

*Financial Statements, Required Supplementary
Information, and Supplementary Information*

Federated States of Micronesia

Development Bank

*(A Component Unit of the Federated States of
Micronesia National Government)*

*Years ended December 31, 2023 and 2022
with Report of Independent Auditors*



Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Years ended December 31, 2023 and 2022

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Report of Independent Auditors

Board of Directors
Federated States of Micronesia Development Bank:

Report on the Audit of the Financial Statements

Opinions

We have audited the financial statements of the business-type activities and fiduciary activities of Federated States of Micronesia (FSM) Development Bank (the Bank), a component unit of the FSM National Government, as of and for the years ended December 31, 2023 and 2022, and the related notes to the financial statements, which collectively comprise the Bank's basic financial statements as listed in the table of contents (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and fiduciary activities of Federated States of Micronesia Development Bank at December 31, 2023 and 2022, and the respective changes in financial position, and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinions

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Bank and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

Responsibilities of Management for the Financial Statements, continued

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Bank's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Bank's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Bank's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 6 be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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 GAAS, 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.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Bank's basic financial statements. The Schedule of European Investment Bank December 2018 and August 2010 Finance Contract Ratios, as Amended November 2023 on page 33 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with GAAS. In our opinion, the Schedule of European Investment Bank December 2018 and August 2010 Finance Contract Ratios, as Amended November 2023 is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 13, 2024, 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Bank's 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.

Ernst & Young LLP

May 13, 2024

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Management's Discussion and Analysis

Years ended December 31, 2023 and 2022

The following is a discussion and analysis of the Federated States of Micronesia Development Bank's (FSMDB or the Bank) financial performance for the fiscal years ended December 31, 2023 and 2022.

The year 2023 was a better year than years past. When we take into account changes in the global market, changes in the FSM government, changes in our leadership at the national and state levels, and changes in the economy, the Bank becomes an integral part of these changes because of our role in private sector development.

In terms of statistics, out of the 1,019 approved loans in 2023, 27 in the amount of \$3.12 million were business term loans, 27 in the amount of \$5.61 million were Lines of Credits, 12 in the amount of \$799 thousand were residential home loans, 899 consumer loans amounting to \$5.76 million and 54 in the amount of \$669 thousand were for Micro & Small (M&S) loans. Business loans for commercial, tourism, and agriculture/fisheries represented 59% of approved loans with 41% of the remaining loans making up consumer and residential loans. Of the 54 M&S loans, 30 loans or 56% were for women-owned and women-managed businesses. Lastly, no contributions or subsidies from the government were received in 2023.

Summary Statements of Net Position

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Assets	<u>\$72,717,683</u>	<u>\$68,332,009</u>	<u>\$72,161,441</u>
Liabilities:			
Liabilities	<u>2,960,174</u>	<u>3,298,473</u>	<u>3,585,425</u>
Net Position:			
Net investment in capital assets	1,174,995	1,318,800	1,428,805
Unrestricted	<u>68,582,514</u>	<u>63,714,736</u>	<u>67,147,211</u>
Total net position	<u>69,757,509</u>	<u>65,033,536</u>	<u>68,576,016</u>
Total liabilities and net position	<u>\$72,717,683</u>	<u>\$68,332,009</u>	<u>\$72,161,441</u>

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Management's Discussion and Analysis, continued

Financially, FSMDB ended 2023 with a net increase in assets of \$4.72 million, most of that being attributed to investment gains. From operations, the Bank earned \$0.94 million which represents a substantial increase of 97% comparing to last year's results of \$23,870. The Bank's return on equity improved from a negative 5.4% in 2022 due to the decline in net assets, to a positive 7% resulting from the \$4.9 million change in net position. The Bank was able to generate more than enough revenues to cover expenses, all from internal sources.

At the conclusion of 2023, the single long-term liability with the European Investment Bank (EIB) was reduced from \$3.0 to less than \$2.6 million. Borrowed funds represented only 4% of total assets. 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 in the financial statements.

The Bank's investments in 2023 in the financial markets performed significantly better compared to last year's results. Investment gains totaled \$3.8 million compared to a negative \$3.6 million in 2022.

