.

MANAGEMENT REPORT

Administered Funds Update

Aside from the Direct Loan Portfolio, the Bank manages three non-propriety type funds: 1) the Investment Development Fund (IDF), 2) the Pohnpei Loan Development Fund (PDLF) and 3) the Yap Loan Development Fund (YDLF). The fund status and balances for each of the funds types mentioned above are reported in the financial section of the report.

The IDF was a special fund established during the first Compact Agreement with the United States. The main purpose of this fund was to finance large-scale development projects through joint ventures between citizens of the FSM and United States investors. The fund was pledged $60 million but only $20 million was availed.

Loan decisions for the states' IDF sub-accounts are made with a body called the Federal Development Authority (FDA) made up of the executives of the five governments – the President of the FSM and the Governors of the four states. The FSMDB has sole approval authority on the Private Reserve sub-account. FSMDB's role on the sub-accounts aside from the custodian of the funds is limited to reviewing project proposals and presenting its findings to the FDA for its decision.

Similarly, the PDLF and the YDLF are set up the same as the IDF. All loan decisions are made by the Governors of the respective States.

Loans to Women Update

The Bank's total lending to loans classified as loans to women to date since 2000 totaled 299 loans with a total value of $9.6 million. These are loans with women being the principal borrowers. It should be noted, however, that a large portion of the projects under the current portfolio is either co-owned or managed by a woman.

Personnel Update

The bank employed 34 people as of December 31, 2008. During the year, the following changes in personnel took place:

Chuuk Branch: Loan Officers Anselmo Daniel and Evelyn Paul resigned to pursue other career opportunities. Two loan officer vacancies were announced. Janet Sisam was hired to fill one of the vacancies and the other was vacant as of December 31, 2008.

Yap Branch: Loan Officer Christopher Buchun resigned for personal reasons. A vacancy was announced but unfilled as of December 31, 2008.

Corporate Office: Rohma Silbanuz resumed her former role as the Legal Secretary. Sincerlyn Alten was hired as an Administrative Secretary.

Training Update

Because of the bank's poor financial performance, staff training was minimal. The bank expended only 20% of its 2008 budget as compared to 92% in 2007. The bank's training needs are primarily focused on the credit officers and management.

Information System Update

The bank launched its official website (fsmdb.fm) in the second quarter of 2008. As an added benefit to the website at no additional cost, all staff members now have access to e-mail and chat, unlike the former e-mail set up where only a few staff members had access. The current e-mail system is web based and has significantly improved communication between offices and amongst employees.

With concurrence from the Department of Economic Affairs of the FSM National Government, the bank cancelled the implementation of the Banker's Realm software in 2008. The main reason for the cancellation was because numerous issues regarding the functionality of the program remained unresolved and the company that was contracted to develop the program became unresponsive to our inquiries. The project began in October of 2005. After almost three years and the company unable to address the concerns, we felt it was necessary to cancel the project and look for other alternatives.

As of yearend 2008, the bank has yet to find a suitable program and will continue its search.

Strategic Plan Update

The bank's strategic plan is due for a review. We are working with the office of SBOC for a TA to hire a consultant to assist management assess the bank's strategic accomplishments and directions with respect to its current strategic plan.

Management contends that the bank is pretty much on track on its financial objectives.

Bank Facilities and Equipment Update

There were no major developments in the bank's facilities and equipment in 2008. The Chuuk branch office was in the process of relocating to a different location. Relocation was expected to be completed by the second Quarter of 2009.

No large equipment purchases were made in 2008.

MANAGEMENT REPORT

Programs Update

The Bank contributed to various civic activities throughout the FSM during the year. However, because of the poor financial performance, management curtailed the bank's contributions in 2008 as compared to previous years.

The Bank awarded two scholarships in the amount of $5,000 each in 2008. The program primarily targets students pursuing graduate degrees in business, economics, finance, accounting and other related fields. Applications for undergraduates can also be considered if there are no qualified graduate applications.

Associations and Memberships Update

The Bank is an active member of the following professional and regional associations.

