2012 Annual Report

Federated States of Micronesia Development Bank

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Letters to Shareholders

Dear Shareholders:

On behalf of the Board of Directors, we are pleased to submit the annual report for the year ended December 31, 2012 and the audited financial statement of the FSM Development Bank for the years ended December 31, 2012 and 2011.

We ended the year 2012 with a net profit of $1.9 million despite the overall slowed economic growth. A total revenue of $3.6 million, of which $2.1 million came from loan interest income, was realized for the year. Overall, total expenses of $1.8 million were contained within the approved budget.

Total assets were $42.3 million, which indicates an increase of 3% from last year's $41 million. The increase in total assets was largely a result of the increase in the value of the investment portfolio and increase in equity investment in Bank of FSM. The liabilities for the bank decreased as we have paid down borrowed funds and accounts payable.

We approved 262 loans for $7.6 million compared to last year's approval of $5.8 million for 208 loans. Although the level of loan approval increased in 2012, these loan basically replaces loan run offs. We are budgeting for further growth in the loan portfolio in 2013 focusing mainly on small businesses in Agriculture and Fisheries.

Looking ahead, however, we anticipate no significant economic growth in 2013. Therefore, we will continue our focus to target potential small start-up projects in the agriculture, fisheries and food preparation and tailoring sectors. It is believed that such move will increase the number of projects with export oriented potentials. In addition, we will continue to lend to larger projects with the commercial real estate and tourism projects as well as the other sectors to be sustainable in the long-run.

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

John Sohl, Chairman - Board of Directors

Part I: Background Information

ABOUT THE BANK

The Federated States of Micronesia Development Bank (FSMDB) is a component unit of the National Government of the Federated States of Micronesia. It was established in 1979 by Public Law 1-37. The bank opened in 1980 but lending did not start 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 primary function of FSMDB is to provide financing to commercial businesses mainly in the FSM. Over the years, the bank has added new lending programs to meet its strategic objectives and customer needs. In 2008, the bank created its residential home loan program to help locals build their homes. In 2011, the bank created a consumer lending revolving fund mainly to help generate revenue.

The Bank Headquarters is located in the State of Pohnpei, the capital of the FSM. It has branch offices in the other three (3) FSM states.

VISION AND MISSION

Vision:

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:

FSM Development Bank actively promotes the growth of micro, small and medium enterprises in the Federates 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.

SHAREHOLDERS

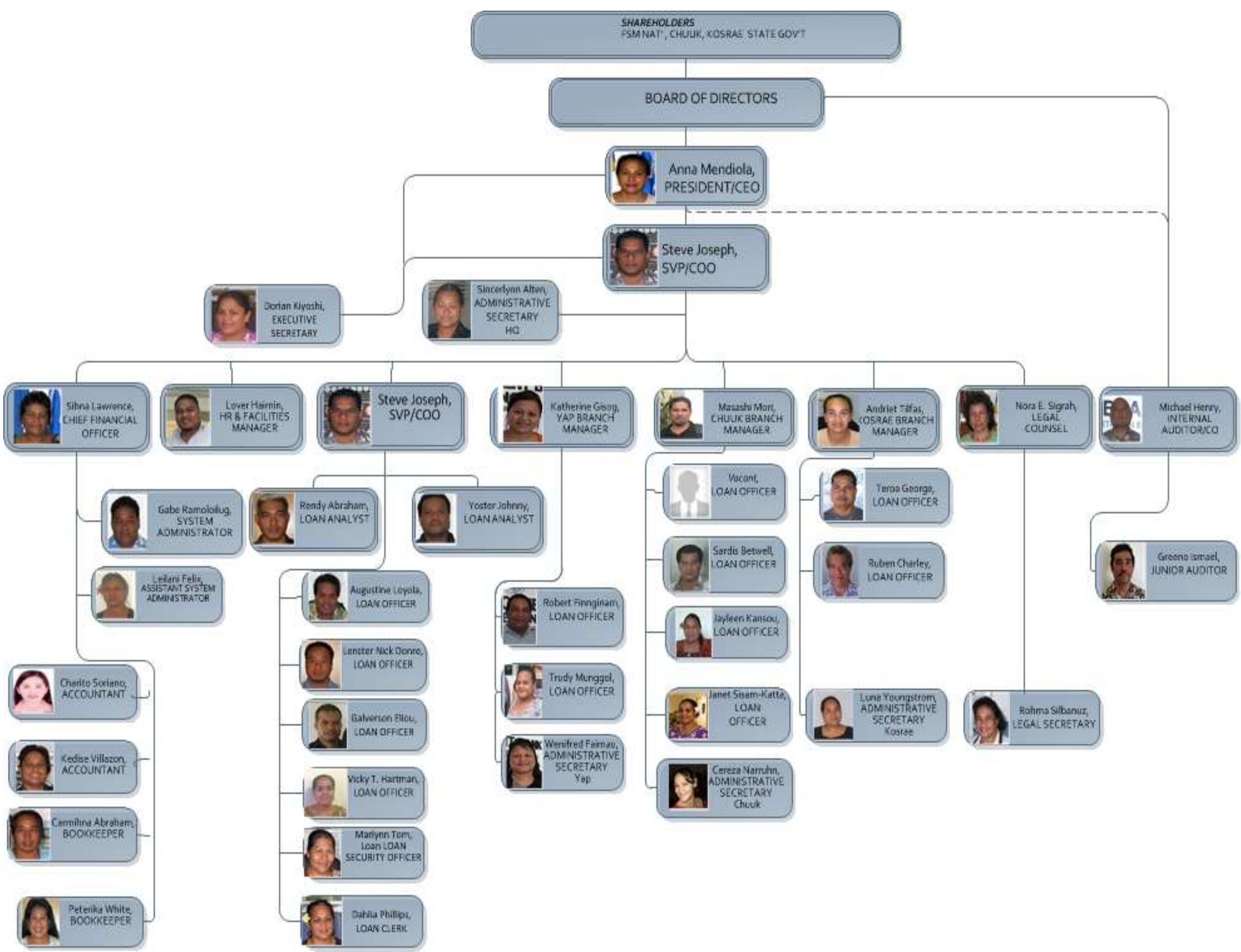
The FSM National Government is the principal shareholder of the bank. It owns 98.8% of the outstanding shares. The States of Chuuk and Kosrae each own 0.9% and 0.3% of the bank's outstanding shares respectively. The States of Pohnpei and Yap are not shareholders but they are given representation on the Bank's Board of Directors as a courtesy.

Shareholder	No. of Shares	Amount
FSM National Government	3,197,883	$31,978,830
State of Kosrae	9,000	$90,000
State of Chuuk	30,000	$300,000
Total Shares Outstanding	**3,236,883**	**$32,368,830**

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.

ORGANIZATIONAL CHART

The bank organizational chart - see below



BOARD OF DIRECTORS

The board is comprised of seven members. Six of them are elected by the shareholders. The seventh member is the President and Chief Executive Officer (CEO), who serves as the Ex-Officio to the board. Aside from the Ex-Officio, all board members serve a term of 3 years on a staggering basis. The composition and representation of the board as of December 31, 2012 were as follows:

Name	Position	Representation
John Sohl	Chairman	Pohnpei State
Hilary Tacheliol	Vice Chairman	Yap State
Gillian Doone	Member	FSM National Government
Wilson Waguk	Member	Kosrae State
Sisinio Willy	Member	Chuuk State
Juliet Jimmy	Member	FSM National Government
Anna Mendiola	Ex-Officio	President/CEO FSMDB

MANAMGEMENT

The bank is managed by a management team comprised of a President/Chief Executive Officer (CEO), a Senior Vice President/Chief Operating Officer (COO), and Chief Financial Officer (CFO). The composition of the Senior Management of the Bank as of December 31, 2012 was as follows:

Name	*Position*	*E-mail*
Anna Mendiola	President/CEO	annam@fsmdb.fm
Stevenson Joseph	Senior Vice President/COO	stevej@fsmdb.fm
Sihna Lawrence	Chief Financial Officer	sihnal@fsmdb.fm

Part 2: Management Report

Lending Activity

The Bank has approved 262 loans worth $7.6 million as of December 31, 2012. See below for details:

Table 1: 2012 Loans Approved by Sector

SECTORS	Number of Loans.	VALUE ($)
Agriculture/Fishery/Forestry	8	$ 609,521.00
Services	9	$ 173,469.33
Manufacturing	1	$ 50,000.00
Real Estate	1	$ 195,527.00
Wholesale/Retail	22	$ 3,333,601.00
Tourism	2	$ 331,674.00
Transportation	3	$ 118,802.00
Construction and Mining	2	$ 400,000.00
Residential	9	$ 401,291.70
Personal Consumer	205	$ 1,965,916.24
Total	262	$ 7,579,802.27

Figure 1:2012 Loans Approved by Sector

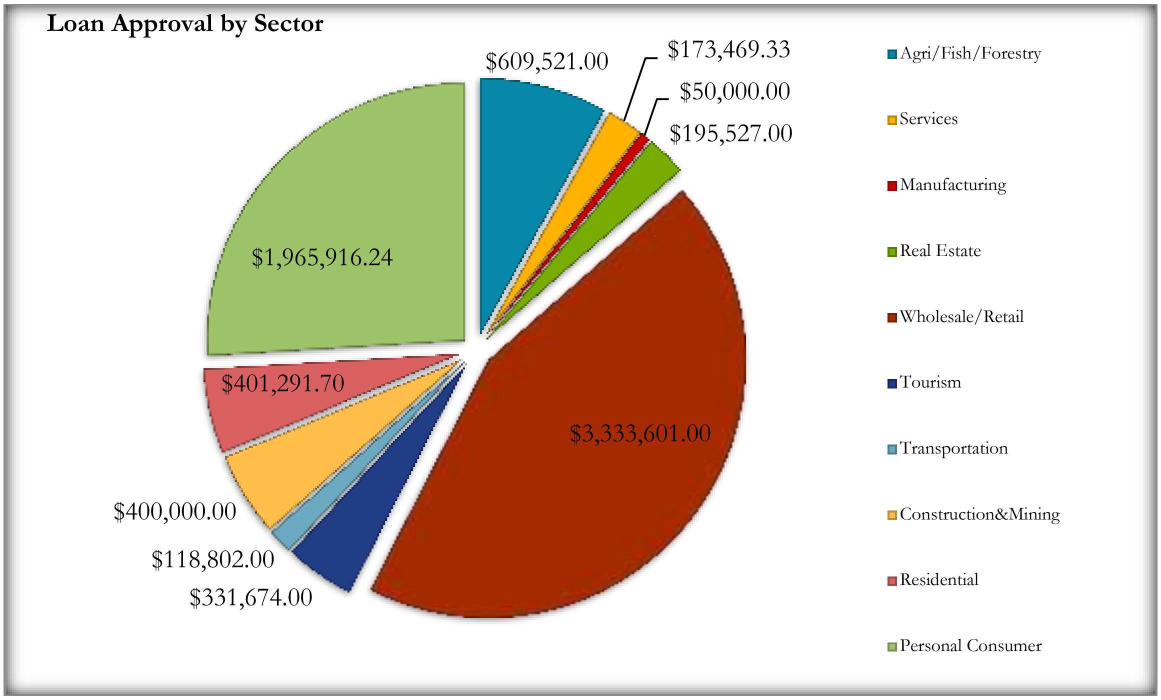
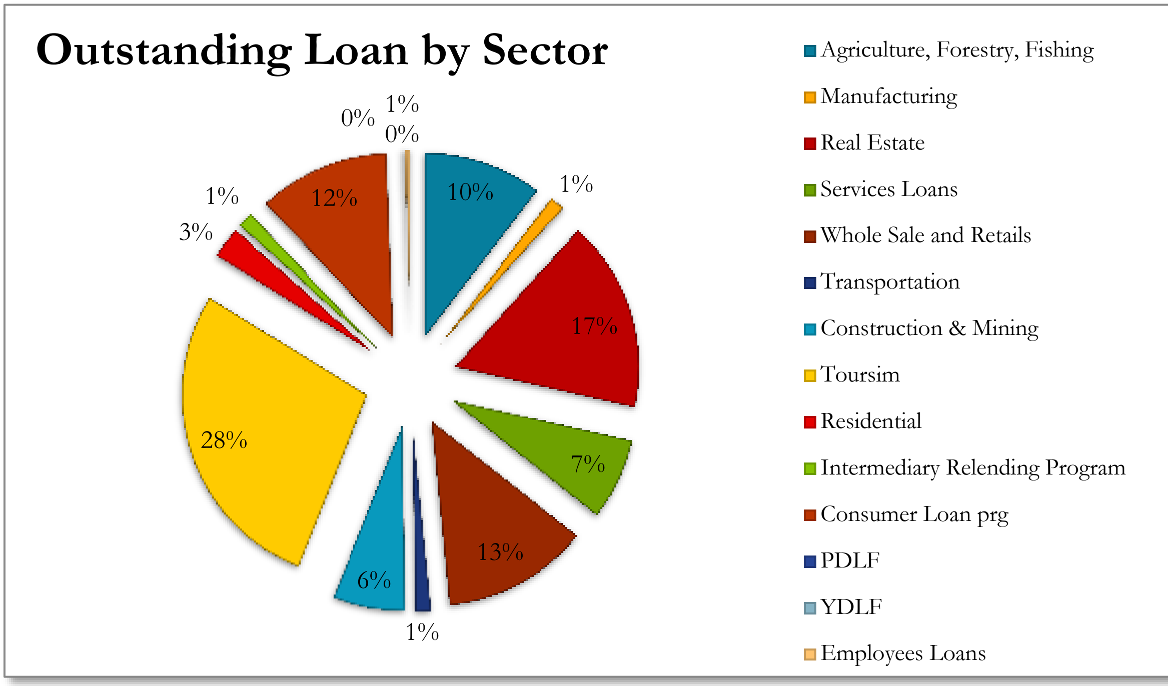


Table 2: Active Loans Outstanding (gross) as of December 31, 2012

SECTORS	No	Org. Loan Amt	Outstanding Bal	% of Outstanding
Agriculture, Forestry, Fishing	9	$ 3,161,544.00	$ 2,532,990.00	10%
Manufacturing	16	$ 695,322.00	$ 320,557.00	1%
Real Estate	24	$ 5,333,395.00	$ 4,105,822.00	17%
Services Loans	22	$ 2,501,519.00	$ 1,749,111.00	7%
Whole Sale and Retails	61	$ 3,808,659.00	$ 3,128,174.00	13%
Transportation	8	$ 574,582.00	$ 315,088.00	1%
Construction & Mining	12	$ 1,867,678.00	$ 1,537,912.00	6%
Toursim	12	$ 8,473,349.00	$ 6,788,207.00	28%
Residential	19	$ 874,349.00	$ 676,423.00	3%
Intermediary Relending Program	7	$ 469,260.00	$ 333,333.00	1%
Consumer Loan prg	327	$ 3,389,486.00	$ 2,796,206.00	11%
PDLF	2	$ 75,435.00	$ 20,476.00	0%
YDLF	2	$ 91,800.00	$ 21,858.00	0%
Employees Loans	12	$ 140,114.00	$ 100,071.00	0%
GRAND TOTAL	**533**	**$ 31,456,492.00**	**$ 24,426,228.00**	**100%**

Figure 2: Outstanding Loans by Sector as of December 31, 2012



At the end of 2012, Tourisms sector (28%) remains the largest portion of the outstanding loan portfolio. In terms of the number of loan, however, consumer loan has the most loans outstanding with a total of 327 loans followed by Whole Sale and Retail Sectors (61) and Real Estate (24).