Summary Statements of Revenues, Expenses and Changes in Net Position

	<u>2023</u>	<u>2022</u>	<u>2021</u>
Operating revenues	\$ 3,433,786	\$ 3,117,469	\$3,194,395
Provision for loan losses	---	(1,000,000)	(3,083,405)
Operating expenses	(2,490,374)	(2,093,599)	(1,806,242)
Earnings (loss) from operations	943,412	23,870	(1,695,252)
Nonoperating revenues (expense), net	<u>3,780,561</u>	<u>(3,566,350)</u>	<u>4,859,478</u>
Change in net position	4,723,973	(3,542,480)	3,164,226
Net position at beginning of year	<u>65,033,536</u>	<u>68,576,016</u>	<u>65,411,790</u>
Total assets	<u>\$69,757,509</u>	<u>\$65,033,536</u>	<u>\$68,576,016</u>

The two bank-managed trust funds: the Investment Development Fund (IDF) and the Yap Development Loan Fund (YDLF) have been inactive for several years with no new loans approved. The total assets for each of the funds at the end of 2023 were \$2,075,186 and \$285,824, respectively.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Management's Discussion and Analysis, continued

Economic Outlook

The year 2023 saw the amended 20-year Compact come to an end, but 2023 also saw the signing of new agreements between the FSM and the United States, with substantially larger financial and economic assistance for the FSM, to name a few. This will greatly affect the bank and the entire nation in the years to come.

FSMDB finally became accredited with the Green Climate Fund (GCF) after many years of working towards this goal. Being accredited will give FSMDB access to funding that will have significant impacts not only on the FSMDB institution, but on the nation as a whole.

We anticipate seeing exciting challenges in the year 2024 and beyond, and they will more than likely be challenging years. However, at the same time, we are hopeful the economic outlook for the Bank and the entire FSM will be a brighter one, what with new compact changes taking effect, our GCF grants being established and operational, and much anticipated improvements in our private and non-private sectors. We are prepared to meet these higher expectations of our stakeholders and the customers we serve. The Bank will continue to strive to meet its mandates and work with the customers we serve to continue to transform lives.

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, 2022 is set forth in the Bank's report on the audit of financial statements, which is dated October 31, 2023. That Discussion and Analysis explains the major factors impacting the 2022 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 Ms. Anna Mendiola, President/Chief Executive Officer, P.O. Box M, Pohnpei, FM 96941 or visit the website at www.fsmdb.fm.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Statements of Net Position

	December 31, <u>2023</u>	<u>2022</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 5,647,755	\$ 5,810,211
Time certificates of deposit	7,932,086	2,981,450
Investments	16,103,008	13,703,962
Interest and other receivables	181,012	329,233
Current portion of loans receivable, net of allowance for loan losses	8,652,397	10,922,476
Prepaid expenses	<u>---</u>	<u>2,580</u>
Total current assets	38,516,258	33,749,912
Loans receivable, net of allowance for loan losses, net of current portion	26,440,739	27,657,857
Equity investment	6,585,691	5,605,440
Depreciable capital assets, net	<u>1,174,995</u>	<u>1,318,800</u>
Total assets	<u>\$72,717,683</u>	<u>\$68,332,009</u>
Liabilities and Net Position		
Current liabilities:		
Accounts payable	\$ 124,379	\$ 93,624
Current portion of long-term debt	399,463	394,140
Credit life payable	70,549	21,466
Payable to trust funds	70,563	46,732
Unearned grant revenues	<u>85,035</u>	<u>132,835</u>
Total current liabilities	749,989	688,797
Long-term debt, net of current portion	<u>2,210,185</u>	<u>2,609,676</u>
Total liabilities	<u>2,960,174</u>	<u>3,298,473</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	1,174,995	1,318,800
Unrestricted	<u>68,582,514</u>	<u>63,714,736</u>
Total net position	<u>69,757,509</u>	<u>65,033,536</u>
Total liabilities and net position	<u>\$72,717,683</u>	<u>\$68,332,009</u>

See accompanying notes.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Statements of Revenues, Expenses, and Changes in Net Position

