FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2013 AND 2012

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

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Years Ended December 31, 2013 and 2012

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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, 2013 and 2012, 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, 2013 and 2012, 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.

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 14, 2014 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 14, 2014

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, 2013.

There were no significant changes to the FSM economy in 2013 as far as the production sectors is concern. The year 2013 was no different from previous year in terms of growth in the portfolio even though loan approvals increased in 2013. Total assets for the Bank increased mainly due to increases in the financial investment portfolio. Decrease in liabilities is due to repayment of the Export Import Bank of China loan. In 2013, the Bank approved loans totaling $9.9 million for 346 borrowers compared to 2012's approval of $7.6 million for 262 borrowers. The four largest loans were for hotel development and improvements. The Bank was able to generate $2.2 million in loan interest income in 2013 and was able to cover its operating expenses in full. The Bank ended the year with a total increase in net assets of about $4.4 million, $3.4 million from its internal resources and $1 million as FSM government contributions.

Summary Statement of Net Position

	2013	2012	2011
Assets:			
Current assets	$ 14,087,286	$ 13,688,117	$ 14,643,824
Noncurrent assets	32,411,664	28,631,658	26,385,382
Total assets	$ 46,498,950	$ 42,319,775	$ 41,029,206
Liabilities:			
Liabilities	$ 712,091	$ 934,607	$ 1,498,801
Net position:			
Invested in fixed assets	1,694,055	1,409,335	1,533,822
Unrestricted	44,092,804	39,975,833	37,996,583
Total net position	45,786,859	41,385,168	39,530,405
Total liabilities and net position	$ 46,498,950	$ 42,319,775	$ 41,029,206

During fiscal year 2013, 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 $449,863. Repayment of $2 million borrowed from the Export and Import Bank of China was completed in 2013. 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 but submitted a drawdown request for about $1 million. For additional information concerning the Bank's debt, please refer to note 8 to the financial statements.

Capital expenditures were made during 2013, mainly on improvements to the Town Plaza Building to which the Bank has relocated its Headquarter during 2013. For additional information concerning the Bank's capital assets, please refer to note 5 to the financial statements.

Earnings from operations were $1,025,020, which presents a 32% increase from last year's results of $777,649. Loan loss provisions of $446,769 and $147,584 were reversed and added back to revenue as there were sufficient loan loss reserves to cover potential losses. As of December 31, 2013, total loan loss provision for total impaired assets (those classified as doubtful and loss) was at 114%. Based on the loan classification policy and review of individual loans, the Bank is adequately reserved for loan losses.

At December 31, 2013, the market value of the Bank's investments stood at $15.2 million, an increase of about 27% from $11.9 million at the end of 2012.

Summary Statement of Revenues, Expenses and Changes in Net Position

	2013	2012	2011
Operating revenues	$ 2,428,051	$ 2,476,471	$ 2,439,560
Reversals of provision for loan losses	446,769	147,584	437,847
Operating expenses	(1,849,800)	(1,846,415)	(1,772,707)
Earnings from operations	1,025,020	777,640	1,104,700
Non-operating revenues, net	3,376,671	1,077,123	148,851
Change in net position	4,401,691	1,854,763	1,253,551
Net position at beginning of year	41,385,168	39,530,405	38,276,854
Net position at end of year	$ 45,786,859	$ 41,385,168	$ 39,530,405

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 2013 were $1,961,446, $898,481, and $293,669 respectively. IDF ended the year with a loss of $2.4 million due to provisions for loan losses. PDLF ended the year with earnings of $4,586 while YDLF earned $2,120. Management had submitted a request to the FSM National Government to repeal the IDF as only two loans remain active in the Private Sector sub-account and all loans in the State sub-accounts have defaulted and the projects are defunct.

Economic Outlook

Management anticipates year 2014 to be similar to 2013 with new loans basically replacing loan run offs. In addition, the creation of resident offices of International and Regional Organizations in Pohnpei is also increasing the need for new real estate developments, 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.

