FSM DEVELOPMENT BANK
2017 ANNUAL REPORT

Your Partner in Business

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LETTER TO THE SHAREHOLDERS:

Dear Shareholders:

On behalf of the Board of Directors, we are pleased to present the Annual Report for the year ended December 31, 2017 and the Audited Financial Statements for the FSM Development Bank for the years ended December 31, 2016 and 2017.

Our achievements in 2017 reflect the commitment of many people working together with a united vision and goal. FSMDB has once again proven its ability to transform challenges into opportunities, achieving growth under difficult economic conditions.

In 2017, with assistance from ADB, FSMDB completed a 10-year Strategic Plan for the years 2017-2026. The plan details higher level actions required over the 10 year period, taking into account changes in key business drivers and success factors, including customer input and needs, infrastructure developments, and the overall private sector business environment of the FSM. FSMDB is of the view that all stakeholders, including Board of Directors, employees of FSMDB, and our valued customers, play an important role in the achievement of our goals. At the end of the day, the 10-year Strategic plan guides us to continually view our business processes in order to effectively serve our customers.

We have made considerable strides in meeting the goal to become accredited by the Green Climate Fund or the GCF. Being accredited will give FSMDB access to funding that will have significant effects not only to the FSMDB institution, but to the nation as a whole.

In terms of statistics, FSMDB in 2017 approved a total of $11.94 million for 435 loans. Business loans represented 76%, consumer loans at 22% and the remaining 2% for residential loans. In terms of loan approvals for 2017, over 75% was approved for loans in the commercial, tourism, and agriculture/fisheries sectors. No contributions or subsidies from the government were received in 2017.

Financially, 2017 was a phenomenal year for FSMDB as we ended the year with a net position of $3.36 MM compared to a budget of $1.33, due in part to earnings in our investments portfolio in the financial markets. We were also able to generate enough revenues from our core operations to cover our expenses, with surplus earnings retained to increase assets. Furthermore, as we have in prior years, we again achieved an unqualified opinion from our external auditors for the period under review.

Though there is much room for improvement, we are pleased with the 2017 results and continue to emphasize to staff the need to do better. We are dedicated in fulfilling our mandate, which is to contribute to the development of our islands. We believe it is important that FSMDB continues to strengthen its balance sheet, improve earnings, and expand its financial, human, and technical resources and capabilities – all the while driving FSM's economic growth. As a commitment to the FSM people, we stand ready to collaborate with our shareholders to advocate for and achieve our mission, our vision, and our goals.

2018 is poised to be another challenging year, but we are prepared to meet the expectations of our stakeholders and the customers we serve. As we move forward, we want to thank our shareholders for their continued support and to the Board of Directors for their tireless efforts. We also want to acknowledge the dedication of FSMDB's management team and hardworking staff, who ensure that our Bank is operating and managed prudently. But most especially, we take this opportunity to thank our customers for allowing us to serve you as "Your partner in business."

Sincerely,

Anna Mendiola, President/CEO

John Sohl, Chairman of the Board

ABOUT THE BANK

Establishment:

The Federated States of Micronesia Development Bank (FSMDB) is a component unit of the National Government of the Federated States of Micronesia. It was established in 1979 by Public Law 1-37. The Bank opened operation in 1980 but lending did not start until 1982. In 1994, the enabling law that created the Bank was amended to reorganize the structure of the Bank into a corporation.

The primary function of the Bank initially was to provide financing to commercial businesses mainly in the FSM. Over the years, the Bank has added more programs to meet its strategic objectives and customer needs. In 2008, the Bank created its residential home loan program to help locals build their homes. In 2011, the Bank added a consumer lending revolving fund mainly to help generate revenue.

The FSM Development Bank is a key player in the development of the private sector in the Federated States of Micronesia that enjoys the confidence of the national and state leaders, its customers, regulators and stakeholders. FSMDB services and performance are comparable to the best-managed development financial institutions in the Pacific region.

The bank's headquarters is located in the State of Pohnpei, the capital of the FSM. The Bank also has branch offices in the other three FSM states of Chuuk, Kosrae and Yap and an online presence at www.fsmdb.fm.

Mission:

To assist new and existing businesses to grow prosperously, creating jobs and producing economic vitality throughout our Nation.

Vision:

To be Micronesia's Premiere Development Finance Partner and Leading Catalyst for Transforming FSM Sustainable Development.

Core Values:

- ***Customer satisfaction*** – through the provision of professional customer service;
- ***Teamwork*** – through mutual respect, cooperation, loyalty, commitment, collaboration and dedication;
- ***Integrity***– through observing the highest standards of ethics, accountability, transparency and to treat all stakeholders equitably;
- ***Inclusiveness*** – through undertaking economic development that enhances the life of all the people of FSM whilst sensitive to the protection of the environment and respectful of our culture and heritage; AND
- ***Excellence*** – through achieving the highest level of performance by continuously improving our skills and business practices.

SHAREHOLDERS:

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

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

BOARD OF DIRECTORS:

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

***John Sohl – Pohnpei State Government – Chairman**
***Florian Yatilman – FSM National Government – Member**
***Peter Aten – Chuuk State Government – Vice Chairman**
***Alik Isaac – Kosrae State Government – Member**
***Senny Phillip – FSM National Government – Member**
***Maria Laaw – Yap State Government - Member**
***Anna Mendiola – CEO & Ex-Officio**

MANAGEMENT:

FSMDB is managed by a senior management team comprised of a President/Chief Executive Officer (CEO), Senior Vice President/Chief Operating Officer (COO), Senior Vice President/Business Development Officer (BDO), and Chief Financial Officer (CFO). Assisting the senior management team are a Legal Counsel and Internal Auditor/Compliance Officer. For the period under review, the Bank's management team comprised of the following individuals:

President/CEO:	**Anna Mendiola**
Senior Vice President/COO:	**Alik J. Alik**
Senior Vice President/BDO:	**Fabian Nimea**
Chief Financial Officer:	**Brandon J. Tara**