	Years ended December 31,	
	<u>2023</u>	<u>2022</u>
Operating revenues:		
Interest income on loans	\$3,119,772	\$ 2,657,025
Loan fees	148,159	279,544
Rental	29,700	29,700
Interest income on time certificates of deposit	11,270	4,836
Miscellaneous	<u>124,885</u>	<u>146,364</u>
Total operating revenues	3,433,786	3,117,469
Provisions for loan losses	<u>---</u>	<u>1,000,000</u>
Net operating revenues	<u>3,433,786</u>	<u>2,117,469</u>
Operating expenses:		
Interest expense	<u>111,981</u>	<u>79,391</u>
General and administrative expenses:		
Personnel services	1,295,394	1,318,562
Miscellaneous	283,475	20,622
Depreciation	163,474	165,960
Travel	93,963	30,854
Retirement plan contributions	79,842	74,522
Contractual services	77,737	86,222
Rent	72,420	85,020
Training	61,204	567
Utilities	56,524	55,462
Communication	44,545	47,859
Branch automation	33,187	32,346
Staff relations	29,624	10,341
Supplies	29,315	28,900
Equipment	18,044	20,367
Community development	13,610	11,030
Fuel, oil and petroleum	10,736	10,160
Repair and maintenance	8,509	8,538
Insurance	<u>6,790</u>	<u>6,876</u>
Total general and administrative expenses	<u>2,378,393</u>	<u>2,014,208</u>
Earnings from operations	943,412	23,870
Nonoperating revenues (expenses) - investment losses, net	<u>3,780,561</u>	<u>(3,566,350)</u>
Change in net position	4,723,973	(3,542,480)
Net position at beginning of year	<u>65,033,536</u>	<u>68,576,016</u>
Net position at end of year	<u>\$69,757,509</u>	<u>\$65,033,536</u>

See accompanying notes.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Statement of Fiduciary Net Position

December 31, 2023

	Investment Development Fund (IDF)	Yap Development Loan Fund (YDLF)	<u>Total</u>
Assets			
Cash and cash equivalents	\$ ---	\$129,708	\$ 129,708
Time certificates of deposit	1,983,938	152,362	2,136,300
Receivable from FSMDB	71,935	---	71,935
Interest and other receivables	<u>19,313</u>	<u>3,754</u>	<u>23,067</u>
 Total assets	 <u>\$2,075,186</u>	 <u>\$285,824</u>	 <u>\$2,361,010</u>
Liabilities and Net Position			
Liabilities:			
Payable to FSMDB	\$ <u>1,372</u>	\$ ---	\$ <u>1,372</u>
Unrestricted net position	<u>2,073,814</u>	<u>285,824</u>	<u>2,359,638</u>
 Total liabilities and net position	 <u>\$2,075,186</u>	 <u>\$285,824</u>	 <u>\$2,361,010</u>

See accompanying notes.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Statement of Fiduciary Net Position

December 31, 2022

	Investment Development Fund (IDF)	Yap Development Loan Fund (YDLF)	<u>Total</u>
Assets			
Cash and cash equivalents	\$ ---	\$127,412	\$ 127,412
Time certificates of deposit	1,969,455	151,221	2,120,676
Receivable from FSMDB	72,950	---	72,950
Interest and other receivables	<u>4,931</u>	<u>---</u>	<u>4,931</u>
 Total assets	 <u>\$2,047,336</u>	 <u>\$278,633</u>	 <u>\$2,325,969</u>
Liabilities and Net Position			
Liabilities:			
Payable to FSMDB	\$ <u>6,111</u>	\$ <u>20,107</u>	\$ <u>26,218</u>
Unrestricted net position	<u>2,041,225</u>	<u>258,526</u>	<u>2,299,751</u>
 Total liabilities and net position	 <u>\$2,047,336</u>	 <u>\$278,633</u>	 <u>\$2,325,969</u>

See accompanying notes.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Statement of Fiduciary Revenues, Expenses and Changes in Fiduciary Net Position

Year ended December 31, 2023

	Investment Development Fund (IDF)	Yap Development Loan Fund (YDLF)	<u>Total</u>
Additions:			
Investment interest	\$ 14,483	\$ 2,169	\$ 16,652
Loan interest	13,367	---	13,367
Miscellaneous	<u>4,739</u>	<u>25,129</u>	<u>29,868</u>
Change in net position	32,589	27,298	59,887
Net position at beginning of year	<u>2,041,225</u>	<u>258,526</u>	<u>2,299,751</u>
Net position at end of year	<u>\$2,073,814</u>	<u>\$285,824</u>	<u>\$2,359,638</u>

See accompanying notes.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Statement of Fiduciary Revenues, Expenses and Changes in Fiduciary Net Position