Figure 3: Loan Approval Trend 2007-2012

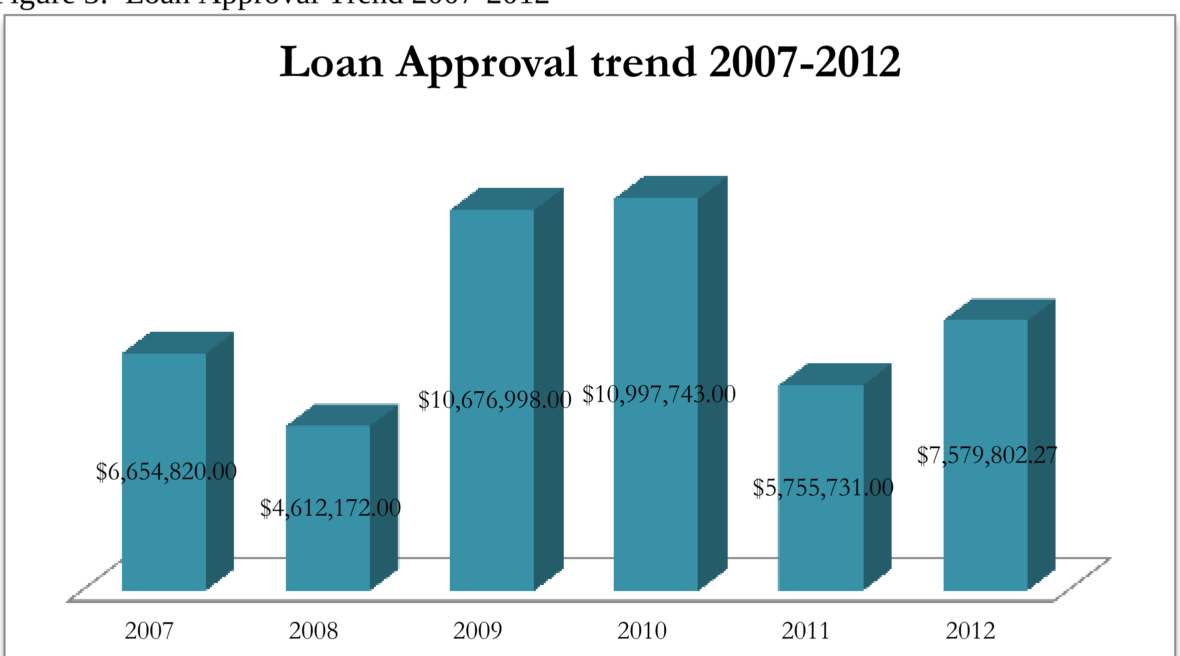
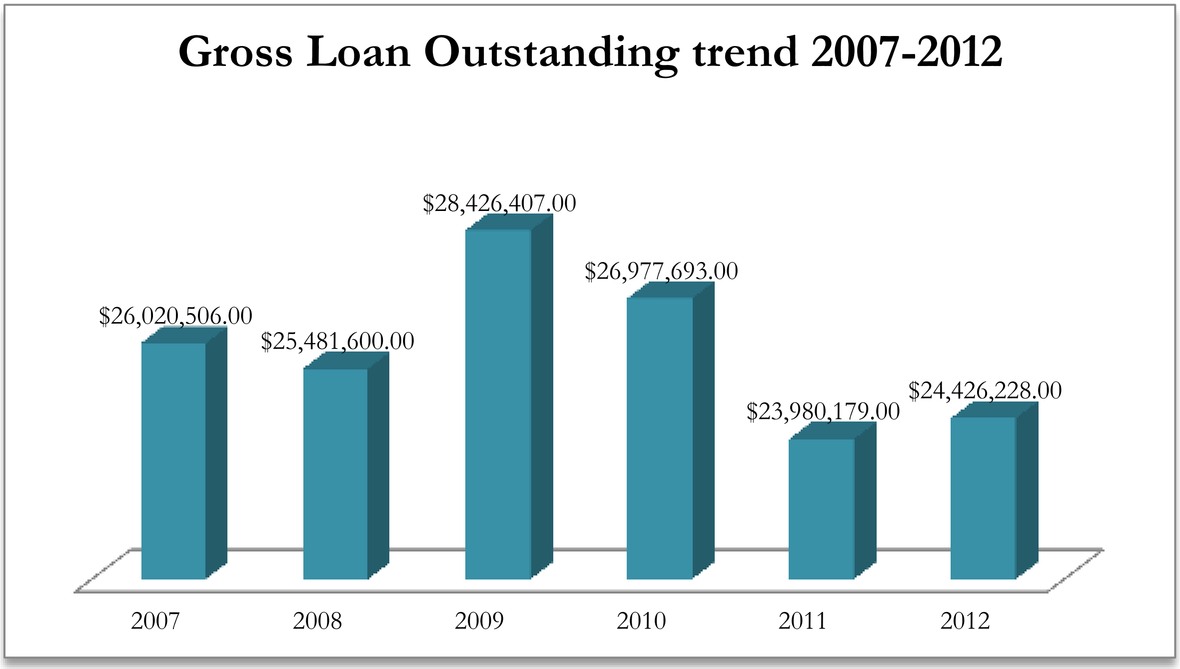


Figure 4: Gross Loan Outstanding Trend 2007-2012



Funding Source Update

Capital contribution from our principal shareholder, the FSM National Government, has not been forthcoming for the last six years of operations as it used to be in the earlier years of the bank's existence. We now rely on loan interests and other sources to fund our lending activities.

Administered Funds Update

We manage three non-propriety type funds: 1) the Investment Development Fund (IDF), 2) the Pohnpei Development Loan Fund (PDLF) and 3) the Yap Development Loan Fund (YDLF). The detail and the current status of these funds can be found in the financial section of the report.

Loans to Women Update

We approved eighty three (83) loans to women as the primary borrower in 2012 with a combined total of $1,339,858.

Personnel Update

As of December 31, 2012 the bank has 37 employees. During the year, there were five newly recruited employees joining the bank. They are:

1) Trudy Munggol, Loan Officer at Yap Branch,
2) Cereza Narruhn, Administrative secretary at Chuuk Branch,
3) Luna Youngstrom, Administrative secretary at Kosrae Branch
4) Vicky T. Hartman, Loan Officer at Headquarters
5) Lover Haimin, Human Resources & Facilities Manager

We would like to also acknowledge the departing members of the FSMDB family. The following employees have resigned from the bank during the year:

1) Curley Sos, Loan Officer atChuuk branch

Training Update

The following trainings were conducted in 2012:

Lending Training by Nimea

In August 2012, the bank sponsored a week long training course for its loan officers. The training focused largely on lending. In addition, it featured a mock Credit Committee which offered a real-life experience and interactions between the loan officers and the members of the mock review committee.

The training was presented by Fabian Nimea, the principal consultant of Nimea Consulting firm, a local consulting company specialized in commercial and development banking, strategic business and financial planning and management training.

FSMDB staff attend 23rd APIPA training

The 23rd APIPA conference week began on August 20 thru 24, 2012 and both FSMDB Internal Auditor and Chief Financial Officer, with an accountant and the Junior Auditor participated. The conference was held in the Republic of Palau.

The annual conference comes with audit and finance training courses aiming to improve regional accounting and auditing knowledge and expose government employees whose jobs involve or directly deal with auditing and accounting to share experience and learn new ideas from each other.

ADFIAP held in Manila, Philippines

From October 1-19, 2012, Yap Branch Manager Katherine Gisog and then Acting Chuuk Branch Manager Masashi Mori attended a training program sponsored by the Association of Development and Financing Institutions in Asia & Pacific (ADFIAP) held in Manila, Philippines.

The training courses objectives were to enhance the capabilities and upgrade the managerial and technical skills of officers and managers of development finance institutions (DFIs) and other financing institutions in the performance of their functions.

Information System Update

Various improvements and updates were made to our information system which included among others the time reporting system and the website. The new computerized time reporting system was installed successfully and implemented in all the offices. Our website was redesigned for better browsing and access. Overall, information system upgrade remained one of top priorities to support our operations and we will continue to strive for improvements.

Strategic Plan Update

Our strategies remain unchanged. As of year-end 2012, we were pretty much in line with the strategic plan.

Bank Facilities and Equipment Update

After the approval for the acquisition of Town Plaza building, bidding for the renovation of the existing office spaces and construction of the 3rd floor began late in the fiscal year.

Programs Update

Scholarship

FSMDB announced 2012 recipients of its scholarships: Rosalinda Yatilman, Desiree Yamase and Universe Yamase. The recipients currently attend the University of Hawaii at Manoa and Chaminade University in Honolulu.

FSMDB offers scholarships to outstanding students pursuing graduate degrees primarily in the fields of Accounting, Finance, Banking, Business, Computer Information System and Economics. The bank's criteria in screening of applicants include, but not limited to, applicants academic achievements, level of college attendance, and financial needs. Copies of official transcripts and costs of courses must be submitted to the bank. Applicants must be citizens of the FSM, have a strong stated desire to return to the FSM after completion of their studies to help in the economic development of the country. Applicants must also provide three letters of reference in support of their applications. All required documentations must be submitted in order to be considered for the scholarship.