- Association of Development Financial Institution Asia and Pacific (ADFIAP)
- Association of Developmental Financial Institutions of the Pacific (ADFIP).
- Association of the Pacific Island Public Auditor (APIPA)
- Asia Pacific Association for Fiduciary Studies (APAFS)
- Federated States of Micronesia Executive Insurance Board (FSMEIB)

Acknowledgements

We extend our sincere appreciation to the FSMDB stockholders for the continued support and confidence in us.

We thank our Board of Directors for the steadfast support of our plans, programs and initiatives. Amidst all the challenges in the operating environment, the steadying hand of the Board and its collective wisdom enabled us to stay the course with focus and persistence.

We thank the hard working staff for their perseverance and patients and for their judicious implementation of their assigned tasks. Without them nothing would have happened.

Finally, we extend appreciation and thanks to those we serve for the trust and confidence they have in us and for allowing the FSMDB the opportunity to serve and assist in their business ventures. We shall always remain your partner in business.

Special Acknowledgements

We would like to take this opportunity and extend our appreciation and thanks to the following staff who left the Bank in 2008 to pursue other career opportunities or for other personal reasons:

- Evelyn Paul, Chuuk Loan Officer
- Anselmo Daniel, Chuuk Loan Officer
- Christopher Buchun, Yap Branch Manager

Likewise, we would like to welcome the new additions to the FSMDB Team:

- Sincerlyn Alten, Corporate Administrative Secretary
- Janet Sisam, Chuuk Branch Loan Officer

FEDERATED STATES OF MICRONESIA

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2008 AND 2007

Deloitte.

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USA
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INDEPENDENT AUDITOR'S REPORT

Chairman
Board of Directors
Federated States of Micronesia
Development Bank:

We have audited the accompanying statements of net assets of the Federated States of Micronesia (FSM) Development Bank, a component unit of the FSM National Government, as of December 31, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Federated States of Micronesia Development Bank as of December 31, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis on pages 3-4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Federated States of Micronesia Development Bank's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 17, 2009, on our consideration of the Bank's internal control over financial reporting and on our tests of its compliance with certain laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

June 17, 2009

Member of
Deloitte Touche Tohmatsu

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Statements of Net Assets
December 31, 2008 and 2007

	2008	2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,425,012	$ 1,890,029
Time certificates of deposit	891,275	300,000
Accounts receivable	6,593	2,638
Receivable from trust funds	225,017	306,008
Prepaid expenses	2,700	2,500
Interest and other receivables	244,252	128,529
Current portion of loans receivable	2,542,990	1,770,062
Total current assets	7,337,839	4,399,766
Noncurrent assets:		
Fixed assets, net	226,565	259,071
Investments	10,369,201	11,349,641
Equity investment, at cost	662,188	662,188
Loans receivable, net of current portion and allowance for loan losses	17,642,961	19,165,324
Total noncurrent assets	28,900,915	31,436,224
Total assets	$ 36,238,754	$ 35,835,990
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 400,000	$ -
Accounts payable	111,049	138,111
Accrued interest payable	69,902	-
Credit life payable	10,425	8,267
Payable to trust funds	15,838	279
Total current liabilities	607,214	146,657
Noncurrent liabilities:		
Long-term debt, net of current portion	1,600,000	-
Total liabilities	2,207,214	146,657
Commitments and contingencies		
Net assets:		
Invested in capital assets	226,565	259,071
Restricted	500,000	500,000
Unrestricted	33,304,975	34,930,262
Total net assets	34,031,540	35,689,333
Total liabilities and net assets	$ 36,238,754	$ 35,835,990