Year ended December 31, 2022

	Investment Development Fund (IDF)	Yap Development Loan Fund (YDLF)	<u>Total</u>
Additions:			
Investment interest	\$ 154	\$ 689	\$ 843
Miscellaneous	<u>920</u>	<u>---</u>	<u>920</u>
Change in net position	1,074	689	1,763
Net position at beginning of year	<u>2,040,151</u>	<u>257,837</u>	<u>2,297,988</u>
Net position at end of year	<u>\$2,041,225</u>	<u>\$258,526</u>	<u>\$2,299,751</u>

See accompanying notes.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Statements of Cash Flows

	Year ended December 31,	
	<u>2023</u>	<u>2022</u>
Cash flows from operating activities:		
Cash received from customers	\$3,582,007	\$ 3,102,140
Cash paid to suppliers for goods and services	(884,907)	(462,305)
Cash paid to employees for services	(1,295,394)	(1,318,562)
Net cash provided by operating activities	<u>1,401,706</u>	<u>1,321,273</u>
Cash flows from noncapital financing activities:		
Principal repayment of long-term debt	(394,168)	(334,014)
Net transfers in from trust funds	23,831	2,143
Interest paid	(111,981)	(104,433)
Net cash used in noncapital financing activities	(<u>482,318</u>)	(<u>436,304</u>)
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	2,515	---
Acquisition of capital assets	(<u>22,184</u>)	(<u>55,955</u>)
Net cash used in capital and related financing activities	(<u>19,669</u>)	(<u>55,955</u>)
Cash flows from investing activities:		
Loan origination and principal disbursements, net	3,487,197	(5,294,483)
Increase in time certificates of deposit	(4,950,636)	(2,976,614)
Sales (purchases) of investments, net	126,763	(171,524)
Dividends received	<u>274,501</u>	<u>245,251</u>
Net cash used in investing activities	(<u>1,062,175</u>)	(<u>8,197,370</u>)
Net change in cash and cash equivalents	(162,456)	(7,368,356)
Cash and cash equivalents at beginning of year	<u>5,810,211</u>	<u>13,178,567</u>
Cash and cash equivalents at end of year	<u>\$5,647,755</u>	<u>\$ 5,810,211</u>

See accompanying notes.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Statements of Cash Flows, continued

	Year ended December 31, <u>2023</u>	<u>2022</u>
Reconciliation of earnings from operations to net cash provided by operating activities:		
Earnings from operations	\$ 943,412	\$ 23,870
Adjustments to reconcile earnings from operations to net cash provided by operating activities:		
Provision for loan losses	---	1,000,000
Depreciation	163,474	165,960
Others	111,981	74,554
Decrease (increase) in assets:		
Interest and other receivables	148,221	(10,493)
Prepaid expenses	2,580	(2,580)
Increase (decrease) in liabilities:		
Accounts payable	30,755	51,641
Credit life payable	49,083	7,146
Unearned grant revenues	(<u>47,800</u>)	<u>11,175</u>
Net cash provided by operating activities	<u>\$1,401,706</u>	<u>\$ 1,321,273</u>

See accompanying notes.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Notes to Financial Statements

Years ended December 31, 2023 and 2022

1. Organization and Summary of Significant Accounting Policies

Organization

The Federated States of Micronesia (FSM) Development Bank (the Bank) was created in 1979 by Public Law 1-37 of the First Congress of the Federated States of Micronesia. The Bank began its operations on October 1, 1980. The Bank was reorganized in January 1994 by Public Law 8-47 of the Eighth Congress of the 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, 2023 and 2022, 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.

Primary Government Financial Statements

The primary government financial statements consist of the statement of net position, statement of revenues, expenses, and changes in net position and statement of cash flows. Fiduciary activities are not included in the primary government financial statements.

Fiduciary Fund Financial Statements

Separate financial statements are provided for fiduciary funds. Fiduciary financial statements include assets, liabilities and activities of the Investment Development Fund (IDF) and the Yap Development Loan Fund (YDLF), for which the Bank has been legally designated to control but the Bank itself is not a beneficiary.

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.

YDLF is administered by the Bank in a Trust capacity. All loan decisions are made by executives of the respective state governments.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Notes to Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Fund Structure and Basis of Accounting

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 primary government financial statements of the Bank are not obligations of the FSM National Government unless specifically authorized by the FSM National Government. To date, no such authorizations have been made.

The 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 accounting policies of the primary government financial statement and fiduciary fund financial statements conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. The Bank utilizes the flow of economic resources measurement focus. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

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.

Accounting 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.