Outreach Program

The FSMDB Outreach Program kicked off on July 31, 2012 for a week in the State of Kosrae. A team comprised of the Branch Manager and staff, led by FSMD Board Director Wilson Waguk and Senior Vice President Stevenson Joseph and Skiller Jackson, Director of Small Business Development Center conducted the program sessions. The sessions involved power point presentations and disseminations of handouts on information about FSMDB products and services.

The sessions were conducted in the various local communities for all four municipalities including the remote village of Walung. In total, there were about 192 individuals who attended the sessions. There were individuals participants who expressed the benefits of the program, others their interests and few voiced their complaints regarding the current level of services provided by FSMDB.

The aim of the program is to proactively go out and educate citizens about the roles of FSMDB. According to one of the Bank's Branch Managers, the program will ultimately drive the project success rate. It will ultimately help both the customer and the bank move efficiently and get what they need. In addition, the program will further extend to all the remaining FSM states to expand the opportunity not only to proactively educate the citizens, but to help facilitate development of small businesses. The program is implemented in collaboration with the small business development organizations such as Small Business Development Center in Kosrae, and others who share the same mission to develop the private sector.

Associations and Memberships Update

We remain active in the following professional 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 want to extend a special recognition, appreciation and many thanks to Director Wilson Waguk who had served the bank as a director for several years. We wish him and his family the best on his future endeavors.