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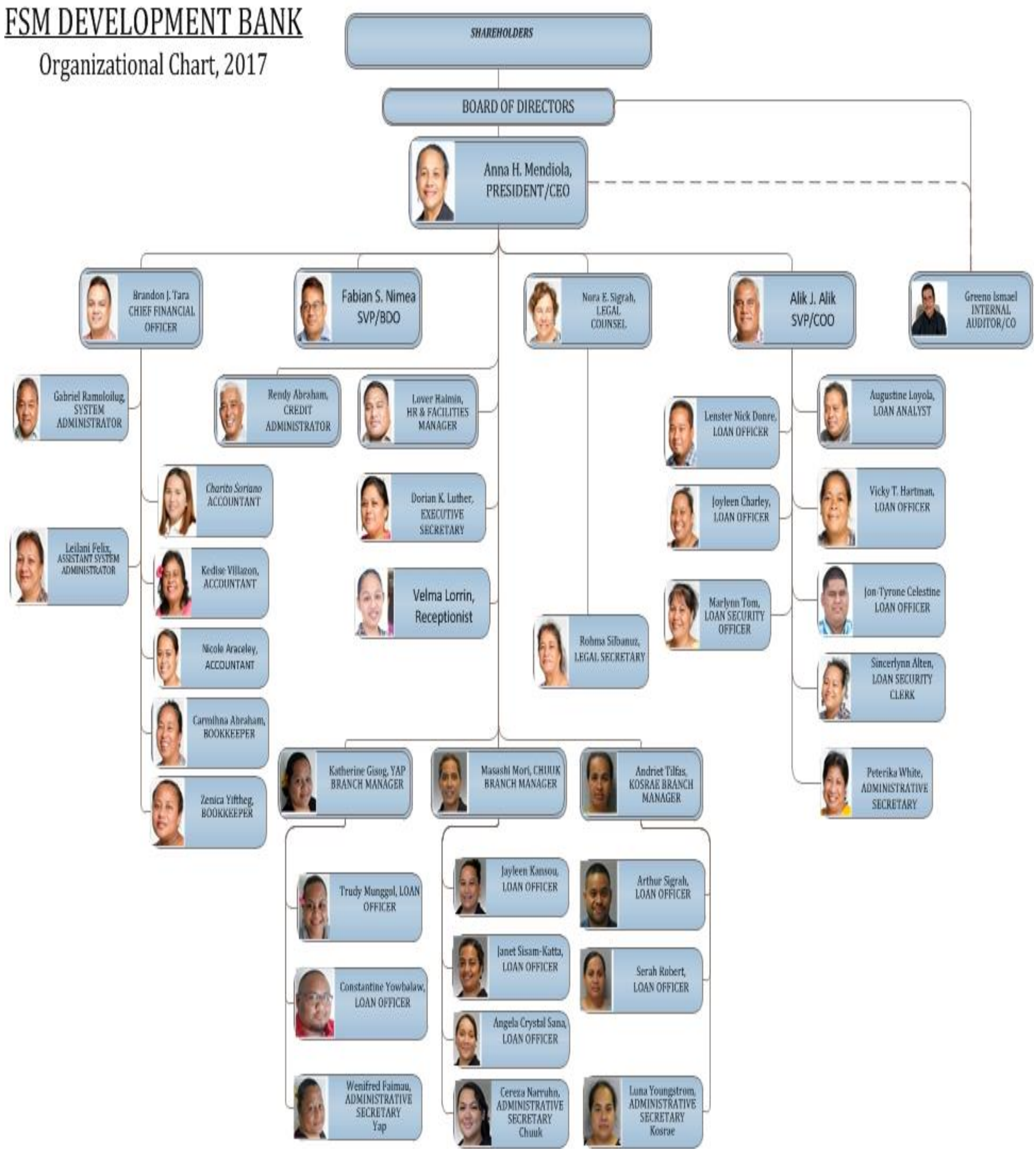
Legal Counsel:	*Nora Sigrah*
Internal Auditor/Compliance Officer:	*Greeno Ismael*

Appreciation to former staff:

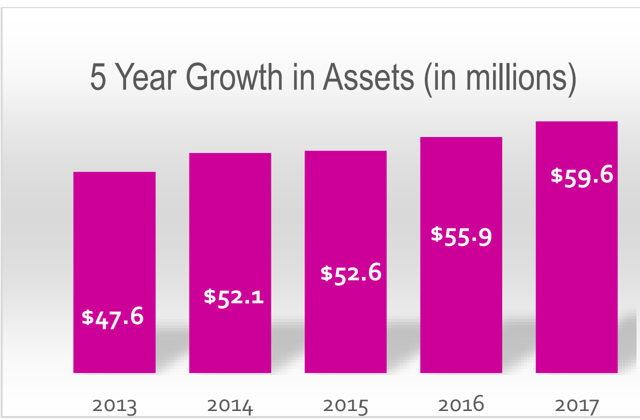
We would like to acknowledge *Mr. Michael Watson*, our former Assistant Legal Counsel, who left the Bank in 2017 to pursue other endeavors, and we wish him well!

FSMDB Organizational Chart:

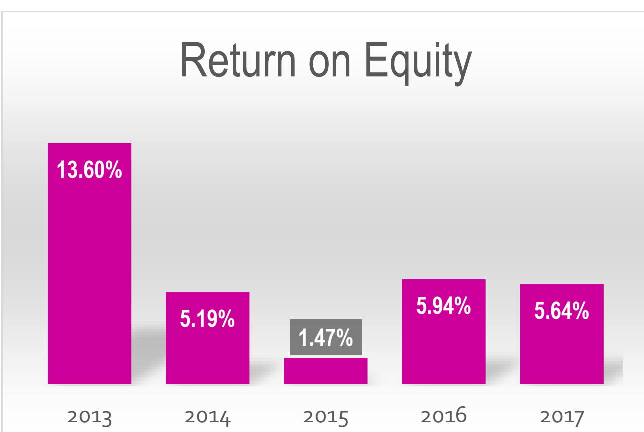


MANAGEMENT REPORT:

FSMDB continues to grow its assets by strategically ensuring that more than enough revenues are generated to cover operating expenses and surplus earnings are retained to increase assets. To ensure future growth and sustainability, within the last five years, the Bank has grown its assets from $47 MM beginning in 2013 to a little over $59 MM at the end of 2017as illustrated below. Our loans receivable have also grown within the last five years. Although the Bank has reduced its interest rates on its business loans from between 6% - 9% down to a range of $3% - 7% to be more attractive to the business community, our 2017 earnings from operations was positive and the return on equity has remained positive over the last few years. FSMDB has for the past 5 years ended the year with a positive net position, allowing for more assets to lend to our valuable customers. Lastly, the Bank has been able improve collections and streamline expenses to maintain financial stability over the years.