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Notes to Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Cash and Cash Equivalents

For the purposes of the statements of net position and cash flows, cash and cash equivalents are defined as cash in bank checking, savings and time certificate of deposit accounts with original maturity dates of three months or less, 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.

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 and recorded as reduction or addition to operating revenues.

For the statement of net position presentation purpose, the current portion of loans is determined based on expected principal collections, including those loans that are scheduled to mature, within the next twelve months. Actual loan collections in subsequent period may differ significantly due to term extensions that may be in the normal course of business.

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.

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

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 twenty-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.

Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. As of December 31, 2023 and 2022, the Bank has no items that qualify for reporting in this category.

Deferred Inflows of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. As of December 31, 2023 and 2022, the Bank has no items that qualify for reporting in this category.

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 \$187,000 and \$179,000 at December 31, 2023 and 2022, respectively.

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Taxes

The Bank exists and operates solely for the benefit of the public and shall be exempted from any State or Municipal taxes or assessments on any of its property, operations or activities. The Authority shall be liable for employees' contributions to the National Social Security System or other employees' benefits of the State or FSM National Governments, if any, in such manner as provided by law.

Net Position

Net position represents the residual interest in the Bank's assets and deferred outflows of resources after liabilities and deferred inflows of resources are deducted and consist of two sections:

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.

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.

Operating and Nonoperating Revenues and Expenses

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, which is lending. Operating expenses include the cost to provide services, including cost of funds, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

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.

Reclassification

Certain reclassifications have been made to the 2022 financial statements for comparative purposes. Such reclassifications have no effect on the previously reported change in net position.

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. This Statement also provides guidance for accounting and financial reporting for availability payment arrangements. The adoption of GASB Statement No. 94 during the year ended December 31, 2023 did not have an effect on the accompanying financial statements.

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. The adoption of GASB Statement No. 96 during the year ended December 31, 2023 did not result in a material effect on the accompanying financial statements.

In April 2022, GASB issued Statement No. 99, *Omnibus 2022*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature. Consistent authoritative literature enables governments and other stakeholders to locate and apply the correct accounting and financial reporting provisions, which improves the consistency with which such provisions are applied more easily. The comparability of financial statements also will improve as a result of this Statement. Better consistency and comparability improve the usefulness of information for users of local government financial statements. The adoption of GASB Statement No. 99 during the year ended December 31, 2023 did not have an effect on the accompanying financial statements.

In June 2022, GASB issued Statement No. 100, *Accounting Changes and Error Corrections – An Amendment of GASB Statement No. 62*. The primary objective of this Statement is to enhance accounting and financial reporting requirements for accounting changes and error corrections to provide more understandable, reliable, relevant, consistent, and comparable information for making decisions or assessing accountability. The requirements of this Statement will improve the clarity of the accounting and financial reporting requirements for accounting changes and error corrections, which will result in greater consistency in application in practice. In turn, more understandable, reliable, relevant, consistent, and comparable information will be provided to financial statement users for making decisions or assessing accountability. In addition, the display and note disclosure requirements will result in more consistent, decision useful, understandable, and comprehensive information for users about accounting changes and error corrections. The adoption of GASB Statement No. 100 during the year ended December 31, 2023 did not have an effect on the accompanying financial statements.

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements

In June 2022, GASB issued Statement No. 101, *Compensated Absences*. The objective of this Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures. The unified recognition and measurement model in this Statement will result in a liability for compensated absences that more appropriately reflects when a government incurs an obligation. In addition, the model can be applied consistently to any type of compensated absence and will eliminate potential comparability issues between governments that offer different types of leave. The model also will result in a more robust estimate of the amount of compensated absences that a government will pay or settle, which will enhance the relevance and reliability of information about the liability for compensated absences. GASB Statement No. 101 will be effective for fiscal year ending December 31, 2024.

In December 2023, GASB issued Statement No. 102, *Certain Risk Disclosures*. The primary objective of this Statement is to provide users of the government financial statements with essential information about risks related to a government's vulnerabilities due to ascertain concentrations or constraints. This Statement requires a government to assess whether a concentration or constraint makes the primary government reporting unit or other reporting units that report a liability for revenue debt vulnerable to the risk of a substantial impact. Additionally, this Statement requires a government to assess whether an event or events associated with a concentration or constraint that could cause the substantial impact have occurred, have begun to occur, or are more likely than not to begin to occur within 12 months of the date the financial statements are issued. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 102 will be effective for fiscal year ending December 31, 2025.