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2008 and 2007

	2008	2007
Operating revenues:		
Interest income on loans	$ 2,130,965	$ 1,900,360
Interest income on time certificates of deposit	49,572	65,625
Loan fees	71,057	111,767
Miscellaneous	81,632	74,702
Total operating revenues	2,333,226	2,152,454
Provision for loan losses	722,000	199,890
Net operating revenues	1,611,226	1,952,564
Operating expenses:		
Interest expense:		
Interest on long-term debt	103,349	-
General and administrative expenses:		
Personnel services	892,372	934,649
Rent	122,016	121,512
Travel	101,031	72,304
Depreciation	80,564	78,141
Contractual services	79,857	65,478
FSM retirement plan	54,035	52,733
Communications	37,174	39,303
Training	15,354	69,210
Supplies	14,606	13,607
Printing	7,639	1,410
Insurance	4,303	4,691
Miscellaneous expenses	165,357	163,955
Total general and administrative expenses	1,574,308	1,616,993
(Loss) earnings from operations	(66,431)	335,571
Non-operating revenues (expenses):		
IDF reimbursement	250,000	250,000
Allocations from managed funds	25,582	45,130
Investment (loss) earnings	(1,938,134)	993,097
Other income	71,190	72,925
Total non-operating revenues (expenses), net	(1,591,362)	1,361,152
Change in net assets	(1,657,793)	1,696,723
Net assets at beginning of year	35,689,333	33,992,610
Net assets at end of year	$ 34,031,540	$ 35,689,333

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Statements of Cash Flows
Years Ended December 31, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash received from customers	$ 2,210,570	$ 2,092,485
Cash paid to suppliers for goods and services	(626,476)	(667,539)
Cash paid to employees for services	(892,372)	(934,649)
Interest received on time certificates of deposit	53,496	60,188
Interest paid	(33,447)	-
Net cash provided by operating activities	711,771	550,485
Cash flows from noncapital financing activities:		
Net transfers in from (out to) trust funds	372,132	(110,493)
Cash flows from capital and related financing activities:		
Proceeds from issuance of long-term debt	2,000,000	-
Acquisition of fixed assets	(48,058)	(82,774)
Proceeds from sale of fixed assets	-	7,925
Net cash provided by (used for) capital and related financing activities	1,951,942	(74,849)
Cash flows from investing activities:		
Loan origination and principal collections, net	27,435	(2,219,525)
Additions to time certificates of deposit	(591,275)	(300,000)
(Additions to) withdrawals from investments	(1,000,000)	250,000
Investment income received	61,474	36,982
Investment fees paid	(63,496)	(40,573)
Dividends received	65,000	65,000
Net cash used for investing activities	(1,500,862)	(2,208,116)
Net change in cash and cash equivalents	1,534,983	(1,842,973)
Cash and cash equivalents at beginning of year	1,890,029	3,733,002
Cash and cash equivalents at end of year	$ 3,425,012	$ 1,890,029
Reconciliation of (loss) earnings from operations to net cash provided by operating activities:		
(Loss) earnings from operations	$ (66,431)	$ 335,571
Adjustment to reconcile (loss) earnings from operations to net cash provided by operating activities:		
Provision for doubtful loans	722,000	199,890
Depreciation	80,564	78,141
(Increase) decrease in assets:		
Accounts receivable	(3,955)	2,895
Prepaid expenses	(200)	-
Interest and other receivables	(65,205)	(2,676)
Increase (decrease) in liabilities:		
Accounts payable	(27,062)	42,793
Accrued interest payable	69,902	-
Credit life payable	2,158	(106,129)
Net cash provided by operating activities	$ 711,771	$ 550,485

See accompanying notes to financial statements.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITIES

The Federated States of Micronesia Development Bank (the Bank) 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 Bank 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 commercial banks to underwrite. Additionally, the Bank's repayment terms tend to be longer than those offered by commercial banks. As of December 31, 2008, the Bank has issued 2,997,883 shares to the FSM National Government (98.7%), Kosrae State (0.3%) and Chuuk State (1.0%).

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 Bank 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 Bank 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 in September 2007 has entered into a line of credit agreement with Export and Import Bank of China for $2,000,000. As of December 31, 2008 and 2007, the Bank has drawn $2,000,000 and $0, respectively, on this line. Additionally, the Bank has entered into a memorandum of understanding with the U.S. Department of Agriculture's Office of Rural Economic and Community Development to provide guarantees for housing loans in the FSM. An escrow account amounting to $510,543 and $500,406, respectively, was established for the housing guarantee as of December 31, 2008 and 2007.