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, 2012 is set forth in the Bank's report on the audit of financial statements, which is dated April 18, 2013. That Discussion and Analysis explains the major factors impacting the 2012 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, 2013 and 2012

	2013	2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,408,568	$ 4,391,374
Time certificates of deposit	1,410,562	2,851,042
Accounts receivable	43,414	50,243
Receivable from trust funds	204,108	475,876
Prepaid expenses	667	4,647
Interest and other receivables	210,967	247,935
Current portion of loans receivable	5,809,000	5,667,000
Total current assets	14,087,286	13,688,117
Noncurrent assets:		
Fixed assets, net	1,694,055	1,409,335
Investments	15,197,400	11,941,576
Equity investment, at cost	1,162,188	1,162,188
Loans receivable, net of current portion and allowance for loan losses	14,358,021	14,118,559
Total noncurrent assets	32,411,664	28,631,658
Total assets	$ 46,498,950	$ 42,319,775
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 15,294	$ 416,685
Accounts payable	143,034	94,354
Accrued interest payable	-	15,088
Credit life payable	52,479	34,312
Payable to trust funds	66,715	80,098
Total current liabilities	277,522	640,537
Noncurrent liabilities:		
Long-term debt, net of current portion	434,569	294,070
Total liabilities	712,091	934,607
Commitments and contingencies		
Net position:		
Net investment in capital assets	1,694,055	1,409,335
Unrestricted	44,092,804	39,975,833
Total net position	45,786,859	41,385,168
Total liabilities and net position	$ 46,498,950	$ 42,319,775

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
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Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2013 and 2012

	2013	2012
Operating revenues:		
Interest income on loans	$ 2,187,963	$ 2,143,044
Interest income on time certificates of deposit	20,197	16,413
Loan fees	105,321	105,839
Rental	40,277	63,077
Miscellaneous	74,293	148,098
Total operating revenues	2,428,051	2,476,471
Reversal of provision for loan losses	446,769	147,584
Net operating revenues	2,874,820	2,624,055
Operating expenses:		
Interest expense	23,847	47,320
General and administrative expenses:		
Personnel services	929,939	953,806
Depreciation	128,940	113,557
Rent	128,820	125,228
Travel	96,176	106,886
Contractual services	81,452	120,833
Utilities	63,771	48,480
Training	52,395	64,054
Retirement plan contributions	44,524	44,797
Communication	42,904	39,174
Supplies	31,923	29,572
Equipment	25,886	20,734
Branch automation	22,743	33,863
Staff relations	12,056	14,951
Fuel, oil and petroleum	10,814	12,388
Community development	8,667	14,854
Repair and maintenance	7,192	9,016
Insurance	7,159	6,799
Printing	5,069	1,767
Miscellaneous	125,523	38,336
Total general and administrative expenses	1,825,953	1,799,095
Earnings from operations	1,025,020	777,640
Nonoperating revenues (expenses):		
IDF reimbursement	250,000	250,000
Investment earnings, net	2,095,025	844,318
FSMNG contributions	1,000,000	-
Gain (loss) on asset disposals	31,646	(17,195)
Total nonoperating revenues, net	3,376,671	1,077,123
Change in net position	4,401,691	1,854,763
Net position at beginning of year	41,385,168	39,530,405
Net position at end of year	$ 45,786,859	$ 41,385,168

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended December 31, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	$ 2,451,651	$ 2,438,359
Cash paid to suppliers for goods and services	(696,247)	(844,764)
Cash paid to employees for services	(929,939)	(953,806)
Interest received on time certificates of deposit	20,197	16,413
Interest paid	(38,935)	(56,800)
Net cash provided by operating activities	806,727	599,402
Cash flows from noncapital financing activities:		
Proceeds from long-term debt	139,108	-
Principal repayment of long-term debt	(400,000)	(400,000)
FSMNG contributions	1,000,000	-
Net transfers in from trust funds	508,385	178,600
Net cash provided by (used for) noncapital financing activities	1,247,493	(221,400)
Cash flows from capital and related financing activities:		
Proceeds from sale of fixed assets	31,646	241
Acquisition of fixed assets	(413,660)	(6,506)
Net cash used for capital and related financing activities	(382,014)	(6,265)
Cash flows from investing activities:		
Loan origination and principal collections, net	65,307	828,453
Additions to time certificates of deposit, net	1,440,480	66,902
Additions to investments, net	(1,290,797)	(1,669,787)
Additions to equity investment	-	(500,000)
Interest income on savings accounts	998	1,458
Dividends received	129,000	85,015
Net cash provided by (used for) investing activities	344,988	(1,187,959)
Net change in cash and cash equivalents	2,017,194	(816,222)
Cash and cash equivalents at beginning of year	4,391,374	5,207,596
Cash and cash equivalents at end of year	$ 6,408,568	$ 4,391,374