The Bank’s assets have steadily grown in the last five years.



The Bank’s return on equity has remained positive the last five years.

BUSINESS DEVELOPMENT:

The Bank's Business Development arm has been successfully meeting its objectives of aligning the strategic elements of the Bank's business in such a way as to best support the fulfillment of its long-term purpose. To ensure strategic alignment, the Bank's people, culture, structure and processes have striven to adapt as the Bank's strategy itself shifts. Over the years, the Bank has made many exciting improvements in delivering its programs.

Hotel Operations in Pohnpei

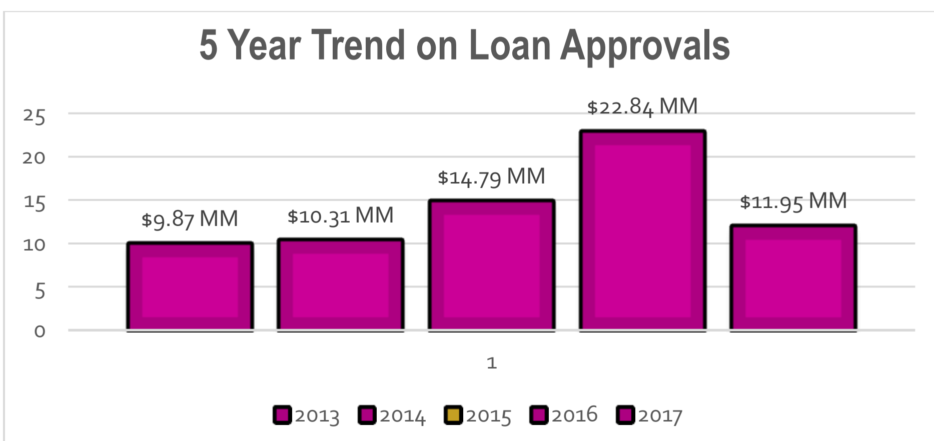
LENDING UPDATES:

For the period between January 2017 and December 2017, FSMDB approved $11.94 million for 435 loans. Business loans represented 76%, consumer loans at 22% and the remaining 2% for residential loans. The loan portfolio at year end stood at $34.22 million; loans to the Tourism Sector constituted 22% followed by Wholesale/Retail at 16%, Real estate development at 11% , Agriculture/Fisheries at 7%, Transportation and Construction at 5% and 4% respectively, and the remaining sectors at 14%. In terms of loan approvals for 2017, over 75% was approved for loans in the commercial, tourism, and agriculture/fisheries sectors. No contributions or subsidies from the government were received in 2017.

Business and Housing Projects

2017 Loan Approvals by Sector		
Agriculture/Fishing	$ 119,795.00	1%
Services	569,907.00	5%
Manufacturing	354,857.00	3%
Real Estate	1,055,111.00	9%
Wholesale/Retail	3,467,317.00	29%
Tourism	97,000.00	1%
Transportation	1,025,738.00	9%
Construction/Mining	2,360,498.00	20%
Consumer	2,613,802.00	22%
Residential	285,775.00	2%
Total	$ 11,949,800.00	100%

Photos: FSMDB-funded HELP Projects (Energy efficient homes)



FSMDB’s Development & Finance Training Institute (DFI):

Human resources development has always been an important component of the bank’s strategic goals. As part of the bank’s reform efforts, the Board of Directors approved in 2014 the establishment of a Development & Finance Training Institute (DFI). Since its establishment, the DFI has conducted several trainings for our borrowers, Board members and staff, employees from our local partners including the governments and component units, commercial banks and lending institutions, members from the private sector, and community members.

Photo 1. Training Courses held in Yap for borrowers and community members. Competitive Business Strategy and Decision Making in Business. Photo 2. FSMDB staff attends APIPA 2017 in Majuro, RMI. Photo 3. Loan Officers’ Training, Manila October 2017

Corporate Social Responsibility:

In addition to supporting FSM's nation building efforts through our many projects, our Home Energy Loan Program (HELP) for energy efficient homes, and our in-house Development Finance & Training Institute, FSMDB also believes in supporting the nation in civic and socially responsible activities that contribute to the development of the FSM. At FSMDB, we value people. We respect our environment. We promote sustainable economic development. As your partners in business, for many years now, we have been contributing and will continue to contribute to disaster mitigation and climate change resilience efforts, local conferences and training/workshops, sporting events, cultural activities, and educational endeavors of many individual students through our scholarship program, to local schools, and other worthy programs.
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This 2017 Annual Report was printed on digital gloss paper and distributed to our shareholders, board members, partner-organizations, and the FSM leadership in limited copies, consistent with our commitment to reduce our carbon footprint. An electronic copy may be downloaded on our website, www.fsmdb.fm.