FUND STRUCTURE AND BASIS OF ACCOUNTING

The accounts of the Bank 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 fiduciary fund types as the amounts are to be reported on the respective entities' financial statements (the FSM National Government, Pohnpei State and Yap State, respectively).

The Bank utilizes the flow of economic resources measurement focus. Its financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units using the accrual basis of accounting. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. 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 Principle 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.

The Bank has adopted GASB Statement No. 34, “Basic Financial Statements-and Management’s Discussion and Analysis-for State and Local Governments” (GASB 34) as amended by GASB Statement No. 37, “Basic Financial Statements – Management’s Discussion and Analysis-for State and Local Governments: Omnibus” and GASB Statement No. 38, “Certain Financial Statement Note Disclosures”. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following four net asset categories:

- Invested in capital assets, net of related debt:

  Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:

  - Nonexpendable – Net assets subject to externally imposed stipulations that require the Bank to maintain them permanently. For the years ended December 31, 2008 and 2007, the Bank does not have nonexpendable restricted net assets.

  - Expendable – Net assets whose use by the Bank is subject to externally imposed stipulations that can be fulfilled by actions of the Bank pursuant to those stipulations or that expire by the passage of time.

- Unrestricted:

  Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

CASH AND CASH EQUIVALENTS

For the purposes of the statements of net assets and the statements of cash flows, cash and cash 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.

Time certificates of deposit with original maturities of greater than three months are separately classified.

INVESTMENTS

Investments and related investment earnings are recorded at fair 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.

LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans are stated at unpaid principal balance less the allowance for loan losses.

Management maintains the allowance for loan losses 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 various categories of 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.

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.

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 assets have estimated useful lives of three to five years.

The Bank's policy on fixed assets requires that assets with a purchase value of $5,000 and over are capitalized and depreciated based on its useful life. Assets with a purchase value less than $5,000 are expensed fully in the year of purchase.

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. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

RECLASSIFICATIONS

Certain reclassifications have been made to the 2007 financial statements in order to conform with the 2008 presentation.

NEW ACCOUNTING STANDARDS

During fiscal year 2008, the Bank implemented GASB Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, GASB Statement No. 45, Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions, GASB Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues, GASB Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations, and GASB Statement No. 50, Pension Disclosures an amendment of GASB Statements No. 25 and 27. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments and GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing, and includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments – financial arrangements used by governments to manage specific risks or make investments – in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

DEPOSITS AND INVESTMENTS

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The deposit and investment policies of the Bank are governed by its enabling legislation. The Board is required to engage one or more fund custodians to assume responsibility for the physical possession of the Bank's investments. Legally authorized investments are as follows:

(i) Government obligations - Obligations issued or guaranteed as to principal and interest by the National Government and/or State governments of the Federated States of Micronesia or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.

(ii) Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the Federated States of Micronesia or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or other mortgage-backed securities provided that the obligation is an agency of the United States Government, the National Government of the Federated States of Micronesia, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the investment fund or ten percent of the outstanding value of the issue at the time of purchase.

(iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the Bank's investment advisor at the time of purchase, that not more than five percent of the market value of its investments shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of its investments shall be invested in any one industry group.

(iv) Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments.

A. Deposits:

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1	Deposits that are federally insured or collateralized with securities held by the Bank or its agent in the Bank's name;
Category 2	Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Bank's name; or
Category 3	Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Bank's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Bank's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Bank does not have a deposit policy for custodial credit risk.

As of December 31, 2008 and 2007, the carrying amount of the Bank's total cash and cash equivalents and time certificates of deposit was $4,316,287 and $2,190,029, respectively, and the corresponding bank balances were not materially different. Of the bank balance amounts, all are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2008 and 2007, bank deposits in the amount of $500,000 and $200,000, respectively, were FDIC insured. The Bank does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. 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 years ended December 31, 2008 and 2007.