Part 3: Financial Report

Figure 5: Total Revenue 2007-2012

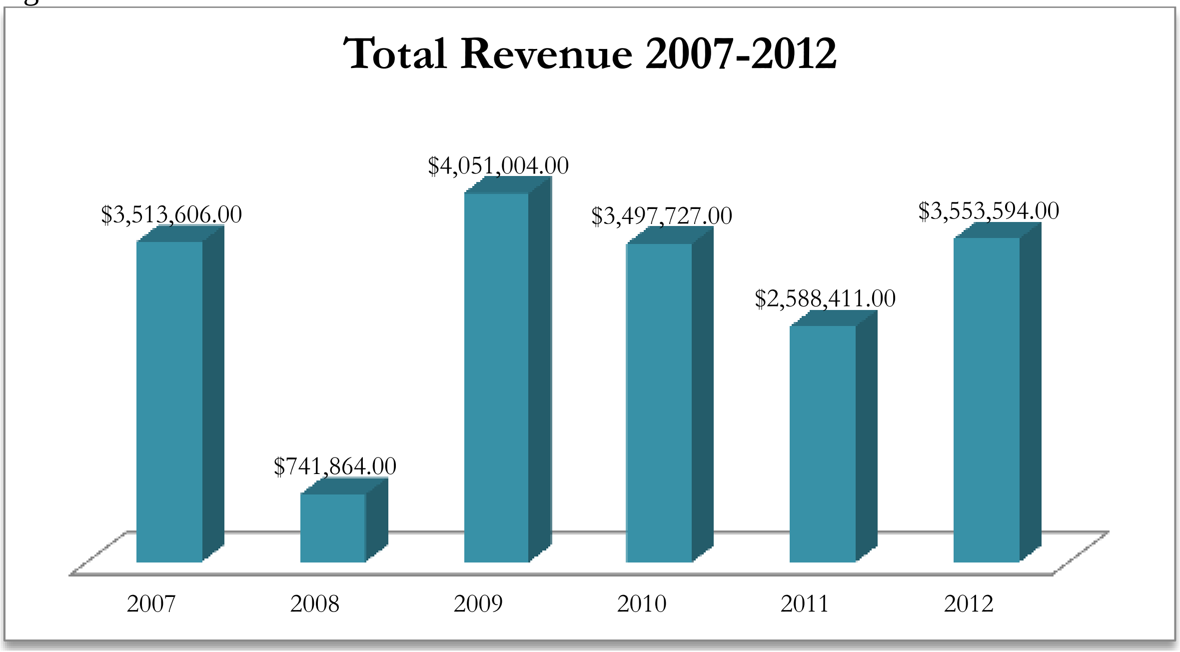


Figure 6: Total Expenditure 2007-2012

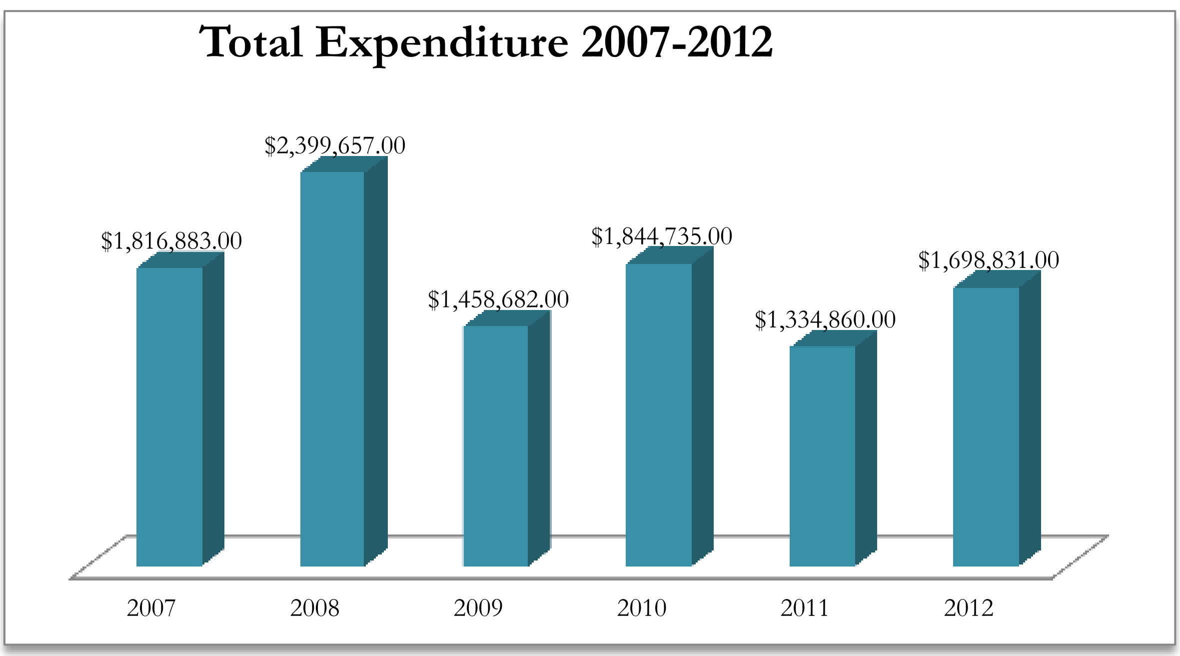


Figure 7: Net Profit Trend 2007-2012

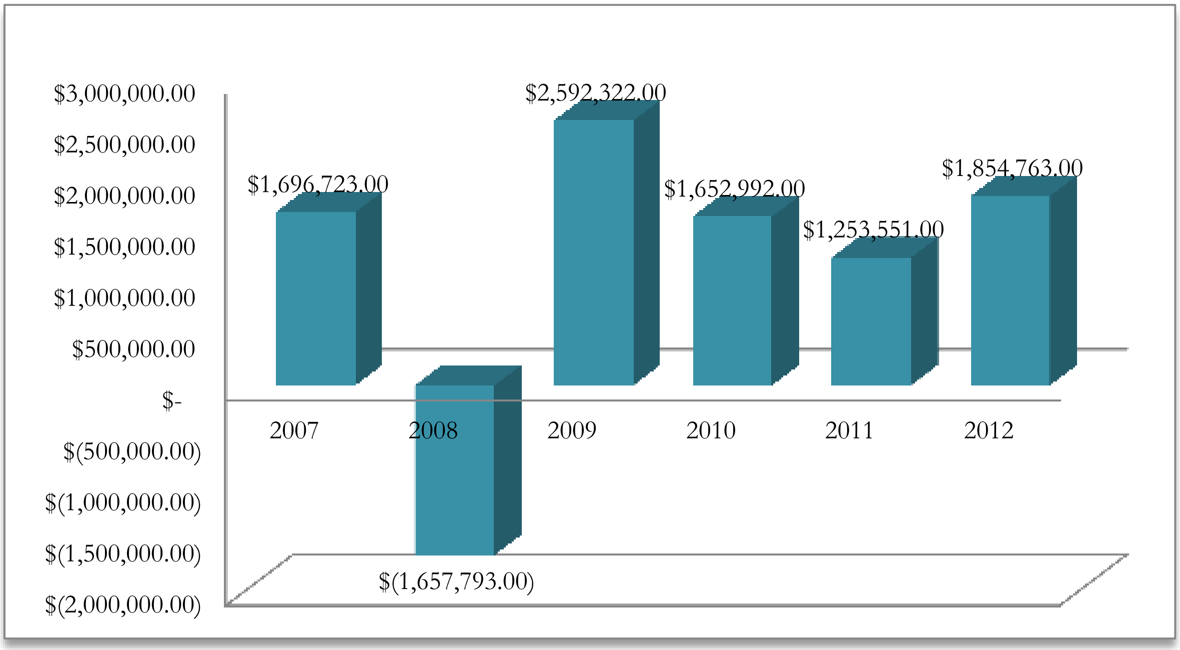
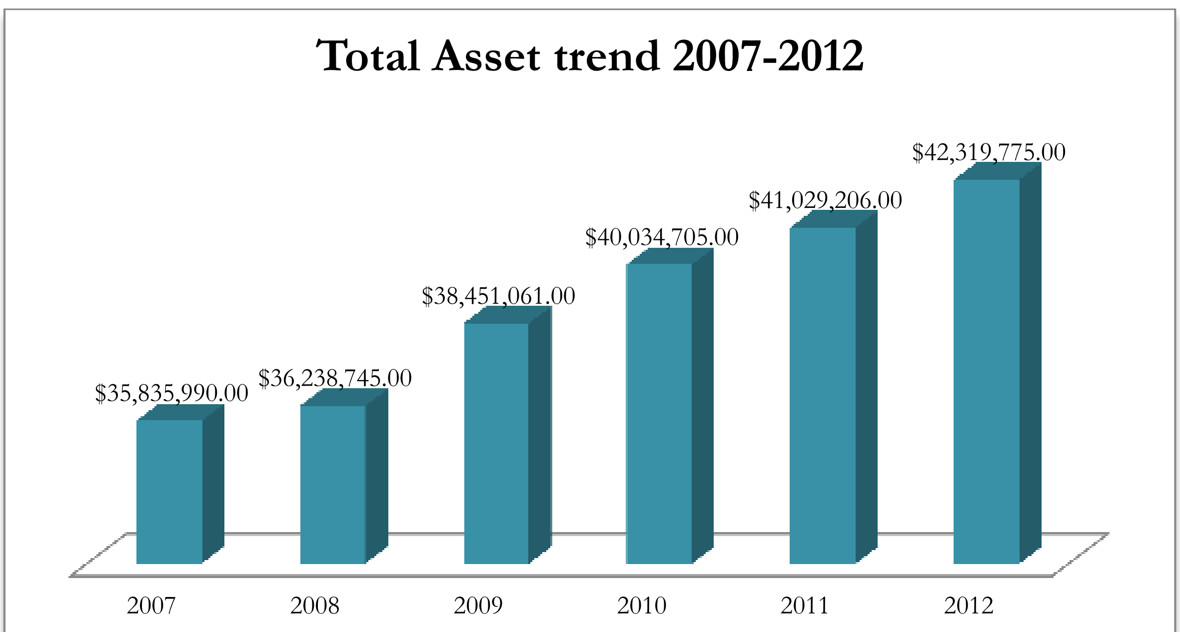


Figure 8: Total Asset Trend 2007-2012



Federated States of Micronesia
Development Bank

(A component Unit of the FSM National Government)

Financial Statements and Independent Auditors' Report

Years ended December 31, 2012 and 2011

Deloitte.

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USA

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia Development Bank:

Report on the Financial Statements

We have audited the accompanying financial statements of the Federated States of Micronesia Development Bank (the Bank), which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express 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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federated States of Micronesia Development Bank as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 1 to the financial statements, during the year ended December 31, 2012, the Bank has implemented the Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, and Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 to 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Bank's basic financial statements. The supplemental schedule of net position - Intermediary Relending Program and schedule of revenues, expenses and changes in net position - Intermediary Relending Program on pages 22 and 23 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplemental schedule of net position - Intermediary Relending Program and schedule of revenues, expenses and changes in net position - Intermediary Relending Program are the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental schedule of net position - Intermediary Relending Program and schedule of revenues, expenses and changes in net position - Intermediary Relending Program are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 18, 2013 on our consideration of the Bank's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Bank's internal control over financial reporting and compliance.

Deloitte & Touche LLP

April 18, 2013

The following is a discussion and analysis of the Federated States of Micronesia Development Bank's (the Bank) financial performance for the fiscal year ended December 31, 2012.

With the completion of most of the major infrastructure construction projects and winding down of remaining projects, economic growth slowed in 2012. The growth the Bank anticipated in its 2012 portfolio did not materialize due to failures in the construction sector and lack of investment interest in the tourism sector as anticipated with the extension of Pohnpei airport. Although the level of loan approval increased in 2012, these loan basically replaces loan run offs. Total assets for the Bank increased due mainly to increase in the value of the investment portfolio and increase in equity investment in Bank of FSM. Bank liabilities decreased as the bank paid down its borrowed funds and accounts payable. The Bank approved 262 loans for $7.6 million compared to last year's approval of $5.8 million for 208 loans. The Bank is budgeting for further growth in the loan portfolio in 2013 focusing mainly on small businesses in Agriculture and Fisheries. The Bank was able to generate $2.9 million in loan interest income in 2012 and was able to cover its operating expenses in full. The Bank ended the year with a total increase in net position of about $1.9 million.

As described in Note 1 to the financial statements, during the year ended December 31, 2012, the Bank has implemented the Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position,* and Statement No. 65, *Items Previously Reported as Assets and Liabilities.*

Summary Statement of Net Position

	2012	2011	2010
Assets:			
Current assets	$ 13,688,117	$ 14,643,824	$ 13,361,733
Noncurrent assets	28,631,658	26,385,382	26,672,972
Total assets	$ 42,319,775	$ 41,029,206	$ 40,034,705
Liabilities:			
Liabilities	$ 934,607	$ 1,498,801	$ 1,757,851
Net position:			
Invested in fixed assets	1,409,335	1,533,822	229,453
Unrestricted	39,975,833	37,996,583	38,047,401
Total net position	41,385,168	39,530,405	38,276,854
Total liabilities and net position	$ 42,319,775	$ 41,029,206	$ 40,034,705

During fiscal year 2012, the Bank did not draw down any money from its borrowed funds from USDA RECD Intermediary Relending Program nor from the European Investment Bank. The draw down period for the European Investment Bank line of credit will expire at the beginning of second quarter of 2013. The bank would mostly likely request extension of the drawdown period to allow the bank to utilize the line of credit for its 2013 projects. For additional information concerning the Bank's debt, please refer to note 8 to the financial statements.

There were no significant capital expenditures incurred by the Bank during 2012. The Bank is currently renovating the Town Plaza Building, which was acquired during 2011 through a foreclosure settlement, to which the Bank will relocate. The renovations and the move are expected to be completed by mid-2013. For additional information concerning the Bank's capital assets, please refer to the notes to financial statements, primarily note 5.

Earnings in 2012 were positive at $1.9 million, a 48% increase over last year's earnings of $1.3 million. Loan loss provision was reversed and added back to revenue as there was sufficient loan loss reserve to cover potential losses. At the end of 2012, total allowance for loan losses to NPL (non-performing loans) was at 139%. Based on the loan classification policy and review of individual loans, the Bank is adequately reserved for loan losses.

At December 31, 2012, the market value of the Bank's investments stood at $11.9 million, an increase of about 26% from $9.5 million at the end of 2011.