Staff Listing:

Headquarter Office:		
Rendy	Abraham	Credit Administrator
Carmihna	Abraham	Bookkeeper
Sincerlynn	Alten	Loan Clerk
Nicole	Araceley	Accountant
Charito	Soriano	Accountant
Jon-Tyrone	Celestine	Loan Officer
Joyleen	Charley	Loan Officer
Lenster	Donre	Loan Officer
Leilani	Felix	Assistant Systems Administrator
Lover	Haimin	HR & Facilities Manager
Vicky	Hartman	Loan Officer
Dorian	Kiyoshi	Executive Secretary to the CEO
Augustine	Loyola	Loan Analyst
Velma	Lorrin	Receptionist
Gabriel	Ramoloilug	Systems Administrator
Zenica	Yiftheg	Bookkeeper
Rohma	Silbanuz	Legal Secretary
Marleen	Tom	Loan Security Officer
Kedise	Villazon	Accountant
Peterika	White	Administrative Secretary
Michael	Watson	Assistant Legal Counsel
Kosrae Branch:		
Andriet	Tilfas	Branch Manager
Arthur	Sigrah	Loan Officer
Serah	Robert	Loan Officer
Luna	Youngstrom	Administrative Secretary
Chuuk Branch:		
Masashi	Mori	Branch Manager
Jayleen	Kansou	Loan Officer
Janet	Sisam	Loan Officer
Crystal	Sana	Loan Officer
Cereza	Narruhn	Administrative Secretary
Yap Branch:		
Katherine	Gisog	Branch Manager
Constantine	Yowbalaw	Loan Officer
Trudy	Munggol	Loan Officer
Wenifred	Faimau	Administrative Secretary

FEDERATED STATES OF MICRONESIA
DEVELOPMENT BANK

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2017 AND 2016

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

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Years Ended December 31, 2017 and 2016

Deloitte.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia Development Bank:

Report on the Financial Statements

We have audited the accompanying financial statements of the Federated States of Micronesia Development Bank (the Bank), which comprise the statements of net position as of December 31, 2017 and 2016, 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.

Deloitte.

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, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Financial Statement Presentation

As discussed in Note 1 to the financial statements, the Bank elected to present an unclassified statement of net position because current assets are not matched with current liabilities. Our opinion is not modified with respect to this matter.

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 Financial Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedule of European Investment Bank August 2010 Finance Contract Ratios on page 24 is presented for purposes of additional analysis and is not a required part of the financial statements. The Schedule of European Investment Bank August 2010 Finance Contract Ratios is the responsibility of 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 the 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, the Schedule of European Investment Bank August 2010 Finance Contract Ratios is fairly stated, in all material respects, in relation to the financial statements as a whole.

Deloitte.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2018, 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

March 26, 2018

The following is a discussion and analysis of the Federated States of Micronesia Development Bank's (the Bank or FSMDB) financial performance for the fiscal year ended December 31, 2017.

In the year 2017, FSMDB has once again proven its ability to transform challenges into opportunities, achieving growth under difficult economic conditions. FSMDB in 2017 approved $11.49 million for 435 loans. Business loans represented 76%, consumer loans at 22% and the remaining 2% for residential loans. The loan portfolio at year end stood at $34.2 million; loans to the Tourism Sector constituted 22%, Wholesale/Retail at 16%, Real Estate Development at 11%, Agriculture/Fisheries at 7%, Transportation at 5%, Construction at 4%, and the remaining sectors at 35%. In terms of loan approvals for 2017, over 75% was approved for loans in the commercial, tourism, and agriculture/fisheries sectors. No contributions or subsidies from the government were received in 2017.

Summary Statements of Net Position

	2017	2016	2015
Assets	$ 59,559,529	$ 55,920,795	$ 52,613,412
Liabilities	$ 1,884,033	$ 1,615,233	$ 1,627,103
Net position:			
Net investment in capital assets	1,510,124	1,624,211	1,633,285
Unrestricted	56,165,372	52,681,351	49,353,024
Total net position	57,675,496	54,305,562	50,986,309
Total liabilities and net position	$ 59,559,529	$ 55,920,795	$ 52,613,412

In 2017, the lone long-term liability the Bank has with European Investment Bank (EIB) was reduced to $1.0 million compared to $1.2 million in 2016. Borrowed funds represented only 2.0% of total asset. Leverage has been very low providing ample room for the Bank to borrow funds for its lending activities should the need arises. For additional information concerning the Bank's debt, please refer to note 8 to the financial statements.

From operations, the Bank earned $910,360, which represents a 57% decrease comparing to last year's results of $2,126,856. The Bank's return on total net position remained positive but decreased from 6.1 % in 2016 to 5.8% in 2017. Moreover, the ratio of total net position to assets was at 97% in 2017. The Bank was able to generate more than enough revenues to cover expenses, all from internal sources.

In 2017, the Bank's investments in the financial markets earned nearly $2 million in investment interest. The total ratio of non-performing loans to total loans at the end of the 2017 was 8%. As of December 31, 2017, total loan loss provision for total impaired assets (those classified as doubtful and loss) was at 164%. Based on the loan classification policy and review of individual loans, the Bank is adequately reserved for loan losses.

Summary Statements of Revenues, Expenses and Changes in Net Position

	2017	2016	2015
Operating revenues	$ 2,808,000	$ 2,736,600	$ 2,460,513
Recoveries of (provision for) loan losses	-	1,179,871	(286,209)
Operating expenses, including interest	(1,897,640)	(1,789,615)	(1,840,452)
Earnings from operations	910,360	2,126,856	333,852
Non-operating revenues, net	2,459,574	1,192,397	439,213
Change in net position	3,369,934	3,319,253	773,065
Net position at beginning of year	54,305,562	50,986,309	50,213,244
Net position at end of year	$ 57,675,496	$ 54,305,562	$ 50,986,309

The Bank manages two trust funds, namely, the Investment Development Fund (IDF) and the Yap Development Loan Fund (YDLF). The total assets for each of these funds at the end of 2017 were $1,894,503 and $270,724 respectively. Assets under IDF continues to decrease as all the States have withdrawn their funds from the State sub-accounts. The Bank stopped drawing management fee from the IDF due to insufficient revenue generated in the IDF Private Reserve portfolio. YDLF earned $372 in 2017. Management had resubmitted a request to the FSM National Government to repeal the IDF law 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 the year 2018 to be better than 2017 in terms of economic activities, therefore, expects an increase in lending activities and loan approvals. The Bank continues to seek out projects that are export oriented or import substituting. Additionally, the Bank continues to work on its accreditation to access the Green Climate Fund (GCF) to provide projects to help climate change adaptation, resilience, and mitigation and hopes to be accredited soon. FSMDB believes that it can assist the nation in its efforts to combat climate change, especially in building resilience for adaptation to climate change in all sectors within the FSM, and perhaps even the region, by providing its banking and technical expertise in future GCF-related projects and programs.