B. Investments:

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

Category 1 Investments that are insured or registered, or securities held by the Bank or its agent in the Bank's name;

Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the Bank's name; or

Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Bank's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of December 31, 2008 and 2007, investments at fair value are as follows:

	2008	2007
Fixed income securities:		
Domestic fixed income	$ 3,032,615	$ 2,859,371
Other investments:		
Domestic equities	3,199,435	5,347,165
Money market funds	4,137,151	3,143,105
	$ 10,369,201	$ 11,349,641

As of December 31, 2008 and 2007, the Bank's fixed income securities had the following maturities:

2008	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Greater Than 10 Years	Fair Value
U.S. Treasury obligations	$ -	$ 1,058,189	$ 659,806	$ -	$ 1,717,995
U.S. Government agency obligations	945,651	216,962	152,007	-	1,314,620
	$ 945,651	$ 1,275,151	$ 811,813	$ -	$ 3,032,615

2007	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Greater Than 10 Years	Fair Value
U.S. Treasury obligations	$ 69,976	$ 904,910	$ 398,561	$ -	$ 1,373,447
U.S. Government agency obligations	351,582	931,443	202,899	-	1,485,924
	$ 421,558	$ 1,836,353	$ 601,460	$ -	$ 2,859,371

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

The Bank's exposure to credit risk at December 31, 2008 and 2007, was as follows:

2008	Total	Domestic	International
Moody's Rating – AAA	$ 3,032,615	$ 3,032,615	$ -
Total credit risk debt securities	$ 3,032,615	$ 3,032,615	$ -

2007	Total	Domestic	International
Moody's Rating – AAA	$ 2,859,371	$ 2,859,371	$ -
Total credit risk debt securities	$ 2,859,371	$ 2,859,371	$ -

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Bank will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Bank's investments are held and administered by trustees. Accordingly, these investments are exposed to custodial credit risk. Based on negotiated trust and custody contracts, all of these investments were held in the Bank's name by the Bank's custodial financial institutions at December 31, 2008 and 2007.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Bank. As of December 31, 2008, the Bank's investment in agency obligations of the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association constituted 5% and 7%, respectively, of its total investments. As of December 31, 2007, the Bank's investment in agency obligations of the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association constituted 6% and 7%, respectively, of its total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Bank has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

EQUITY INVESTMENT AT COST

The equity investment in Bank of the FSM, carried at cost, represents 100,000 common shares and approximately an 11% ownership interest. Since the book value of the shares exceeds the carrying value, management believes that the equity investment has not become impaired.

LOAN RECEIVABLES

A summary of loans receivable at December 31, 2008 and 2007 follows:

	2008	2007
Unpaid principal balance	$ 25,481,600	$ 26,020,506
Allowance for loan losses	(5,295,649)	(5,085,120)
	$ 20,185,951	$ 20,935,386

Movements in the allowance for loan losses during the years ended December 31, 2008 and 2007, are as follows:

	2008	2007
Balance at beginning of year	$ 5,085,120	$ 3,779,247
Provision for loan losses	722,000	199,890
Loans charged off	(772,684)	(1,415,881)
Loan recoveries from previously charged off loans	261,213	471,415
Loan reactivations from previously charged off loans	-	2,050,449
Balance at end of year	$ 5,295,649	$ 5,085,120

FIXED ASSETS

A summary of fixed assets as of December 31, 2008 and 2007, is as follows:

	Beginning Balance January 1, 2008	Additions	Deletions	Ending Balance December 31, 2008
Office furniture, fixtures and equipment	$ 144,996	$ 5,968	$ -	$ 150,964
Home furniture, fixtures and equipment	13,123	-	-	13,123
Vehicles	232,104	-	-	232,104
Computers and software	478,547	42,090	-	520,637
	868,770	48,058	-	916,828
Less accumulated depreciation	(609,699)	(80,564)	-	(690,263)
Net fixed assets	$ 259,071	$ (32,506)	$ -	$ 226,565

	Beginning Balance January 1, 2007	Additions	Deletions	Ending Balance December 31, 2007
Office furniture, fixtures and equipment	$ 144,996	$ -	$ -	$ 144,996
Home furniture, fixtures and equipment	13,608	-	(485)	13,123
Vehicles	171,348	76,762	(16,006)	232,104
Computers and software	472,535	6,012	-	478,547
	802,487	82,774	(16,491)	868,770
Less accumulated depreciation	(548,049)	(78,141)	16,491	(609,699)
Net fixed assets	$ 254,438	$ 4,633	$ -	$ 259,071

RELATED PARTY TRNSACTIONS

As of December 31, 2008 and 2007, the Bank has direct loans with outstanding balances of $238,941 and $150,696, respectively, to employees of the Bank and project loans extended to businesses owned by or affiliated with employees of $2,625,840 and $2,802,120, respectively. These loans were made under similar terms and conditions as exist with other borrowers. Officers and Board members are not eligible to borrow from the Bank.

