FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2011 AND 2010

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

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Years Ended December 31, 2011 and 2010

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INDEPENDENT AUDITORS' 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 (the "Bank"), a component unit of the FSM National Government, as of December 31, 2011 and 2010, 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, 2011 and 2010, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 20, 2012, 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 to 5 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. This supplementary information is the responsibility of the Bank's management. 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.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental Schedule of Net Assets - Intermediary Relending Program and Schedule of Revenues, Expenses and Changes in Net Assets - Intermediary Relending Program on pages 23 and 24 are presented for the purpose of additional analysis and are not a required part of the financial statements. This supplementary information is the responsibility of the Bank's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, such information is fairly stated in all material respects in relation to the financial statements as a whole.

Deloitte & Touche LLP

June 20, 2012

The anticipated growth in 2011 did not materialize due to delay in completion of certain major infrastructure coupled with deteriorating utility services mainly in Pohnpei and Chuuk. The year 2011 was no different from previous year in terms of growth in the portfolio, as there were limited bankable projects. However the Bank was able to salvage some previously defunct projects mainly in the tourism sector. These projects are now actively operating and are creating employment and tax revenue. There were more construction and mining projects in 2011 that are still on-going, these contribute to the buying power of the private sector, which helps to maintain stable employment throughout the year. Total assets for the Bank decreased due to loan run off and charged off loans. There is a corresponding decrease in liabilities as the Bank continues to repay borrowed funds. In addition to the residential home loan program, the Bank approved 208 loans for $5.8 million compared to last year's approval of $11 million for 39 loans. The Bank anticipates further growth in the loan portfolio in 2012 for the real estate, construction and tourism sectors. The Bank was able to generate $2.2 million in loan interest income in 2011 and was able to cover its operating expenses in full. The Bank ended the year with a total increase in net assets of about $1.25 million.

Summary Statement of Net Assets

	2011	2010	2009
Assets:			
Current assets	$ 11,803,893	$ 13,361,733	$ 13,622,277
Noncurrent assets	29,225,313	26,672,972	24,828,784
Total assets	$ 41,029,206	$ 40,034,705	$ 38,451,061
Liabilities:			
Liabilities	$ 1,498,801	$ 1,757,851	$ 1,827,199
Net assets:			
Invested in fixed assets	1,533,822	229,453	224,450
Unrestricted	37,996,583	38,047,401	36,399,412
Total net assets	39,530,405	38,276,854	36,623,862
Total liabilities and net assets	$ 41,029,206	$ 40,034,705	$ 38,451,061

In 2011 the Bank acquired the Town Plaza Building through a foreclosure settlement of about $1.4 million. The Bank is planning to relocate its operations to this new office building and will not need to rent office space in Pohnpei. For additional information concerning the Bank's capital assets, please refer to the notes to financial statements, primarily note 5.

During fiscal year 2011, the Bank continued to draw down funds borrowed from USDA RECD Intermediary Relending Program to facilitate lending to small and medium enterprises in the FSM. At year end, the outstanding balance of this loan was $310,755. Repayment of the $2 million borrowed from the Export and Import Bank of China continued in 2011 and the outstanding balance at year end was $800,000. During 2010, the Bank signed a Finance Contract for a loan in the amount of EUR 4 million with the European Investment Bank. At year end, the Bank has not drawn from this loan due to lack of projects eligible to be funded under this source. For additional information concerning the Bank's debt, please refer to note 8 to the financial statements.

Earnings in 2011 were positive at $1,253,551 but less than last year's earnings of $1,652,992. 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 2011, total allowance for loan losses to total classified assets (those classified as substandard or doubtful) was at 39%. Based on the loan classification policy and review of individual loans, the Bank is adequately reserved for loan losses.

At December 31, 2011, the market value of the Bank's investments stood at $9,513,944, a slight decrease from $9,698,232 at the end of 2010.