The Bank is also looking into helping the construction sector by providing real estate development loans and surety bonds. The Bank has picked up more Home Energy Loan Program (HELP) projects in 2017 with the rolling out of this program to the other states to help promote energy efficient homes and hopes that this program grows going forward.

In 2017, the Bank adopted its 10-year strategic plan which outlines where the Bank is now and what needs to be done in order to achieve its goals. With the end of the financial provisions in the Compact facing the FSM in 2023, the Bank intends to work with all of its stakeholders, including the government, to confront any future challenges, whatever they may be. As a partner, the Bank anticipates to be more proactive in developing ideas into viable business proposals and providing entrepreneurial training to help improve the management of successful businesses in the FSM.

Contacting Financial Management

The Management's 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, 2016 is set forth in the Bank's report on the audit of financial statements, which is dated April 17, 2017. That Discussion and Analysis explains the major factors impacting the 2016 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 96941 or 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, 2017 and 2016

	2017	2016
ASSETS		
Cash and cash equivalents	$ 3,811,745	$ 7,903,776
Time certificates of deposit	4,119,739	937,542
Investments	14,982,015	15,066,298
Loans receivable, net of allowance for loan losses	29,606,784	25,172,819
Equity investment	5,352,240	5,100,240
Prepaid expenses	60,542	1,317
Interest and other receivables	116,340	114,592
Depreciable capital assets, net	1,510,124	1,624,211
Total assets	$ 59,559,529	$ 55,920,795
LIABILITIES AND NET POSITION		
Liabilities:		
Accounts payable	$ 84,630	$ 111,581
Accrued interest payable	13,325	13,325
Long-term debt	1,020,904	1,154,881
Credit life payable	6,938	100,357
Payable to trust funds	577,185	129,273
Payable to grantor	181,051	-
Unearned grant revenues	-	105,816
Total liabilities	1,884,033	1,615,233
Commitments and contingencies		
Net position:		
Net investment in capital assets	1,510,124	1,624,211
Unrestricted	56,165,372	52,681,351
Total net position	57,675,496	54,305,562
Total liabilities and net position	$ 59,559,529	$ 55,920,795

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2017 and 2016

	2017	2016
Operating revenues:		
Interest income on loans	$ 2,365,198	$ 2,423,610
Loan fees	191,253	196,457
Rental	24,438	26,931
Interest income on time certificates of deposit	9,744	11,193
Miscellaneous	217,367	78,409
Total operating revenues	2,808,000	2,736,600
Recoveries of loan losses	-	1,179,871
Net operating revenues	2,808,000	3,916,471
Operating expenses:		
Interest expense	46,400	52,030
General and administrative expenses:		
Personnel services	1,050,226	991,136
Depreciation	121,425	146,069
Travel	113,972	98,481
Rent	87,960	87,549
Contractual services	80,825	92,922
Training	62,486	22,316
Retirement plan contributions	57,506	55,467
Utilities	45,583	42,071
Communication	40,801	40,286
Branch automation	28,309	28,319
Supplies	24,198	20,373
Community development	15,708	14,745
Equipment	11,806	13,936
Repair and maintenance	10,582	8,076
Staff relations	10,203	12,936
Fuel, oil and petroleum	8,534	9,555
Insurance	5,614	5,978
Printing	3,961	2,210
Miscellaneous	71,541	45,160
Total general and administrative expenses	1,851,240	1,737,585
Earnings from operations	910,360	2,126,856
Nonoperating revenues, net:		
Investment earnings, net	2,459,574	1,192,397
Total nonoperating revenues, net	2,459,574	1,192,397
Change in net position	3,369,934	3,319,253
Net position at beginning of year	54,305,562	50,986,309
Net position at end of year	$ 57,675,496	$ 54,305,562

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from customers	$ 2,796,508	$ 2,741,532
Cash received from grantor	99,970	-
Cash paid to suppliers for goods and services	(883,919)	(523,672)
Cash paid to employees for services	(1,050,226)	(991,136)
Interest received on time certificates of deposit	9,744	11,193
Interest paid	(46,400)	(52,030)
Net cash provided by operating activities	925,677	1,185,887
Cash flows from noncapital financing activities:		
Principal repayment of long-term debt	(133,977)	(128,465)
Net transfers in from trust funds	447,912	326,721
Net cash provided by noncapital financing activities	313,935	198,256
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(7,302)	(136,995)
Net cash used for capital and related financing activities	(7,302)	(136,995)
Cash flows from investing activities:		
Loan origination and principal disbursements, net	(4,433,965)	(2,112,227)
Increase in time certificates of deposit	(3,182,197)	(1,161)
Purchases (withdrawals) of investments, net	2,066,821	(14,608)
Dividends received	225,000	157,500
Net cash used for investing activities	(5,324,341)	(1,970,496)
Net change in cash and cash equivalents	(4,092,031)	(723,348)
Cash and cash equivalents at beginning of year	7,903,776	8,627,124
Cash and cash equivalents at end of year	$ 3,811,745	$ 7,903,776

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued
Years Ended December 31, 2017 and 2016

	2017	2016
Reconciliation of earnings from operations to net cash provided by operating activities:		
Earnings from operations	$ 910,360	$ 2,126,856
Adjustments to reconcile earnings from operations to net cash provided by operating activities:		
Recoveries of loan losses	-	(1,179,871)
Depreciation	121,425	146,069
(Increase) decrease in assets:		
Interest and other receivables	(1,748)	16,125
Prepaid expenses	(59,225)	89,386
Increase (decrease) in liabilities:		
Accounts payable	(26,951)	(16,440)
Credit life payable	(93,419)	21,956
Payable to grantor	181,051	-
Unearned grant revenues	(105,816)	(18,194)
Net cash provided by operating activities	$ 925,677	$ 1,185,887

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

Reporting Entities

The Federated States of Micronesia (FSM) Development Bank (the Bank or FSMDB) 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 FSM. 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, 2017, the Bank has issued 3,236,883 shares to the FSM National Government (98.80%), Chuuk State (0.92%) and Kosrae State (0.28%). 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; and (5) contribute to the furtherance of close economic relations with the United States.