COMMITMENTS AND CONTINGENCIES

GUARANTY

The Bank, from time-to-time, is contingently liable on loan guarantees ranging from 50% to 90% of the outstanding loan balances for commercial projects within the FSM. There were no outstanding guaranteed loan balances as of December 31, 2008 and 2007.

LOAN COMMITMENTS

The Bank has entered into loan commitments for loans approved but undisbursed in the amount of $2,321,744 at December 31, 2008.

LITIGATION

The Bank is a party to various legal proceedings, the ultimate impact of which is not currently predictable. Therefore, no liability has been recorded in the accompanying financial statements due to management's inability to predict the ultimate outcome of these proceedings.

SELF INSURANCE

The FSM Development Bank carries insurance to cover its potential risks from vehicle usage. FSM Development Bank is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

LEASE COMMITMENTS

The Bank has six operating leases as of December 31, 2008. Three are residential real estate leases for contract employees. Four leases are for the branch offices in each State (one with a lease term of two years, two for five years and one for fifteen years). All leases have an attached option allowing FSMDB to renew the lease upon expiration of the current term. It is likely that these options will be exercised by the Bank and the leases renewed. The approximate future minimum annual lease payments payable by the Bank, assuming all options are exercised, are as follows:

Fiscal year ending December 31,	Total
2009	$ 122,016
2010	122,016
2011	122,016
2012	122,016
2013	122,016
2014 – 2018	610,080
2019 – 2023	610,080
2024 – 2028	610,080
2029 – 2033	610,080
	$ 3,050,400

NOTE PAYABLE

On September 29, 2007, the Bank entered into a line of credit agreement with Export and Import Bank of China in the amount of $2,000,000, due July 21, 2013, for the purpose of funding its loan programs. The loan is uncollateralized, bears interest at 7.38% per annum. Repayment of principal and interest commenced January 21, 2009 in semi-annual installment of $200,000. As of December 31, 2008 and 2007, the amount outstanding and payable under this loan agreement was $2,000,000 and $0, respectively.

Annual debt service requirements to maturity for principal and interest are as follows:

Year ending December 31,	Principal	Interest	Total
2009	$ 400,000	$ 135,844	$ 535,844
2010	400,000	110,700	510,700
2011	400,000	81,180	481,180
2012	400,000	51,660	451,660
2013	400,000	22,140	422,140
	$ 2,000,000	$ 401,524	$ 2,401,524

Long-term debt changes during the year ended December 31, 2008 is as follows:

	Balance January 1,	Additions	Reductions	Balance December 31,	Due Within One Year
2008:					
Loan payable	$ -	$ 2,000,000	$ -	$ 2,000,000	$ 400,000

CONTRIBUTION FROM THE FSM NATIONAL GOVERNMENT

During the years ended December 31, 2008 and 2007, the Bank was reimbursed for expenses incurred in administering the IDF program from the IDF Private Sub Account for $250,000 in each of the years.

RETIREMENT PLAN

The Bank's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees receive from the FSM Social Security System. The Plan is a contributory plan in which the Bank matches 100% of the participants' contributions up to a maximum of 10 percent of the participant's annual salary, if the participant contributes 3 or more percent from his or her annual salary. Employee participation is optional. The Bank's CFO is the designated Plan Administrator. Matching contributions to the Plan during the years ended December 31, 2008 and 2007 were $54,035 and $52,733, respectively. Management is of the opinion that the Plan does not represent an asset or a liability of the Bank.