Summary Statement of Revenues, Expenses and Changes in Net Assets

	2011	2010	2009
Operating revenues	$ 2,439,560	$ 2,444,276	$ 2,500,007
Reversals of provision for loan losses	437,847	103,860	365,582
Operating expenses	(1,772,707)	(1,948,595)	(1,824,264)
Earnings from operations	1,104,700	599,541	1,041,325
Non-operating revenues, net	148,851	1,053,451	1,550,997
Change in net assets	1,253,551	1,652,992	2,592,322
Net assets at beginning of year	38,276,854	36,623,862	34,031,540
Net assets at end of year	$ 39,530,405	$ 38,276,854	$ 36,623,862

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 2011 were $6,431,343, $850,204, and $287,002 respectively. IDF and YDLF ended the year with net losses of $2,618,969 and $1,467, respectively, whereas PDLF earned net income of $13,511. The net losses recorded by IDF are mainly due to provisions for loan losses of $2,502,681 recorded for the year.

Management's Discussion and Analysis for the year ended December 31, 2010 is set forth in the FSMDB's report on the audit of financial statements, which is dated April 26, 2011. That Discussion and Analysis explains the major factors impacting the 2010 financial statements and can be viewed at the banks website at www.fsmdb.fm or Office of the Public Auditor's website at www.fsmopa.fm.

Economic Outlook

Management anticipates some improvement in lending year 2012 as the private sector expands as a result of improved infrastructure in the FSM. Improvements in the foreign investment environment particularly in Pohnpei could contribute to increase in foreign and local partnership in the tourism industry. The Bank foresees an increase in business activities relating to infrastructure development that is stimulating the economy, not only in the construction businesses but the other support service sectors. The Bank still anticipates improvement in the tourism industry beyond 2012 particularly in Pohnpei after the new extended airport runway in Pohnpei is completed. This was originally anticipated in 2011; however, the completion of the airport was significantly delayed. In addition, the creation of resident offices of International and Regional Organizations in Pohnpei is also increasing the need for new real estate development, both for office space as well as rental units for housing. The Bank sees a continued increase in lending in the real estate development sector.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
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Statements of Net Assets
December 31, 2011 and 2010

	2011	2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,207,596	$ 5,609,400
Time certificates of deposit	2,917,944	1,701,042
Housing escrow account	-	520,295
Accounts receivable	7,632	19,704
Receivable from trust funds	448,305	400,624
Prepaid expenses	2,500	2,500
Interest and other receivables	268,847	237,596
Current portion of loans receivable	2,951,069	4,870,572
Total current assets	11,803,893	13,361,733
Noncurrent assets:		
Fixed assets, net	1,533,822	229,453
Investments	9,513,944	9,698,232
Equity investment, at cost	662,188	662,188
Loans receivable, net of current portion and allowance for loan losses	17,515,359	16,083,099
Total noncurrent assets	29,225,313	26,672,972
Total assets	$ 41,029,206	$ 40,034,705
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 400,000	$ 400,000
Accounts payable	209,306	184,130
Accrued interest payable	24,568	45,264
Credit life payable	30,245	23,519
Payable to trust funds	123,927	188,374
Total current liabilities	788,046	841,287
Noncurrent liabilities:		
Long-term debt, net of current portion	710,755	916,564
Total liabilities	1,498,801	1,757,851
Commitments and contingencies		
Net assets:		
Invested in capital assets	1,533,822	229,453
Unrestricted	37,996,583	38,047,401
Total net assets	39,530,405	38,276,854
Total liabilities and net assets	$ 41,029,206	$ 40,034,705

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
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Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2011 and 2010