The Yap Development Loan Fund (YDLF) is 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 Bank follows the pronouncements of the Governmental Accounting Standards Board (GASB), which is the nationally accepted standard setting body for establishing generally accepted accounting principles (GAAP) for governmental entities.

GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments,* requires assets and liabilities of enterprise funds be presented in a classified format to distinguish between current and long-term assets and liabilities. FSMDB is a government-owned bank. Banks do not present a classified statement of net position because current assets are not matched with current liabilities. The statements of net position of the Bank present assets and liabilities in order of their relative liquidity, rather than in a classified format.

(1) Summary of Significant Accounting Policies, Continued

Fund Structure and Basis of Accounting, Continued

The accounts of the IDF 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 and Yap State, respectively).

The Bank utilizes the flow of economic resources measurement focus.

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 three net position 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

Investments and related investment earnings are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

An equity investment in the common stock of Bank of the FSM (investee) is stated at the net asset value (NAV). The NAV is used as a practical expedient to estimate fair value. The NAV is determined based on the total shareholders' equities reported by the investee.

(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.

Capital Assets

Capital 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 capital 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.

Unearned Grant Revenues

Unearned grant revenues represent amounts received from grant and contract sponsors that have not yet been earned.

Compensated Absences

Earned but unused annual leave is paid to employees upon termination of their employment. Accordingly, vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. It is the policy of the Bank to record the cost of sick leave when leave is actually taken and an expense is actually incurred. Accordingly, no liability is recorded for non-vesting accumulating rights to receive sick pay benefits, which approximated $174,000 and $169,000 at December 31, 2017 and 2016, respectively.

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 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

Reclassification

Certain amounts in the 2016 statement of net position have been reclassified to conform with 2017 presentation.

New Accounting Standards

During the year ended December 31, 2017, the Bank implemented the following pronouncements:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68.

- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB).

- GASB Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units.

- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

- GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

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

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). The provisions in Statement No. 85 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt. The provisions in Statement No. 86 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

(2) Deposits and Investments

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

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

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

(2) Deposits and Investments, Continued

(iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the 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, 2017 and 2016, the carrying amount of the Bank's total cash and cash equivalents and time certificates of deposit was $7,931,484 and $8,841,318, respectively, and the corresponding bank balances were $8,715,409 and $8,904,033, respectively, which were all maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2017 and 2016, bank deposits in the amounts of $3,931,033 and $1,520,366, 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, 2017 and 2016.

B. Investments

As of December 31, 2017 and 2016, investments at fair value are as follows:

	2017	2016
Fixed income securities:		
Domestic fixed income	$ 5,223,941	$ 5,121,414
Equity securities:		
Domestic equities	8,681,595	8,895,921
Shares in a mutual fund (Templeton Global BD FD ADV TGBAX)	1,076,479	1,048,963
	$ 14,982,015	$ 15,066,298

(2) Deposits and Investments, Continued

B. Investments, Continued

As of December 31, 2017, investments in domestic fixed income are as follows:

	Moody's Credit Rating	Investment maturities (in Years) Less Than 1	1 to 5	6 to 10	Greater Than 10	Fair Value
U.S. Government securities:						
U.S. Treasury Notes	Aaa	$ -	$ -	$ 1,557,939	$ -	$ 1,557,939
U.S. Government agencies:						
Federal Home Loan Bank	Aaa	199,826	714,875	-	-	914,701
Federal Farm Credit Bank	Aaa	580,322	100,034	-	-	680,356
Federal National Mortgage Association	Not rated	295,062	-	68,559	304,928	668,549
Federal Home Loan Mortgage Corp.	Not rated	-	274,736	-	187,658	462,394
Corporate bonds	A3	-	220,914	128,426	-	349,340
Corporate bonds	A2	-	198,479	-	-	198,479
Corporate bonds	Baa3	-	87,646	304,537	-	392,183
		$ 1,075,210	$ 1,596,684	$ 2,059,461	$ 492,586	$ 5,223,941

As of December 31, 2016, investments in domestic fixed income are as follows:

	Moody's Credit Rating	Investment maturities (in Years) Less Than 1	1 to 5	6 to 10	Greater Than 10	Fair Value
U.S. Government securities:						
U.S. Treasury Notes	Aaa	$ -	$ -	$ 1,827,784	$ -	$ 1,827,784
U.S. Government agencies:						
Federal Home Loan Bank	Aaa	210,199	-	-	-	210,199
Federal Farm Credit Bank	Aaa	320,176	580,003	-	-	900,179
Federal National Mortgage Association	Not rated	-	295,620	97,234	402,970	795,824
Federal Home Loan Mortgage Corp.	Not rated	-	-	-	243,677	243,677
Corporate bonds	A3	-	87,617	714,338	-	801,955
Corporate bonds	A2	-	147,416	-	-	147,416
Corporate bonds	Baa3	-	-	194,380	-	194,380
		$ 530,375	$ 1,110,656	$ 2,833,736	$ 646,647	$ 5,121,414

(2) Deposits and Investments, Continued

B. Investments, Continued

The Bank categorizes its fair value measurements within the fair value hierarchy established by GASB Statement No. 72. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The Bank has the following recurring fair value measurements as of December 31, 2017 and 2016:

	December 31, 2017	Fair Value Measurements Using Level 1	Level 2	Level 3
Fixed income:				
U.S. Treasury obligations	$ 1,557,939	$ -	$ 1,557,939	$ -
U.S. Government Agencies	2,726,000	-	2,726,000	-
Corporate notes	940,002	-	940,002	-
Total fixed income	5,223,941	-	5,223,941	-
Equity securities:				
U.S. equities	8,681,595	8,681,595	-	-
Mutual fund shares	1,076,479	1,076,479	-	-
Total investments at fair value	$ 14,982,015	$ 9,758,074	$ 5,223,941	$ -

	December 31, 2016	Fair Value Measurements Using Level 1	Level 2	Level 3
Fixed income:				
U.S. Treasury obligations	$ 1,827,784	$ -	$ 1,827,784	$ -
U.S. Government Agencies	2,149,879	-	2,149,879	-
Corporate notes	1,143,751	-	1,143,751	-
Total fixed income	5,121,414	-	5,121,414	-
Equity securities:				
U.S. equities	8,895,921	8,895,921	-	-
Mutual fund shares	1,048,963	1,048,963	-	-
Total investments at fair value	$ 15,066,298	$ 9,944,884	$ 5,121,414	$ -

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

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 institution at December 31, 2017 and 2016.