Summary Statement of Revenues, Expenses and Changes in Net Position

	2012	2011	2010
Operating revenues	$ 2,476,471	$ 2,439,560	$ 2,444,276
Reversals of provision for loan losses	147,584	437,847	103,860
Operating expenses	(1,846,415)	(1,772,707)	(1,948,595)
Earnings from operations	777,640	1,104,700	599,541
Non-operating revenues, net	1,077,123	148,851	1,053,451
Change in net position	1,854,763	1,253,551	1,652,992
Net position at beginning of year	39,530,405	38,276,854	36,623,862
Net position at end of year	$ 41,385,168	$ 39,530,405	$ 38,276,854

The Bank manages three trust funds, namely, the Investment Development Fund (IDF), Pohnpei Development Loan Fund (PDLF) and Yap Development Loan Fund (YDLF). The total assets for each of these funds at the end of 2012 were $5,062,475, $873,776, and $291,549 respectively. IDF and PDLF ended the year with net losses of $1,365,704 and $7,163, respectively, whereas YDLF earned net income of $4,547. The net losses recorded by IDF are mainly due to provisions for loan losses of $1.2 million recorded for the year.

Economic Outlook

Management does not anticipate significant improvement in the economy in 2013 unless the investment environment particularly for foreign investment improves. Investment policies need changing before any kind of improvement could happen. For the Bank, it had shifted its focus to very small start-up projects in the agriculture and fisheries sectors and food preparation and tailoring sectors. The focus is in increasing the number of projects with export oriented potentials to complement the Export Lending Program with the Pacific Islands Development Bank. But for the Bank to remain sustainable, it will continue to lend to larger projects with the commercial real estate and tourism projects as well as the other sectors. The FSM governments are working on improving the foreign investment laws and introduction of a Value Added Tax regime. With some changes, the economy might see some growth after 2013.

Contacting Financial Management

The Management Discussion and Analysis report is intended to provide information concerning known facts and conditions affecting the Bank's operations. This financial report is designed to provide a general overview of the Bank's finances and to demonstrate the Bank's accountability for the funds it receives and expends.

Management's Discussion and Analysis for the year ended December 31, 2011 is set forth in the Bank's report on the audit of financial statements, which is dated June 20, 2012. That Discussion and Analysis explains the major factors impacting the 2011 financial statements and can be viewed at the Bank's website at www.fsmdb.fm or Office of the Public Auditor's website at www.fsmopa.fm.

For additional information about this report, please contact Anna Mendiola, President/Chief Executive Officer, P.O. Box M, Kolonia, Pohnpei 96941or visit the website at www.fsmdb.fm.

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

Statements of Net Position
December 31, 2012 and 2011

	2012	2011
ASSETS		
-		
Current assets:		
Cash and cash equivalents	$ 4,391,374	$ 5,207,596
Time certificates of deposit	2,851,042	2,917,944
Accounts receivable	50,243	7,632
Receivable from trust funds	475,876	448,305
Prepaid expenses	4,647	2,500
Interest and other receivables	247,935	268,847
Current portion of loans receivable	5,667,000	5,791,000
Total current assets	13,688,117	14,643,824
Noncurrent assets:		
Fixed assets, net	1,409,335	1,533,822
Investments	11,941,576	9,513,944
Equity investment, at cost	1,162,188	662,188
Loans receivable, net of current portion and allowance for loan losses	14,118,559	14,675,428
Total noncurrent assets	28,631,658	26,385,382
Total assets	$ 42,319,775	$ 41,029,206
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 416,685	$ 400,000
Accounts payable	94,354	209,306
Accrued interest payable	15,088	24,568
Credit life payable	34,312	30,245
Payable to trust funds	80,098	123,927
Total current liabilities	640,537	788,046
Noncurrent liabilities:		
Long-term debt, net of current portion	294,070	710,755
Total liabilities	934,607	1,498,801
Commitments and contingencies		
Net position:		
Net investment in capital assets	1,409,335	1,533,822
Unrestricted	39,975,833	37,996,583
Total net position	41,385,168	39,530,405
Total liabilities and net position	$ 42,319,775	$ 41,029,206

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 Position
Years Ended December 31, 2012 and 2011

	2012	2011
Operating revenues:		
Interest income on loans	$ 2,143,044	$ 2,198,821
Interest income on time certificates of deposit	16,413	29,228
Loan fees	105,839	93,381
Rental	63,077	44,854
Miscellaneous	148,098	73,276
Total operating revenues	2,476,471	2,439,560
Reversal of provision for loan losses	147,584	437,847
Net operating revenues	2,624,055	2,877,407
Operating expenses:		
Interest expense	47,320	63,851
General and administrative expenses:		
Personnel services	953,806	955,026
Rent	125,228	119,657
Contractual services	120,833	161,124
Depreciation	113,557	130,700
Travel	106,886	62,063
Training	64,054	18,599
Utilities	48,480	43,525
Retirement plan contributions	44,797	48,835
Communication	39,174	30,879
Branch automation	33,863	13,909
Supplies	29,572	21,430
Equipment	20,734	20,779
Staff relations	14,951	12,379
Community development	14,854	10,892
Loan and collection	12,821	12,337
Fuel, oil and petroleum	12,388	10,941
Repair and maintenance	9,016	4,369
Insurance	6,799	7,225
Printing	1,767	1,202
Miscellaneous	25,515	22,985
Total general and administrative expenses	1,799,095	1,708,856
Earnings from operations	777,640	1,104,700
Nonoperating revenues (expenses):		
IDF reimbursement	250,000	250,000
Investment earnings (losses), net	844,318	(104,434)
(Loss) gain on asset disposals	(17,195)	3,285
Total nonoperating revenues, net	1,077,123	148,851
Change in net position	1,854,763	1,253,551
Net position at beginning of year	39,530,405	38,276,854
Net position at end of year	$ 41,385,168	$ 39,530,405

See accompanying notes to financial statements.

Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from customers	$ 2,438,359	$ 2,391,153
Cash paid to suppliers for goods and services	(844,764)	(591,228)
Cash paid to employees for services	(953,806)	(955,026)
Interest received on time certificates of deposit	16,413	29,228
Interest paid	(56,800)	(84,547)
Net cash provided by operating activities	599,402	789,580
Cash flows from noncapital financing activities:		
Proceeds from long-term debt	-	194,191
Principal repayment of long-term debt	(400,000)	(400,000)
Net transfers in from trust funds	178,600	137,872
Net cash used for noncapital financing activities	(221,400)	(67,937)
Cash flows from capital and related financing activities:		
Proceeds from sale of fixed assets	241	-
Acquisition of fixed assets	(6,506)	(282,892)
Net cash used for capital and related financing activities	(6,265)	(282,892)
Cash flows from investing activities:		
Loan origination and principal collections, net	828,453	(223,802)
Additions to time certificates of deposit, net	66,902	(1,216,902)
Change in escrow accounts, net	-	520,295
Additions to (withdrawals from) investments, net	(1,669,787)	(1,637)
Additions to equity investment	(500,000)	-
Interest income on savings accounts	1,458	1,491
Dividends received	85,015	80,000
Net cash used for investing activities	(1,187,959)	(840,555)
Net change in cash and cash equivalents	(816,222)	(401,804)
Cash and cash equivalents at beginning of year	5,207,596	5,609,400
Cash and cash equivalents at end of year	$ 4,391,374	$ 5,207,596

Statements of Cash Flows, Continued
Years Ended December 31, 2012 and 2011

	2012	2011
Reconciliation of earnings from operations to net cash provided by operating activities:		
Earnings from operations	$ 777,640	$ 1,104,700
Adjustment to reconcile earnings from operations to net cash provided by operating activities:		
Reversal of provision for loan losses	(147,584)	(437,847)
Depreciation	113,557	130,700
(Increase) decrease in assets:		
Accounts receivable	(42,611)	12,072
Interest and other receivables	20,912	(31,251)
Prepaid expenses	(2,147)	-
Increase (decrease) in liabilities:		
Accounts payable	(114,952)	25,176
Accrued interest payable	(9,480)	(20,696)
Credit life payable	4,067	6,726
Net cash provided by operating activities	$ 599,402	$ 789,580
Summary of noncash investing activities:		
Decrease in loans receivable	$ -	$ (1,148,892)
Increase in fixed assets	-	1,148,892
	$ -	$ -

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

Reporting Entities

The Federated States of Micronesia (FSM) Development Bank (the Bank) was created in 1979 by Public Law 1-37 of the First Congress of the Federated States of Micronesia. The 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 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, 2010, the Bank has issued 2,997,883 shares to the FSM National Government (98.7%), Kosrae State (0.3%) and Chuuk State (1.0%). These shares do not convey ownership and have been made in accordance with the aforementioned law but these shares have no financial impact on the accompanying financial statements.