	2011	2010
Operating revenues:		
Interest income on loans	$ 2,198,821	$ 2,239,484
Interest income on time certificates of deposit	29,228	37,866
Loan fees	93,381	101,094
Miscellaneous	118,130	65,832
Total operating revenues	2,439,560	2,444,276
Reversal of provision for loan losses	437,847	103,860
Net operating revenues	2,877,407	2,548,136
Operating expenses:		
Interest expense	63,851	104,831
General and administrative expenses:		
Personnel services	955,026	1,002,303
Rent	161,124	122,983
Depreciation	130,700	94,925
Contractual services	119,657	167,657
Travel	62,063	89,367
FSM retirement plan	48,835	56,824
Communication	30,879	37,960
Supplies	21,430	19,006
Training	18,599	85,243
Printing	5,515	1,092
Insurance	1,202	5,581
Miscellaneous	153,826	160,823
Total general and administrative expenses	1,708,856	1,843,764
Earnings from operations	1,104,700	599,541
Nonoperating revenues (expenses):		
IDF reimbursement	250,000	250,000
Investment (losses) earnings, net	(104,434)	803,451
Other income	3,285	-
Total nonoperating revenues, net	148,851	1,053,451
Change in net assets	1,253,551	1,652,992
Net assets at beginning of year	38,276,854	36,623,862
Net assets at end of year	$ 39,530,405	$ 38,276,854

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
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Statements of Cash Flows
Years Ended December 31, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash received from customers	$ 2,391,153	$ 2,319,004
Cash paid to suppliers for goods and services	(591,228)	(677,110)
Cash paid to employees for services	(955,026)	(1,002,303)
Interest received on time certificates of deposit	29,228	39,328
Interest paid	(84,547)	(112,299)
Net cash provided by operating activities	789,580	566,620
Cash flows from noncapital financing activities:		
Proceeds from long-term debt	194,191	116,564
Principal repayment of long-term debt	(400,000)	(400,000)
Net transfers in from trust funds	137,872	360,351
Net cash (used for) provided by noncapital financing activities	(67,937)	76,915
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	(282,892)	(99,928)
Net cash used for capital and related financing activities	(282,892)	(99,928)
Cash flows from investing activities:		
Loan origination and principal collections, net	(223,802)	1,787,335
Additions to time certificates of deposit, net	(1,216,902)	(111,106)
Change in escrow accounts, net	520,295	(2,340)
Additions to (withdrawals from) investments, net	(1,637)	38,058
Interest income on savings accounts	1,491	1,971
Dividends received	80,000	68,000
Net cash (used for) provided by investing activities	(840,555)	1,781,918
Net change in cash and cash equivalents	(401,804)	2,325,525
Cash and cash equivalents at beginning of year	5,609,400	3,283,875
Cash and cash equivalents at end of year	$ 5,207,596	$ 5,609,400

Statements of Cash Flows, Continued
Years Ended December 31, 2011 and 2010

	2011	2010
Reconciliation of earnings from operations to net cash provided by operating activities:		
Earnings from operations	$ 1,104,700	$ 599,541
Adjustment to reconcile earnings from operations to net cash provided by operating activities:		
Reversal of provision for loan losses	(437,847)	(103,860)
Depreciation	130,700	94,925
(Increase) decrease in assets:		
Accounts receivable	12,072	(8,670)
Interest and other receivables	(31,251)	(77,273)
Increase (decrease) in liabilities:		
Accounts payable	25,176	54,228
Accrued interest payable	(20,696)	(7,468)
Credit life payable	6,726	15,197
Net cash provided by operating activities	$ 789,580	$ 566,620
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.

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, entered into a line of credit agreement with Export and Import Bank of China for $2,000,000. As of December 31, 2011 and 2010, the amount outstanding and payable under this line was $800,000 and $1,200,000, respectively. Additionally, the Bank 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 $520,295 as of December 31, 2010 was established for the housing guarantee. The agreement was later rescinded during the year ended December 31, 2011.

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

(1) Summary of Significant Accounting Policies, Continued

Fund Structure and Basis of Accounting, Continued

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.

  - 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.

    For the years ended December 31, 2011 and 2010, the Bank does not have expendable or nonexpendable restricted net assets.

(1) Summary of Significant Accounting Policies, Continued

Fund Structure and Basis of Accounting, Continued

- 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

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 market for this investment.