(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, 2017, the Bank's investment in U.S. Treasury securities and agency obligations of the Federal Home Loan Bank constituted 10% and 6%, respectively, of its total investments. As of December 31, 2016, the Bank's investment in U.S. Treasury securities and agency obligations of the Federal Farm Credit Bank constituted 12% and 6%, 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 December 31, 2017 and 2016, the equity investment in Bank of the FSM represents 225,000 common shares and approximately 24% ownership interest. Total shareholders' equity reported by Bank of the FSM approximated $22,301,000 and $21,251,000 at December 31, 2017 and 2016, respectively.

(4) Loans Receivable

A summary of loans receivable at December 31, 2017 and 2016 follows:

	2017	2016
Unpaid principal balance	$ 34,216,033	$ 28,392,819
Allowance for loan losses	(4,609,249)	(3,220,000)
	$ 29,606,784	$ 25,172,819

At December 31, 2017, estimated total principal collections and loan maturities in 2018 approximated $7,638,000.

Movements in the allowance for loan losses during the years ended December 31, 2017 and 2016, are as follows:

	2017	2016
Balance at beginning of year	$ 3,220,000	$ 3,952,258
Recoveries of loan losses	-	(1,179,871)
Loans charged off	(430,881)	(436,642)
Loan recoveries from previously charged off loans	1,820,130	884,255
Balance at end of year	$ 4,609,249	$ 3,220,000

In 2017, the Bank granted a new loan in the amount of $2,735,000, of which $1,362,064 was applied to the borrower's loan charged off in 2014 and included as a loan recovery. At December 31, 2017 $1,218,000 has not been disbursed.

(5) Capital Assets

A summary of capital assets as of December 31, 2017 and 2016, is as follows:

	Beginning January 1, 2017	Additions/ Transfers	Deletions/ Transfers	Ending December 31, 2017
Building	$ 1,674,348	$ -	$ -	$ 1,674,348
Computers and software	762,473	7,302	(211,063)	558,712
Vehicles	172,006	-	-	172,006
Office furniture, fixtures and equipment	39,733	-	(16,576)	23,157
	2,648,560	7,302	(227,639)	2,428,223
Less accumulated depreciation	(1,024,349)	(121,425)	227,675	(918,099)
Capital assets, net	$ 1,624,211	$ (114,123)	$ 36	$ 1,510,124

	Beginning January 1, 2016	Additions/ Transfers	Deletions/ Transfers	Ending December 31, 2016
Building	$ 1,674,348	$ -	$ -	$ 1,674,348
Computers and software	652,912	109,561	-	762,473
Vehicles	144,572	27,434	-	172,006
Office furniture, fixtures and equipment	39,733	-	-	39,733
	2,511,565	136,995	-	2,648,560
Less accumulated depreciation	(878,280)	(146,069)	-	(1,024,349)
Capital assets, net	$ 1,633,285	$ (9,074)	$ -	$ 1,624,211

(6) Related Party Transactions

As of December 31, 2017 and 2016, the Bank has direct loans with outstanding balances of $431,186 and $428,438, respectively, to employees of the Bank and project loans extended to businesses owned by or affiliated with employees and component units of FSM governments of $4,748,564 and $2,019,105, 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) 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, 2017 and 2016, the account has a balance of $147,190 and $104,723, respectively.

(8) Long-Term Debt

Long-term debt consists of the following at December 31, 2017 and 2016:

	2017	2016
Unsecured loans payable to European Investment Bank under a August 2010 master finance contract of EUR 4 million:		
Drawn on August 20, 2014; original amount of $275,000 (equivalent EUR 205,500), bearing interest fixed at 3.705%, and payable through semi-annual principal and interest installments of $24,778 on January 15, 2015 and equal installments of $25,772 beginning on July 15, 2015 through maturity on July 15, 2020.	$ 145,064	$ 189,975
Drawn on August 20, 2014; original amount of $334,550 (equivalent EUR 250,000), bearing interest fixed at 4.520%, and payable through semi-annual principal and interest installments of $17,997 on January 15, 2015 and equal installments of $19,467 beginning on July 15, 2015 through maturity on July 15, 2025.	258,953	285,287
Drawn on August 20, 2014; original amount of $796,976 (equivalent EUR 595,558), bearing interest fixed at 4.520%, and payable through semi-annual principal and interest installments of $42,873 on January 15, 2015 and equal installments of $46,375 beginning on July 15, 2015 through maturity on July 15, 2025.	616,887	679,619
	$ 1,020,904	$ 1,154,881

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

Year Ending December 31,	Principal	Interest	Total
2018	$ 139,710	$ 43,518	$ 183,228
2019	145,709	37,519	183,228
2020	151,968	31,260	183,228
2021	106,476	25,207	131,683
2022	111,343	20,340	131,683
2023-2025	365,698	29,542	395,240
	$ 1,020,904	$ 187,386	$ 1,208,290

Long-term debt changes during the years ended December 31, 2017 and 2016 are as follows:

	Balance January 1,	Additions	Reductions	Balance December 31,	Due Within One Year
2017:					
Loans payable	$ 1,154,881	$ -	$ (133,977)	$ 1,020,904	$ 139,710

	Balance January 1,	Additions	Reductions	Balance December 31,	Due Within One Year
2016:					
Loans payable	$ 1,283,346	$ -	$ (128,465)	$ 1,154,881	$ 133,961

(9) Unearned Grant Revenues

During the year ended December 31, 2015, the Bank was awarded a $250,000 Home Energy Loan Program grant from the International Union for Conservation of Nature Resources (IUCN). $232,000 of the grant is to be awarded to the qualified borrowers for new loans to construct homes that demonstrate features and measures designed to conserve energy, reduce consumption of fossil fuels and enhance energy efficiency as principle reduction of loans, while the remaining $18,000 will be used by the Bank for renovations to improve energy efficiency. As of December 31, 2017 and 2016, $224,940 and $124,970 has been received and $43,889 and $19,154, respectively, expended by the Bank. The grant expired on December 31, 2017, and the unused portion is presented as payable to grantor in the accompanying statements of net position. The Bank is in the process of applying for a grant extension.