STAFF LOAN REVOLVING FUND

In July 2007, the Bank's Board of Directors approved the establishment of a Staff Loan Revolving Fund. In September 2007, a savings account was established for this purpose. As of December 31, 2008 and 2007, the account has a balance of $16,423 and $99,383, respectively.

TRUST FUNDS ADMINISTERED BY THE FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2008

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

Chairman
Board of Directors
Federated States of Micronesia
Development Bank:

We have audited the accompanying statement of fiduciary net assets of the Investment Development Fund (IDF), the Pohnpei Development Loan Fund (PDLF), and the Yap Development Loan Fund (YDLF) (the Funds) as of December 31, 2008, and the related statement of changes in fiduciary net assets for the year then ended. The Funds are administered by the Federated States of Micronesia Development Bank (FSMDB), a component unit of the National Government of the Federated States of Micronesia. These financial statements are the responsibility of the 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 respective financial status of the Investment Development Fund, the Pohnpei Development Loan Fund and the Yap Development Loan Fund at December 31, 2008, and the changes in their respective financial status 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 issued our report dated June 17, 2009, on our consideration of the Bank's internal control over financial reporting and on our tests of their compliance with certain laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

June 17, 2009

Member of
Deloitte Touche Tohmatsu

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Trust Funds
Statement of Fiduciary Net Assets
December 31, 2008

	IDF	PDLF	YDLF	Total
ASSETS				
Held by FSMDB:				
Cash in bank and on hand	$ -	$ 262,139	$ 94,683	$ 356,822
Time certificates of deposit	541,482	557,995	140,282	1,239,759
Held by trustee:				
Investments	2,471,854	-	-	2,471,854
Total cash and equivalents	3,013,336	820,134	234,965	4,068,435
Receivable from FSMDB	15,838	-	-	15,838
Interest and other receivables	19,544	4,500	139	24,183
Loans receivable, net	7,735,675	55,239	71,816	7,862,730
Total receivables	7,771,057	59,739	71,955	7,902,751
	$ 10,784,393	$ 879,873	$ 306,920	$ 11,971,186
LIABILITIES AND NET ASSETS				
Liabilities:				
Payable to FSMDB	$ -	$ 159,958	$ 65,059	$ 225,017
Credit life payable	-	-	1,975	1,975
Total liabilities	-	159,958	67,034	226,992
Commitments				
Net assets:				
Restricted	7,735,675	55,239	71,816	7,862,730
Unrestricted	3,048,718	664,676	168,070	3,881,464
Total net assets	10,784,393	719,915	239,886	11,744,194
	$ 10,784,393	$ 879,873	$ 306,920	$ 11,971,186

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Trust Funds
Statement of Changes in Fiduciary Net Assets
December 31, 2008

	IDF	PDLF	YDLF	Total
Additions:				
Investment interest	$ 94,264	$ 14,496	$ 5,152	$ 113,912
Loan interest	250,548	4,417	7,268	262,233
Miscellaneous	5,441	443	32	5,915
Total additions	350,253	19,356	12,452	382,061
Deductions:				
Investment management fee	250,000	-	-	250,000
Transfer to Pohnpei State Government	1,635,000	-	-	1,635,000
Transfers to FSMDB	-	19,356	6,226	25,582
Total deductions	1,885,000	19,356	6,226	1,910,582
Change in net assets	(1,534,747)	-	6,226	(1,528,521)
Net assets at beginning of year	12,319,140	719,915	233,660	13,272,715
Net assets at end of year	$ 10,784,393	$ 719,915	$ 239,886	$ 11,744,194

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Notes to Financial Statement
December 31, 2008

PURPOSE AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PURPOSE

The Investment Development Fund (IDF), the Pohnpei Development Loan Fund (PDLF), and the Yap Development Loan Fund (YDLF), are administered by the Federated States of Micronesia Development Bank (the Bank). The Bank utilizes the Funds to carry out its stated purpose of providing loans for the economic development of the FSM. The specific purpose of each fund is as follows:

IDF – IDF was created 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 IDF is administered by the Bank in a Trust capacity.

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.