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.

(1) Summary of Significant Accounting Policies, Continued

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.

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 2010 financial statements in order to conform with the 2011 presentation.

New Accounting Standards

During fiscal year 2011, the Bank implemented the following pronouncements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements,* which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

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.

In December 2010, GASB issued 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 provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (*an amendment of GASB Statement No. 53*), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

(2) 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 fall 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;

(2) Deposits and Investments, Continued

A. Deposits, Continued

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, 2011 and 2010, the carrying amount of the Bank's total cash and cash equivalents and time certificates of deposit was $8,125,540 and $7,830,737, respectively, and the corresponding bank balances were $8,178,086 and $7,935,602, respectively. All bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2011 and 2010, bank deposits in the amounts of $638,336 and $750,164, 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, 2011 and 2010.

B. Investments:

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fall 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.

(2) Deposits and Investments, Continued

B. Investments, Continued

As of December 31, 2011 and 2010, investments at fair value are as follows:

	2011	2010
Fixed income securities:		
Domestic fixed income	$ 3,287,268	$ 2,907,993
Other investments:		
Domestic equities	4,954,480	5,229,535
Money market funds	1,272,196	1,560,704
	$ 9,513,944	$ 9,698,232

As of December 31, 2011 and 2010, the Bank's fixed income securities had the following maturities:

2011	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Fair Value
U.S. Treasury obligations	$ 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

2010	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Fair Value
U.S. Treasury obligations	$ 316,611	$ 972,193	$ 388,883	$ 1,677,687
U.S. Government agency obligations	244,824	616,767	368,715	1,230,306
	$ 561,435	$ 1,588,960	$ 757,598	$ 2,907,993

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, 2011 and 2010, were as follows:

2011	Total	Domestic	International
Moody's Rating – AAA	$ 3,287,268	$ 3,287,268	$ -

2010	Total	Domestic	International
Moody's Rating – AAA	$ 2,907,993	$ 2,907,993	$ -

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, 2011 and 2010.

(2) Deposits and Investments, Continued

B. Investments, Continued

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, 2011, the Bank's investment in U.S. treasury notes and agency obligations of the Federal National Mortgage Association constituted 22% and 9%, respectively, of its total investments. As of December 31, 2010, the Bank's investment in U.S. treasury notes and agency obligations of the Federal National Mortgage Association constituted 17% 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

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.

(4) Loans Receivable

A summary of loans receivable at December 31, 2011 and 2010 follows:

	2011	2010
Unpaid principal balance	$ 24,057,757	$ 27,152,788
Allowance for loan losses	(3,591,329)	(6,199,117)
	$ 20,466,428	$ 20,953,671

Movements in the allowance for loan losses during the years ended December 31, 2011 and 2010, are as follows:

	2011	2010
Balance at beginning of year	$ 6,199,117	$ 5,789,261
Reversal of provision for loan losses	(437,847)	(103,860)
Loans charged off	(3,248,450)	-
Loans restructured	4,324	115,851
Loan recoveries from previously charged off loans	607,840	397,865
Loan recoveries from foreclosure of assets	128,345	-
Loan reactivations from previously charged off loans	338,000	-
Balance at end of year	$ 3,591,329	$ 6,199,117

(5) Fixed Assets

A summary of fixed assets as of December 31, 2011 and 2010, is as follows:

	Beginning Balance January 1, 2011	Additions/ Transfers	Deletions/ Transfers	Ending Balance 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

	Beginning Balance January 1, 2010	Additions/ Transfers	Deletions/ Transfers	Ending Balance December 31, 2010
Office furniture, fixtures and equipment	$ 154,579	$ -	$ -	$ 154,579
Home furniture, fixtures and equipment	14,098	-	-	14,098
Vehicles	231,129	53,269	-	284,398
Computers and software	596,631	46,659	-	643,290
	996,437	99,928	-	1,096,365
Less accumulated depreciation	(771,987)	(94,925)	-	(866,912)
Net fixed assets	$ 224,450	$ 5,003	$ -	$ 229,453

(6) Related Party Transactions

As of December 31, 2011 and 2010, the Bank has direct loans with outstanding balances of $128,305 and $195,881, respectively, to employees of the Bank and project loans extended to businesses owned by or affiliated with employees of $2,536,686 and $2,446,679, 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, 2011 and 2010.