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Statements of Cash Flows, Continued
Years Ended December 31, 2013 and 2012

	2013	2012
Reconciliation of earnings from operations to net cash provided by operating activities:		
Earnings from operations	$ 1,025,020	$ 777,640
Adjustment to reconcile earnings from operations to net cash provided by operating activities:		
Reversal of provision for loan losses	(446,769)	(147,584)
Depreciation	128,940	113,557
(Increase) decrease in assets:		
Accounts receivable	6,829	(42,611)
Interest and other receivables	36,968	20,912
Prepaid expenses	3,980	(2,147)
Increase (decrease) in liabilities:		
Accounts payable	48,680	(114,952)
Accrued interest payable	(15,088)	(9,480)
Credit life payable	18,167	4,067
Net cash provided by operating activities	$ 806,727	$ 599,402

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 include 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 2012 financial statements in order to conform with the 2013 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, 2013, the Bank implemented the following pronouncements:

- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus,* which improved 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 66, *Technical Corrections - 2012*, which enhanced 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. The implementation of this statement did not have a material effect on the accompanying financial statements.

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 *N*o. 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.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations,* which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of the Bank.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 69 are effective for fiscal years beginning after June 15, 2013. 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:

(2) Deposits and Investments, Continued

(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:

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, 2013 and 2012, the carrying amount of the Bank's total cash and cash equivalents and time certificates of deposit was $7,819,130 and $7,242,416, respectively, and the corresponding bank balances were $9,138,875 and $7,316,177, respectively. As of December 31, 2012, $283,963 of the bank balances was not maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2013 and 2012, bank deposits in the amounts of $500,000 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, 2013 and 2012.

(2) Deposits and Investments, Continued

B. Investments

As of December 31, 2013 and 2012, investments at fair value are as follows:

	2013	2012
Fixed income securities:		
Domestic fixed income	$ 4,640,931	$ 4,606,478
Other investments:		
Domestic equities	7,985,153	6,113,756
Money market funds	2,571,316	1,221,342
	$ 15,197,400	$ 11,941,576

As of December 31, 2013 and 2012, the Bank's fixed income securities had the following maturities:

2013	Less than 1 Year	1 to 5 Years	6 to 10 Years	Total
U.S. Treasury notes	$ 458,118	$ 1,800,691	$ 452,374	$ 2,711,183
U.S. Government agency obligations	139,717	1,790,031	-	1,929,748
	$ 597,835	$ 3,590,722	$ 452,374	$ 4,640,931

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

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

At December 31, 2013 and 2012, 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, 2013 and 2012.

(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, 2013, the Bank's investment in U.S. treasury notes (T-notes) and agency obligations of the Federeal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) constituted 18%, 7% and 6%, respectively, of its total investments. 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.

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, 2013 and 2012, the equity investment in Bank of the FSM, carried at cost, represents 150,000 common shares and approximately 16.1% 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, 2013 and 2012 follows:

	2013	2012
Unpaid principal balance	$ 24,415,555	$ 24,412,424
Allowance for loan losses	(4,248,534)	(4,626,865)
	$ 20,167,021	$ 19,785,559

Movements in the allowance for loan losses during the years ended December 31, 2013 and 2012, are as follows:

	2013	2012
Balance at beginning of year	$ 4,626,865	$ 3,591,329
Reversal of provision for loan losses	(446,769)	(147,584)
Loans charged off	(981,744)	-
Loan recoveries from previously charged off loans	1,050,182	1,183,120
Balance at end of year	$ 4,248,534	$ 4,626,865

(5) Fixed Assets

A summary of fixed assets as of December 31, 2013 and 2012, is as follows:

	Beginning January 1, 2013	Additions/ Transfers	Deletions/ Transfers	Ending December 31, 2013
Building	$ 1,413,988	$ 260,360	$ -	$ 1,674,348
Office furniture, fixtures and equipment	31,769	7,964	-	39,733
Vehicles	151,565	90,750	(71,664)	170,651
Computers and software	411,613	54,586	-	466,199
	2,008,935	413,660	(71,664)	2,350,931
Less accumulated depreciation	(599,600)	(128,940)	71,664	(656,876)
Net fixed assets	$ 1,409,335	$ 284,720	$ -	$ 1,694,055

	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

(6) Related Party Transactions

As of December 31, 2013 and 2012, the Bank has direct loans with outstanding balances of $128,388 and $107,337, respectively, to employees of the Bank and project loans extended to businesses owned by or affiliated with employees of $295,216 and $377,952, 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, 2013 and 2012.

Loan Commitments

Undrawn balances on lines of credit and loan commitments for loans approved but undisbursed approximated $1,050,000 at December 31, 2013.

(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 four operating leases for each of its State operating locations. Additionally, the Bank pays for the residential leases for 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. In 2013, the Bank moved its Pohnpei branch and the headquarters office (the "HQ building") to the building which was acquired in a loan settlement during 2011. In July 2013, the Bank entered into a sub-lease agreement for the former location, for which the lease expires in April 2015. The Bank is incurring monthly lease expense of $4,860 and sublease income of $1,100. Future minimum annual lease payments payable, net of sub-lease income, under the noncancellable lease agreements are as follows:

Year ending December 31,	Expense	Income	Net
2014	$ 112,670	$ 13,200	$ 99,470
2015	57,990	4,400	53,590
2016	27,100	-	27,100
2017	15,000	-	15,000
2018	1,250	-	1,250
	$ 214,010	$ 17,600	$ 196,410

Additionally, the Bank leases portions of the HQ building under three separate agreements expiring from May 2015 to November 2020. Future minimum annual lease income receivable under the noncancellable lease agreements are as follows:

Year ending December 31,	
2014	$ 28,200
2015	17,600
2016	9,000
2017	9,000
2018	17,600
	$ 81,400

Total recorded lease expense and income under the aforementioned agreements amounted to $128,820 and $40,277, respectively for the year ended December 31, 2013 and $113,557 and $63,077, respectively, for the year ended December 31, 2012.

(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, the amount outstanding and payable was $400,000, which was paid off in 2013.

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, 2013 and 2012, outstanding balances were $449,863 and $310,755. Undrawn balance as of December 31, 2013 was $16,391.

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, 2013 and 2012.

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

Year Ending December 31,	Principal	Interest	Total
2014	$ 15,294	$ 4,499	$ 19,793
2015	15,447	4,346	19,793
2016	15,602	4,191	19,793
2017	15,758	4,035	19,793
2018	15,915	3,878	19,793
2019-2023	81,997	16,968	98,965
2024-2028	86,177	12,788	98,965
2029-2033	90,574	8,391	98,965
2034-2038	95,195	3,770	98,965
2039	17,904	179	18,083
	$ 449,863	$ 63,045	$ 512,908

Long-term debt changes during the years ended December 31, 2013 and 2012 are as follows:

	Balance January 1,	Additions	Reductions	Balance December 31,	Due Within One Year
2013:					
Loan payable	$ 710,755	$ 139,108	$ (400,000)	$ 449,863	$ 15,294

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

(9) Nonoperating Revenue

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, 2013 and 2012. Additionally, the Bank received $1,000,000 in contributions from FSMNG in 2013.

(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, 2013 and 2012 were $44,524 and $44,797 respectively. Total Plan assets as of December 31, 2013 and 2012 were $676,487 and $702,622, 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, 2013 and 2012, the account has a balance of $177,810 and $178,576, respectively.

(12) Subsequent Events

Management has evaluated subsequent events through April 14, 2014, 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, 2013.