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 United States.

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.

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).

(1) Summary of Significant Accounting Policies, Continued

Fund Structure and Basis of Accounting, Continued

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 (GAAP) 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.

The Statement of Net Position presents all of the Bank's non-fiduciary assets, deferred outflows of resources, liabilities and deferred inflows of resources, with the difference reported as net position. Net position is classified for accounting and reporting purposes into the following four net asset categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets as well as deferred outflows of resources and deferred inflows of resources that are attributable to those assets or related debt.

- Restricted - restricted assets reduced by liabilities and deferred inflows of resources related to those assets that are subject to externally imposed stipulations.

- Unrestricted - the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

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 position 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

Investment securities 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 and is primarily determined based on quoted market values.

An equity investment in the common stock of Bank of the FSM is stated at cost as there is no active market for this investment.

(1) Summary of Significant Accounting Policies, Continued

Loans and Allowance for Loan Losses

Loans receivable 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 their useful lives. 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 Bank enters 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.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements in order to conform with the 2012 presentation.

Estimates

The preparation of financial statements in conformity with GAAP 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.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended December 31, 2012, the Bank implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements,* which addressed how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities,* which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus,* which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity,* and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012,* which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Bank.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans,* which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions,* which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of the Bank.

(2) Deposits and Investments

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.

(2) Deposits and Investments, Continued

(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:

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, 2012 and 2011, the carrying amount of the Bank's total cash and cash equivalents and time certificates of deposit was $7,242,416 and $8,125,540, respectively, and the corresponding bank balances were $7,316,177 and $8,178,086, respectively. As of December 31, 2012 and 2011, $283,963 and $0 of the bank balances are not maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2012 and 2011, bank deposits in the amounts of $500,000 and $638,336, 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, 2012 and 2011.

B. Investments

As of December 31, 2012 and 2011, investments at fair value are as follows:

	2012	2011
Fixed income securities:		
Domestic fixed income	$ 4,606,478	$ 3,287,268
Other investments:		
Domestic equities	6,113,756	4,954,480
Money market funds	1,221,342	1,272,196
	$ 11,941,576	$ 9,513,944

As of December 31, 2012 and 2011, the Bank's fixed income securities had the following maturities:

2012	Less than 1 Year	1 to 5 Years	6 to 10 Years	Total
U.S. Treasury notes	$ 690,450	$ 1,630,144	$ 343,343	$ 2,663,937
U.S. Government agency obligations	214,925	1,727,616	-	1,942,541
	$ 905,375	$ 3,357,760	$ 343,343	$ 4,606,478

(2) Deposits and Investments, Continued

B. Investments, Continued

2011	Less than 1 Year	1 to 5 Years	6 to 10 Years	Total
U.S. Treasury notes	$ 368,603	$ 1,336,638	$ 348,436	$ 2,053,677
U.S. Government agency Obligations	234,979	840,365	158,247	1,233,591
	$ 603,582	$ 2,177,003	$ 506,683	$ 3,287,268

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

At December 31, 2012 and 2011, all of the Bank's domestic fixed income securities are invested in the U.S Government Treasury notes and U.S. Government agency securities with AAA rating by Moody's.

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, 2012 and 2011.

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, 2012, the Bank's investment in U.S. treasury notes (T-notes) and agency obligations of the Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) constituted 22%, 9% and 7%, respectively, of its total investments. As of December 31, 2011, the Bank's investment in T-notes and FNMA constituted 22% and 9%, 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.

(3) Equity Investment, at Cost

At December 31, 2012 and 2011, the equity investment in Bank of the FSM, carried at cost, represents 150,000 and 100,000 common shares, respectively, and approximately an 16.1% and 10.7% ownership interest, respectively. Since the book value of the shares exceeds the carrying value, management believes that the equity investment has not become impaired.

(4) Loans Receivable

A summary of loans receivable at December 31, 2012 and 2011 follows:

	2012	2011
Unpaid principal balance	$ 24,412,424	$ 24,057,757
Allowance for loan losses	(4,626,865)	(3,591,329)
	$ 19,785,559	$ 20,466,428

Movements in the allowance for loan losses during the years ended December 31, 2012 and 2011, are as follows:

	2012	2011
Balance at beginning of year	$ 3,591,329	$ 6,199,117
Reversal of provision for loan losses	(147,584)	(437,847)
Loans charged off	-	(3,248,450)
Loans restructured	-	4,324
Loan recoveries from previously charged off loans	1,183,120	607,840
Loan recoveries from foreclosure of assets	-	128,345
Loan reactivations from previously charged off loans	-	338,000
Balance at end of year	$ 4,626,865	$ 3,591,329

(5) Fixed Assets

A summary of fixed assets as of December 31, 2012 and 2011, is as follows:

	Beginning January 1, 2012	Additions/ Transfers	Deletions/ Transfers	Ending December 31, 2012
Building	$ 1,413,988	$ -	$ -	$ 1,413,988
Office furniture, fixtures and equipment	154,579	-	(122,810)	31,769
Home furniture, fixtures and equipment	14,098	-	(14,098)	-
Vehicles	285,115	-	(133,550)	151,565
Computers and software	667,142	6,506	(262,035)	411,613
	2,534,922	6,506	(532,493)	2,008,935
Less accumulated depreciation	(1,001,100)	(113,557)	515,057	(599,600)
Net fixed assets	$ 1,533,822	$ (107,051)	$ (17,436)	$ 1,409,335

	Beginning January 1, 2011	Additions/ Transfers	Deletions/ Transfers	Ending December 31, 2011
Building	$ -	$ 1,413,988	$ -	$ 1,413,988
Office furniture, fixtures and equipment	154,579	-	-	154,579
Home furniture, fixtures and equipment	14,098	-	-	14,098
Vehicles	284,398	717	-	285,115
Computers and software	643,290	23,852	-	667,142
	1,096,365	1,438,557	-	2,534,922
Less accumulated depreciation	(866,912)	(130,700)	(3,488)	(1,001,100)
Net fixed assets	$ 229,453	$ 1,307,857	$ (3,488)	$ 1,533,822

(6) Related Party Transactions

As of December 31, 2012 and 2011, the Bank has direct loans with outstanding balances of $107,337 and $128,305, respectively, to employees of the Bank and project loans extended to businesses owned by or affiliated with employees of $377,952 and $2,536,686, 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.

(7) 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, 2012 and 2011.

Loan Commitments

Undrawn balances on lines of credit and loan commitments for loans approved but undisbursed approximated $1,587,000 at December 31, 2012.

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.

Insurance

The Bank carries insurance to cover its potential risks from vehicle usage. The 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 during the past three years.

Lease Commitments

The Bank has four operating leases for each of its State operating locations. Additionally, the Bank pays for the residential leases for four contract employees. These leases expire in varying dates through February 2018. Several of these leases provide options to renew upon expiration, based on renegotiated rates. Future minimum annual lease payments payable by the Bank under the uncancellable lease agreements are as follows:

Year ending December 31,	Total
2013	$ 130,170
2014	96,120
2015	47,640
2016	27,100
2017	15,000
Thereafter	1,250
	$ 317,280

(7) Commitments and Contingencies, Continued

Lease Commitments, Continued

The Bank acquired a building as a part of a debt settlement during 2011. Rental income generated from existing leases approximated $63,000 and $45,000 in 2012 and 2011, respectively. The Bank will be relocating to this building during 2013 and will occupy most of the building. The lease agreement for the current location expires April 2015, and as such the Bank is in the process of entering into a sub-lease agreement.

(8) Long-Term Debt

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 fixed at 7.38% per annum. Repayment of principal and interest commenced on January 21, 2009 in semi-annual principal installments of $200,000. As of December 31, 2012 and 2011, the amount outstanding and payable was $400,000 and $800,000, respectively.

On December 8, 2009, the Bank was awarded an Intermediary Relending Program (IRP) loan by the U.S. Department of Agriculture in the amount of $466,254. The loan requires interest only payments for the first three years; thereafter, principal and interest, at a fixed rate of 1% per annum, is payable in equal annual installments beginning on December 8, 2013 through December 8, 2039. At December 31, 2012 and 2011, outstanding balance was $310,755. Undrawn balance as of December 31, 2012 was $155,499.