Loan Commitments

The Bank has entered into loan commitments for loans approved but undisbursed in the amount of $802,213 at December 31, 2011.

(7) Commitments and Contingencies, Continued

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 seven operating leases as of December 31, 2011. Three are residential real estate leases for contract employees. Four leases are for the branch offices in each State. The leases expire through December 1, 2016. Future minimum annual lease payments payable by the Bank under the uncancellable lease agreements are as follows:

Year ending December 31,	Total
2012	$ 196,320
2013	84,370
2014	71,520
2015	32,640
2016	12,100
	$ 396,950

(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, 2011 and 2010, the amount outstanding and payable was $800,000 and $1,200,000, 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 is payable in equal annual installments beginning on December 8, 2013. The loan matures on December 8, 2039. The loan bears a fixed interest rate of one percent per annum. At December 31, 2011 and 2010, outstanding balances were $310,755 and $116,564, respectively. The loan is assumed to be fully disbursed by December 8, 2012, which is the last annual interest-only payment period.

(8) Long-Term Debt, Continued

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, 2011.

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

Year ending December 31,	Principal	Interest	Total
2012	$ 400,000	$ 54,768	$ 454,768
2013	415,128	26,803	441,931
2014	15,279	4,511	19,790
2015	15,432	4,358	19,790
2016	15,586	4,204	19,790
2017-2021	80,301	18,649	98,950
2022-2026	84,397	14,553	98,950
2027-2031	84,632	10,247	94,879
	$ 1,110,755	$ 138,093	$ 1,248,848

Long-term debt changes during the years ended December 31, 2011 and 2010 are as follows:

	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

	Balance January 1,	Additions	Reductions	Balance December 31,	Due Within One Year
2010:					
Loan payable	$ 1,600,000	$ 116,564	$ (400,000)	$ 1,316,564	$ 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, 2011 and 2010.

(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, 2011, 2010, and 2009 were $48,835, $56,824, and $51,395, 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, 2011 and 2010, the account has a balance of $138,535 and $81,574, respectively.

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

Schedule of Net Assets - Intermediary Relending Program
December 31, 2011

ASSETS		
Current assets:		
Cash and cash equivalents	$	563,511
Receivable from FSMDB		17,254
Interest and other receivables		776
Loans receivable		221,663
Total assets	$	803,204
LIABILITIES		
Current liabilities:		
Credit life payable	$	63
Noncurrent liabilities:		
Long-term debt		310,755
Total liabilities		310,818
Net assets:		
Unrestricted		492,386
Total net assets		492,386
Total liabilities and net assets	$	803,204

See accompanying Independent Auditors' Report.

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

Schedule of Revenues, Expenses and Changes in Net Assets - Intermediary Relending Program
Year Ended December 31, 2011

Operating revenues:	
Interest income on loans	$ 17,611
Loan fees	503
Miscellaneous	150
Total operating revenues	18,264
Operating expenses:	
Interest expense	2,178
Earnings from operations	16,086
Non-operating revenues:	
Interest income on savings account	1,491
Change in net assets	17,577
Net assets at beginning of year	474,809
Net assets at end of year	$ 492,386

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, 2011

Deloitte.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA
Tel: (671)646-3884
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INDEPENDENT AUDITORS' 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, 2011, 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 (the Bank), 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 accordance with *Government Auditing Standards*, we have issued our report dated June 20, 2012, 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.