FUND STRUCTURE AND BASIS OF ACCOUNTING

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

CASH

For the purposes of the statement of fiduciary net assets, cash is defined as cash in bank checking and savings accounts, and commercial paper with original maturities of three months or less from the date of acquisition. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified.

INVESTMENTS

Investments and related investment earnings are recorded at fair 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.

LOAN AND ALLOWANCE FOR LOAN LOSSES

Loans under the trust funds are usually reported at gross unpaid principal balances, without an allowance for loan losses. The loans are reserved in net assets as restricted net assets. Loans are written off directly against income based on discussions with the owners of the managed funds. When the loans are recorded in the respective owner's financial statements, the owners of these funds will bear responsibility for establishing the related loan loss reserve.

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.

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.

DEPOSITS AND INVESTMENTS

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The deposit and investment policies of the Funds are governed by their enabling legislation. The Bank is required to engage one or more fund custodians to assume responsibility for the physical possession of the Funds' investments. Legally authorized investments are as follows:

(i) Government obligations - Obligations issued or guaranteed as to principal and interest by the National Government and/or State governments of the Federated States of Micronesia or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.

(ii) Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the Federated States of Micronesia or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or other mortgage-backed securities provided that the obligation is an agency of the United States Government, the National Government of the Federated States of Micronesia, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the Funds' investments or ten percent of the outstanding value of the issue at the time of purchase.

(iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the Funds' investment advisor at the time of purchase, that not more than five percent of the market value of its investments shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of its investments shall be invested in any one industry group.

(iv) Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments.

A. Deposits

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1 — Deposits that are federally insured or collateralized with securities held by the Funds or its agent in the Funds' name;

Category 2 — Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Funds' name; or

Category 3 — Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Funds' name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Funds' deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Funds do not have a deposit policy for custodial credit risk.

As of December 31, 2008, the carrying amount of the Funds' total cash and cash equivalents and time certificates of deposits was $1,596,581 and the corresponding bank balances approximated the same amount. All of the bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2008, bank deposits in the amount of $500,000 were FDIC insured. The Funds do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. 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, 2008.

B. Investments

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

Category 1 Investments that are insured or registered, or securities held by the Funds or its agent in the Funds' name;

Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the Funds' name; or

Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Funds' name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of December 31, 2008, investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	$ 949,595
Other investments:	
Money market funds	1,522,259
	$ 2,471,854

As of December 31, 2008, the Funds' fixed income securities had the following maturities:

	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Greater 10 Years	Fair Value
U.S. Government agency obligations	$949,595	$ -	$ -	$ -	$949,595

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

The Funds' exposure to credit risk at December 31, 2008, was as follows:

Moody's Rating	Total	Domestic	International
AAA	$ 949,595	$ 949,595	$ -
Total credit risk debt securities	$ 949,595	$ 949,595	$ -

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Funds will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Funds' investments are held and administered by trustees. Accordingly, these investments are exposed to custodial credit risk. Based on negotiated trust and custody contracts, all of these investments were held in the Funds' name by the Funds' custodial financial institutions at December 31, 2008.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Bank. As of December 31, 2008, the Funds' investment in agency obligations of Federal Home Loan Bank and Federal Home Loan Mortgage Corporation constituted 20% and 18%, respectively, of its total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Funds do not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

LOANS RECEIVABLE

The following is a schedule of loans receivable as of December 31, 2008:

	Loan Balance	Allowance	Net
State Development Funds (Pohnpei and Yap)	$ 127,055	$ -	$ 127,055
IDF	7,749,175	13,500	7,735,675
	$ 7,876,230	$ 13,500	$ 7,862,730

Management is of the opinion that since these are trust funds, they are unable to provide against these balances, and therefore these loans have been presented as restricted net assets.

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Gabriel Ramoloilug	System Administrator
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Melshihner Hadley	Accountant
Lucille Martinez Loan	Security Officer
Leilani Felix Assistant	System Manager
Senyorina Yang	Administrative Assistant
Rohma Sibanuz	Legal Secretary
Carmihna Abraham	Account Clerk
Dahlia Phillips	Loan Clerk