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

Schedule of Net Position - Intermediary Relending Program
December 31, 2013

ASSETS		
Current assets:		
Cash and cash equivalents	$	765,574
Interest and other receivables		1,042
Loans receivable, net		373,159
Total assets	$	1,139,775
LIABILITIES		
Current liabilities:		
Due to FSMDB, net	$	216,763
Credit life payable		173
Noncurrent liabilities:		
Long-term debt		449,863
Total liabilities		666,799
Net position:		
Unrestricted		472,976
Total net position		472,976
Total liabilities and net position	$	1,139,775

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 Position - Intermediary Relending
Year Ended December 31, 2013

Operating revenues:	
Interest income on loans	$ 26,526
Miscellaneous	362
Total operating revenues	26,888
Operating expenses:	
Provision for loan losses	88,492
Loss from operations	(61,604)
Non-operating revenues:	
Interest income on savings account	998
Change in net position	(60,606)
Net position at beginning of year	533,582
Net position at end of year	$ 472,976

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, 2013

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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, 2013, 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, 2013, 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.

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 14, 2014 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 14, 2014

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

Trust Funds
Statement of Fiduciary Net Position
December 31, 2013

	IDF	PDLF	YDLF	Total
ASSETS				
Cash and cash equivalents	$ -	$ 301,930	$ 110,731	$ 412,661
Time certificates of deposit	1,438,538	579,659	147,096	2,165,293
Receivable from FSMDB	52,123	-	14,592	66,715
Interest and other receivables	3,817	851	608	5,276
Loans receivable, net	466,968	16,041	20,642	503,651
Total receivables	522,908	16,892	35,842	575,642
	$ 1,961,446	$ 898,481	$ 293,669	$ 3,153,596
LIABILITIES AND NET POSITION				
Liabilities:				
Payable to FSMDB	$ -	$ 162,901	$ 41,207	$ 204,108
Commitments				
Net position:				
Restricted	466,968	16,041	20,642	503,651
Unrestricted	1,494,478	719,539	231,820	2,445,837
Total net position	1,961,446	735,580	252,462	2,949,488
	$ 1,961,446	$ 898,481	$ 293,669	$ 3,153,596

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 Position
Year Ended December 31, 2013

	IDF	PDLF	YDLF	Total
Additions:				
Loan interest	$ 59,100	$ 1,494	$ 1,385	$ 61,979
Investment interest	2,760	2,089	735	5,584
Miscellaneous	-	1,003	-	1,003
Total additions	61,860	4,586	2,120	68,566
Deductions:				
Provision for loan losses	2,181,485	-	-	2,181,485
Investment management fee	250,000	-	-	250,000
Miscellaneous	651	-	-	651
Total deductions	2,432,136	-	-	2,432,136
Change in net position	(2,370,276)	4,586	2,120	(2,363,570)
Net position at beginning of year	4,770,588	730,994	250,342	5,751,924
Distributions	(438,866)	-	-	(438,866)
Net position at end of year	$ 1,961,446	$ 735,580	$ 252,462	$ 2,949,488

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 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 receivable are stated at unpaid principal balance less the allowance for loan losses and are reserved in net position as restricted net position.

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) Purpose and Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended December 31, 2013, the Bank implemented the following pronouncements:

- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus,* which improved 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 66, *Technical Corrections - 2012*, which enhanced 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. The implementation of this statement did not have a material effect on the accompanying financial statements.

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 *N*o. 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 Funds.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations,* which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of the Funds.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 69 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of the Funds.

(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

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

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

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

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

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

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.

(2) Deposits, Continued

As of December 31, 2013, the carrying amount of the Funds' total cash and time certificates of deposit was $2,577,954 and the corresponding bank balances were $2,580,484. 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, 2013.

(3) Loans Receivable

The following is a schedule of loans receivable as of December 31, 2013:

	Loan Balance	Allowance	Net
PDLF and YDLF	$ 36,683	$ -	$ 36,683
IDF	6,799,148	6,332,180	466,968
	$ 6,835,831	$ 6,332,180	$ 503,651

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 14, 2014, 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, 2013.

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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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Federated States of Micronesia Development Bank (the Bank), which comprise the statement of net position as of December 31, 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 14, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Bank's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Bank’s internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Bank in a separate letter dated April 14, 2014.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

April 14, 2014

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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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Investment Development Fund, the Pohnpei Development Loan Fund, and the Yap Development Loan Fund, administered by the Federated States of Micronesia Development Bank (the Bank), which comprise the respective statements of fiduciary net position as of December 31, 2013, and the related statements of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 14, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Bank's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Bank’s internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Bank in a separate letter dated April 14, 2014.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

April 14, 2014