In our opinion, such financial statements 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 at December 31, 2011, and the changes in their respective financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

June 20, 2012

Trust Funds
Statement of Fiduciary Net Assets
December 31, 2011

	IDF	PDLF	YDLF	Total
ASSETS				
Held by FSMDB:				
Cash in bank and on hand	$ -	$ 245,044	$ 87,585	$ 332,629
Time certificates of deposit	1,430,763	575,563	145,415	2,151,741
Held by trustee:				
Investments	787,532	-	-	787,532
Total cash and equivalents	2,218,295	820,607	233,000	3,271,902
Receivable from FSMDB	96,662	-	27,265	123,927
Interest and other receivables	47,297	770	663	48,730
Loans receivable, net	4,069,089	28,827	26,074	4,123,990
Total receivables	4,213,048	29,597	54,002	4,296,647
	$ 6,431,343	$ 850,204	$ 287,002	$ 7,568,549
LIABILITIES AND NET ASSETS				
Liabilities:				
Payable to FSMDB	$ 295,051	$ 112,047	$ 41,207	$ 448,305
Commitments				
Net assets:				
Restricted	4,069,089	28,827	26,074	4,123,990
Unrestricted	2,067,203	709,330	219,721	2,996,254
Total net assets	6,136,292	738,157	245,795	7,120,244
	$ 6,431,343	$ 850,204	$ 287,002	$ 7,568,549

See accompanying notes to financial statements.

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

Trust Funds
Statement of Changes in Fiduciary Net Assets
Year Ended December 31, 2011

	IDF	PDLF	YDLF	Total
Additions:				
Loan interest	$ 122,963	$ 6,547	$ 1,748	$ 131,258
Investment interest	13,849	3,708	2,870	20,427
Miscellaneous	65	3,256	49	3,370
Total additions	136,877	13,511	4,667	155,055
Deductions:				
Provision for loan losses	2,502,681	-	-	2,502,681
Investment management fee	250,000	-	-	250,000
Miscellaneous	3,165	-	6,134	9,299
Total deductions	2,755,846	-	6,134	2,761,980
Change in net assets	(2,618,969)	13,511	(1,467)	(2,606,925)
Net assets at beginning of year	8,836,261	724,646	247,262	9,808,169
Less: return of net assets	81,000	-	-	81,000
Net assets at end of year	$ 6,136,292	$ 738,157	$ 245,795	$ 7,120,244

See accompanying notes to financial statements.

(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

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 and is primarily determined based on quoted market values.

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 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.

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

Estimates

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

(2) Deposits and Investments

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.

(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

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fall 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 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, 2011, the carrying amount of the Funds' total cash and time certificates of deposit was $2,484,370 and the corresponding bank balances approximated the same amount. All of the bank balances are maintained in interest-bearing transaction accounts in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. However, none of the balances were covered as total balances in interest-bearing accounts deposited by 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, 2011.

(2) Deposits and Investments, Continued

B. Investments

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fall 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, 2011, investments at fair value are as follows:

Discount note issued by the Federal National Mortgage Association (FNMA)	$ 499,995
Money market funds	287,537
	$ 787,532

The FNMA discount note matures on January 17, 2012.

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The discount note in FNMA has attained an 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 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, 2011.

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.

(3) Loans Receivable

The following is a schedule of loans receivable as of December 31, 2011:

	Loan Balance	Allowance	Net
PDLF and YDF	$ 54,901	$ -	$ 54,901
IDF	7,061,191	2,992,102	4,069,089
	$ 7,116,092	$ 2,992,102	$ 4,123,990

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) Return of Net Assets

During the year ended December 31, 2011, $81,000 of net assets were returned to the Kosrae State.

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

The Board of Directors
Federated States of Micronesia Development Bank:

We have audited the financial statements of the Federated States of Micronesia Development Bank (the Bank), as of and for the year ended December 31, 2011, and have issued our report thereon dated June 20, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Bank is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Bank's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control over financial reporting

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Bank's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Bank in a separate letter dated June 20, 2012.

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

Deloitte & Touche LLP

June 20, 2012