Management is currently evaluating the effects the above upcoming accounting pronouncements might have 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 of America, provided that the principal and interest on each obligation are payable in the currency of the United States of America.

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

2. Deposits and Investments, continued

- (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 of America or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or other mortgage-backed securities provided that the obligation is an agency of the United States Government, the National Government of the Federated States of Micronesia, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the investment fund or ten percent of the outstanding value of the issue at the time of purchase.
- (iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the Bank's investment advisor at the time of purchase, that not more than five percent of the market value of its investments shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of its investments shall be invested in any one industry group.
- (iv) Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments.

A. Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Bank's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Bank does not have a deposit policy for custodial credit risk.

As of December 31, 2023 and 2022, the carrying amount of the Bank's total cash and cash equivalents and time certificates of deposit, including fiduciary funds, amounted to \$15,845,849 and \$11,039,749, respectively, and the corresponding bank balances were \$16,027,999 and \$11,735,396, respectively, which were all maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2023 and 2022, bank deposits in the amounts of \$8,604,242 and \$4,281,614 respectively, are subject to the FDIC insurance limit. 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, 2023 and 2022.

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

2. Deposits and Investments, continued

B. Investments

As of December 31, 2023 and 2022, investments at fair value are as follows:

	<u>2023</u>	<u>2022</u>
Fixed income securities:		
Domestic fixed income	\$ 5,018,427	\$ 4,786,707
Equity securities:		
Domestic equities	9,504,636	7,463,082
Shares in a mutual fund	<u>1,579,945</u>	<u>1,454,173</u>
	<u>\$16,103,008</u>	<u>\$13,703,962</u>

As of December 31, 2023 and 2022, investments in domestic fixed income securities are as follows:

2023

	Moody's Credit Rating	Investment maturities (in Years)				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
U.S. Government securities:						
U.S. Treasury Notes	Aaa	\$ ---	\$1,814,624	\$ 264,534	\$ ---	\$2,079,158
U.S. Government agencies:						
Fannie Mae Pool	Not rated	---	---	---	1,284,030	1,284,030
Freddie Mac Group	Not rated	---	---	---	1,099,933	1,099,933
Corporate bonds	A1	---	192,661	151,282	---	343,943
Corporate bonds	A2	---	---	92,221	---	92,221
Corporate bonds	A3	---	---	<u>119,142</u>	---	<u>119,142</u>
		<u>\$ ---</u>	<u>\$2,007,285</u>	<u>\$ 627,179</u>	<u>\$2,383,963</u>	<u>\$5,018,427</u>

2022

	Moody's Credit Rating	Investment maturities (in Years)				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
U.S. Government securities:						
U.S. Treasury Notes	Aaa	\$ ---	\$852,263	\$ 550,155	\$ ---	\$1,402,418
U.S. Government agencies:						
Fannie Mae Pool	Not rated	---	---	---	1,619,909	1,619,909
Freddie Mac Group	Not rated	---	---	---	1,136,013	1,136,013
Corporate bonds	A1	---	91,725	166,193	---	257,918
Corporate bonds	A2	---	---	256,564	---	256,564
Corporate bonds	A3	---	---	<u>113,885</u>	---	<u>113,885</u>
		<u>\$ ---</u>	<u>\$943,988</u>	<u>\$1,086,797</u>	<u>\$2,755,922</u>	<u>\$4,786,707</u>

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

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, 2023 and 2022:

	December 31, 2023	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Fixed income:				
U.S. Treasury obligations	\$ 2,079,158	\$ ---	\$2,079,158	\$ ---
U.S. Government agencies	2,383,963	---	2,383,963	---
Corporate notes	<u>555,306</u>	<u>---</u>	<u>555,306</u>	<u>---</u>
Total fixed income	<u>5,018,427</u>	<u>---</u>	<u>5,018,427</u>	<u>---</u>
Equity securities:				
U.S. equities	6,853,686	6,853,686	---	---
Non U.S. equities	2,650,950	2,650,950	---	---
Mutual fund shares	<u>1,579,945</u>	<u>1,579,945</u>	<u>---</u>	<u>---</u>
Total investments at fair value	<u>\$16,103,008</u>	<u>\$11,084,581</u>	<u>\$5,018,427</u>	<u>\$ ---</u>