On August 30, 2010, the Bank entered into a line of credit agreement in the amount of EUR 4,000,000 with European Investment Bank for a term of fifteen years. The loan is uncollateralized and bears interest at the London Interbank Offered Rate on the date of drawdown plus a 1.76% risk premium per annum. No drawdowns have occurred as of December 31, 2012.

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

Year ending December 31,	Principal	Interest	Total
2013	$ 416,685	$ 12,186	$ 428,871
2014	16,852	2,941	19,793
2015	17,021	2,772	19,793
2016	17,191	2,602	19,793
2017	17,363	2,430	19,793
2018-2023	89,455	9,510	98,965
2024-2028	94,017	4,948	98,965
2029-2030	42,171	682	42,853
	$ 710,755	$ 38,071	$ 748,826

(8) Long-Term Debt, Continued

Long-term debt changes during the years ended December 31, 2012 and 2011 are as follows:

	Balance January 1,	Additions	Reductions	Balance December 31,	Due Within One Year
2012:					
Loan payable	$ 1,110,755	$ -	$ (400,000)	$ 710,755	$ 416,685

	Balance January 1,	Additions	Reductions	Balance December 31,	Due Within One Year
2011:					
Loan payable	$ 1,316,564	$ 194,191	$ (400,000)	$ 1,110,755	$ 400,000

(9) Contribution from the FSM National Government

The Bank was reimbursed for expenses incurred in administering the IDF program from the IDF Private Sub Account for $250,000 for each of the years ended December 31, 2012 and 2011.

(10) 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 Chief Financial Officer is the designated Plan Administrator. Matching contributions to the Plan during the years ended December 31, 2012, 2011, and 2010 were $44,797, $48,835, and $56,824, respectively. Management is of the opinion that the Plan does not represent an asset or a liability of the Bank.

(11) 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, 2012 and 2011, the account has a balance of $178,576 and $138,535, respectively.

(12) Subsequent Events

Management has evaluated subsequent events through April 18, 2013, which is the date that the financial statements are available to be issued. There were no material subsequent events that would require recognition or disclosure in the financial statements for the year ended December 31, 2012.

Schedule of Net Position - Intermediary Relending Program
December 31, 2012

ASSETS		
-		
Current assets:		
Cash and cash equivalents	$	598,861
Interest and other receivables		3,775
Loans receivable		333,333
Total assets	$	935,969
LIABILITIES		
Current liabilities:		
Due to FSMDB, net	$	91,459
Credit life payable		173
Noncurrent liabilities:		
Long-term debt		310,755
Total liabilities		402,387
Net position:		
Unrestricted		533,582
Total net position		533,582
Total liabilities and net position	$	935,969

See accompanying Independent Auditors' Report.

Schedule of Revenues, Expenses and Changes in Net Position -
Intermediary Relending Program
Year Ended December 31, 2012

Operating revenues:	
Interest income on loans	$ 43,733
Miscellaneous	243
Total operating revenues	43,976
Operating expenses:	
Interest expense	4,238
Earnings from operations	39,738
Non-operating revenues:	
Interest income on savings account	1,458
Change in net position	41,196
Net position at beginning of year	492,386
Net position at end of year	$ 533,582

See accompanying Independent Auditors' Report.

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

DECEMBER 31, 2012

Deloitte.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia Development Bank:

Report on the Financial Statements

We have audited the accompanying financial statements of the Investment Development Fund, the Pohnpei Development Loan Fund, and the Yap Development Loan Fund (the Funds), administered by the Federated States of Micronesia Development Bank (the Bank), which comprise the respective statements of fiduciary net position as of December 31, 2012, and the related statements of changes in fiduciary net position for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our 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 from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Investment Development Fund, the Pohnpei Development Loan Fund, and the Yap Development Loan Fund as of December 31, 2012, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 1 to the financial statements, during the year ended December 31, 2012, the Bank has implemented the Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, and Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

Other Matters

As discussed in Note 1 to the financial statements, the financial statements referred to above present only the respective financial position of the Investment Development Fund, the Pohnpei Development Loan Fund, and the Yap Development Loan Fund and are not intended to present fairly the financial position and results of operations of the Federated States of Micronesia Development Bank in conformity with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 18, 2013 on our consideration of the Bank's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Bank's internal control over financial reporting and compliance.

Deloitte & Touche LLP

April 18, 2013

Trust Funds
Statement of Fiduciary Net Position
December 31, 2012

	IDF	PDLF	YDLF	Total
ASSETS				
Held by FSMDB:				
Cash in bank and on hand	$ -	$ 275,223	$ 106,729	$ 381,952
Time certificates of deposit	789,319	-	-	789,319
Total cash and equivalents	789,319	275,223	106,729	1,171,271
Time certificates of deposit	1,436,757	577,890	146,363	2,161,010
Receivable from FSMDB	64,334	-	15,764	80,098
Interest and other receivables	3,612	847	835	5,294
Loans receivable, net	2,768,453	19,816	21,858	2,810,127
Total receivables	2,836,399	20,663	38,457	2,895,519
	$ 5,062,475	$ 873,776	$ 291,549	$ 6,227,800
LIABILITIES AND NET POSITION				
Liabilities:				
Payable to FSMDB	$ 291,887	$ 142,782	$ 41,207	$ 475,876
Commitments				
Net position:				
Restricted	2,768,453	19,816	21,858	2,810,127
Unrestricted	2,002,135	711,178	228,484	2,941,797
Total net position	4,770,588	730,994	250,342	5,751,924
	$ 5,062,475	$ 873,776	$ 291,549	$ 6,227,800

See accompanying notes to financial statements.

Trust Funds
Statement of Changes in Fiduciary Net Position
Year Ended December 31, 2012

	IDF	PDLF	YDLF	Total
Additions:				
Loan interest	$ 54,843	$ 1,857	$ 1,974	$ 58,674
Investment interest	6,719	3,056	1,106	10,881
Miscellaneous	-	-	1,467	1,467
Total additions	61,562	4,913	4,547	71,022
Deductions:				
Provision for loan losses	1,158,594	-	-	1,158,594
Investment management fee	250,000	-	-	250,000
Miscellaneous	18,672	12,076		30,748
Total deductions	1,427,266	12,076	-	1,439,342
Change in net position	(1,365,704)	(7,163)	4,547	(1,368,320)
Net position at beginning of year	6,136,292	738,157	245,795	7,120,244
Net position at end of year	$ 4,770,588	$ 730,994	$ 250,342	$ 5,751,924

See accompanying notes to financial statements.

Notes to Financial Statements
December 31, 2012

(1) 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 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 United States. The IDF is administered by the Bank in a Trust capacity on behalf of the FSM National Government and its four States.

PDLF and YDLF are administered by the Bank in a Trust capacity. All loan decisions are made by executives of the respective state governments as these funds represent local appropriations designated to be loaned for development purposes.

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 and Time Certificates of Deposit

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

Loans 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 position as restricted net position. 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.

(1) Purpose and Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended December 31, 2012, the Bank implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements,* which addressed how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity,* and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

(1) Purpose and Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012,* which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Bank.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans,* which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions,* which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of the Bank.

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

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.

(2) Deposits, Continued

(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.

Custodial credit risk is the risk that in the event of a bank failure, the Funds' deposits may not be returned to them. 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, 2012, the carrying amount of the Funds' total cash and time certificates of deposit was $3,332,281 and the corresponding bank balances were $3,333,109. All of the bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. However, none of the balances were covered as the FSMDB have already exceeded the insurable limit per depositor. For purposes of FDIC insurance termination, funds held in trust are not differentiable with regular accounts held by FSMDB. 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, 2012.

(3) Loans Receivable

The following is a schedule of loans receivable as of December 31, 2012:

	Loan Balance	Allowance	Net
PDLF and YDLF	$ 41,674	$ -	$ 41,674
IDF	6,919,148	4,150,695	2,768,453
	$ 6,960,822	$ 4,150,695	$ 2,810,127

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

(4) Subsequent Events

Management has evaluated subsequent events through April 18, 2013, which is the date that the financial statements are available to be issued. There were no material subsequent events that would require recognition or disclosure in the financial statements for the year ended December 31, 2012.

Your Partner in Business

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

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