(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 Administration. 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 of 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, 2017 and 2016 were $57,506 and $55,467, respectively. Total Plan assets as of December 31, 2017 and 2016 were $1,066,825 and $845,119, respectively. Management is of the opinion that the Plan does not represent an asset or a liability of the Bank.

(11) 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, 2017 and 2016.

Loan Commitments

Undrawn balances on lines of credit and loan commitments for loans approved but undisbursed approximated $4,665,000 at December 31, 2017, of which $1,218,000 represent approved loans to one borrower (see note 4).

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.

(11) Commitments and Contingencies, Continued

Lease Commitments

The Bank has three operating leases for its State operating locations. These leases expire at varying dates through December 2022. Several of these leases provide options to renew upon expiration, based on renegotiated rates. Future minimum annual lease payments payable under the noncancellable lease agreements are as follows:

Year ending December 31,	
2018	$ 28,250
2019	27,000
2020	27,000
2021	27,000
2022	10,350
	$ 119,600

The Bank leases portions of its headquarters building under three separate agreements expiring from September 2020 to September 2025. Future minimum annual lease income under the noncancellable lease agreements are as follows:

Year ending December 31,	
2018	$ 20,700
2019	20,700
2020	20,700
2021	18,500
2022	11,700
Thereafter	32,200
	$ 124,500

Additionally, the Bank provides housing benefits for certain contract employees with payment included as part of rent expense. The lease agreements are between the respective landlords and the employees.

Total recorded lease expense and income under the aforementioned agreements amounted to $87,960 and $24,438, respectively, for the year ended December 31, 2017 and $87,549 and $26,931, respectively, for the year ended December 31, 2016.

(12) Subsequent Events

Management has evaluated subsequent events through March 26, 2018, 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, 2017.

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

Schedule of European Investments Bank
August 2010 Finance Contract Ratios
December 31, 2017

1.) Ratio of Capital (paid in capital plus reserves) to total assets should be above 20%:

Total net position	$	57,675,496
Total assets	$	59,559,529
		97%

2.) Ratio of non-performing loans (defined as aggregate principal and interest due over 90 days and above) to total loans should not exceed 15%:

Total non-performing loans	$	2,811,120
Total loans	$	34,216,033
		8%

3.) Ratio of allowance for loan losses to non performing loans shall not be less than 100%:

Allowance for loan losses	$	4,609,249
Total non-performing loans	$	2,811,120
		164%

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

YEAR ENDED DECEMBER 31, 2017

Deloitte.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia Development Bank:

Report on the Financial Statements

We have audited the accompanying financial statements of the Investment Development Fund and the Yap Development Loan Fund (the Funds), administered by the Federated States of Micronesia Development Bank (the Bank), which comprise the respective statement of fiduciary net position as of December 31, 2017, and the related statement 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 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 opinions.

Deloitte.

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 and the Yap Development Loan Fund as of December 31, 2017, 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 Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2018, 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

March 26, 2018

TRUST FUNDS ADMINISTERED BY THE
FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Trust Funds
Statement of Fiduciary Net Position
December 31, 2017

	IDF	YDLF	Total
ASSETS			
Cash and cash equivalents	$ -	$ 121,146	$ 121,146
Time certificates of deposit	-	148,945	148,945
Receivable from FSMDB	592,185	-	592,185
Interest and other receivables	8,865	633	9,498
Loans receivable, net of an allowance of $16,801	1,293,453	-	1,293,453
Total assets	$ 1,894,503	$ 270,724	$ 2,165,227
LIABILITIES AND NET POSITION			
Liabilities:			
Payable to FSMDB	$ -	$ 15,000	$ 15,000
Net position:			
Restricted	1,293,453	-	1,293,453
Unrestricted	601,050	255,724	856,774
Total net position	1,894,503	255,724	2,150,227
Total liabilities and net position	$ 1,894,503	$ 270,724	$ 2,165,227

See accompanying notes to financial statements.

TRUST FUNDS ADMINISTERED BY THE
FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Trust Funds
Statement of Changes in Fiduciary Net Position
Year Ended December 31, 2017

	IDF	YDLF	Total
Additions:			
Loan interest	$ 79,465	$ -	$ 79,465
Investment interest	-	372	372
Total additions	79,465	372	79,837
Deductions:			
Miscellaneous	580	-	580
Total deductions	580	-	580
Change in net position	78,885	372	79,257
Net position at beginning of year	1,815,618	255,352	2,070,970
Net position at end of year	$ 1,894,503	$ 255,724	$ 2,150,227

See accompanying notes to financial statements.

(1) Purpose and Summary of Significant Accounting Policies

Purpose

The Investment Development Fund (IDF) and the Yap Development Loan Fund (YDLF) are administered by the Federated States of Micronesia Development Bank (the Bank or FSMDB). 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; and (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.

YDLF is 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 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 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, 2017, the Funds implemented the following pronouncements:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68.

- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB).

- GASB Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units.

- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

- GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

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

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). The provisions in Statement No. 85 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt. The provisions in Statement No. 86 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

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 policies of the Funds are governed by their enabling legislation.

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, 2017, the carrying amount and corresponding bank balances of the Funds' total cash and cash equivalents and time certificates of deposit was $270,091. 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 coverage, 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, 2017.

(3) Subsequent Events

Management has evaluated subsequent events through March 26, 2018, 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, 2017.

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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, 2017, 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 March 26, 2018.

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.

Deloitte.

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 March 26, 2018.

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

March 26, 2018

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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 and the Yap Development Loan Fund (the Funds), administered by the Federated States of Micronesia Development Bank (the Bank), which comprise the respective statement of fiduciary net position as of December 31, 2017, and the related statement of change in fiduciary net position for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 26, 2018.

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.

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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.

Deloitte.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the respective financial statements of the Investment Development 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*.

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Deloitte & Touche LLP

March 26, 2018