	December 31, 2022	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Fixed income:				
U.S. Treasury obligations	\$ 1,402,419	\$ ---	\$1,402,419	\$ ---
U.S. Government agencies	2,755,921	---	2,755,921	---
Corporate notes	<u>628,367</u>	<u>---</u>	<u>628,367</u>	<u>---</u>
Total fixed income	<u>4,786,707</u>	<u>---</u>	<u>4,786,707</u>	<u>---</u>
Equity securities:				
U.S. equities	7,463,082	7,463,082	---	---
Mutual fund shares	<u>1,454,173</u>	<u>1,454,173</u>	<u>---</u>	<u>---</u>
Total investments at fair value	<u>\$13,703,962</u>	<u>\$ 8,917,255</u>	<u>\$4,786,707</u>	<u>\$ ---</u>

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

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

2. Deposits and Investments, continued

B. Investments, continued

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, 2023 and 2022.

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, 2023, the Bank's investment in securities of U.S Treasury Notes and agency obligations of the Fannie Mae Pool and Freddie Mac Group constituted 13%, 8% and 7%, respectively, of its total investments. As of December 31, 2022, the Bank's investment in securities of U.S Treasury Notes and agency obligations of the Fannie Mae Pool and Freddie Mac Group constituted 10%, 12% and 8%, 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, 2023 and 2022, the equity investment in Bank of the FSM represents 225,001 common shares and approximately 24% ownership interest. Total shareholders' equity reported by Bank of the FSM approximated \$6,585,691 and \$5,605,440 at December 31, 2023 and 2022, respectively.

4. Loans Receivable, net of Allowance for Loan Losses

A summary of loans receivable at December 31, 2023 and 2022 follows:

	<u>2023</u>	<u>2022</u>
Unpaid principal balance	\$42,445,264	\$45,568,131
Allowance for loan losses	(<u>7,352,128</u>)	(<u>6,987,798</u>)
	35,093,136	38,580,333
Current portion	(<u>8,652,397</u>)	(<u>10,922,476</u>)
Loans receivable, net of allowance of loan losses, net of current portion	<u>\$26,440,739</u>	<u>\$27,567,857</u>

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Notes to Financial Statements, continued

4. Loans Receivable, net of Allowance for Loan Losses, continued

At December 31, 2023, estimated total principal collections and loan maturities in 2024 approximated \$9,209,000.

Movements in the allowance for loan losses during the years ended December 31, 2023 and 2022, are as follow:

	<u>2023</u>	<u>2022</u>
Balance at beginning of year	\$6,987,798	\$7,521,719
Provision for loan losses	---	1,000,000
Loans charged off	(768,152)	(2,347,365)
Loan recoveries from previously charged off loans	<u>1,132,482</u>	<u>813,444</u>
Balance at end of year	<u>\$7,352,128</u>	<u>\$6,987,798</u>

At December 31, 2023 and 2022, \$2.73 million of the allowance is related to one Yap loan, which was fully provided due to management's assessment of remote collectability.

In an effort to constructively work with borrowers affected by the COVID-19 pandemic, the Bank initiated temporary programs beginning in February 2020 to allow for loan repayment deferrals for eligible borrowers. At December 31, 2022, twenty-seven loans with total outstanding balances of \$11.8 million, were under the deferral program, which ended June 30, 2022. In December 2020, the FSM National Government enacted Public Law No. 21-211 (the Act) towards providing financial assistance to the private sector to mitigate the impact of the COVID-19 pandemic. In accordance with the Act, the Bank received \$220,411 for interest payments for eligible loans during the year ended December 31, 2022.

In August and September 2023, the Bank received an insurance settlement for a sunken ship for a borrower totaling \$4,470,806, which was applied to the outstanding loan balance. As of December 31, 2023 and 2022, the outstanding loan balance amounted to \$1.4 million and \$5.6 million, respectively.

5. Depreciable Capital Assets, net

A summary of capital assets as of December 31, 2023 and 2022, are as follows:

	Beginning January 1, <u>2023</u>	Additions/ <u>Transfers</u>	Deletions/ <u>Transfers</u>	Ending December 31, <u>2023</u>
Land	\$ 7,889	\$ ---	\$ ---	\$ 7,889
Building	1,674,348	---	---	1,674,348
Computers and software	816,673	22,184	(1,709)	837,148
Vehicles	250,261	---	(17,285)	232,976
Office furniture, fixtures and equipment	<u>15,658</u>	<u>---</u>	<u>---</u>	<u>15,658</u>
	2,764,829	22,184	(18,994)	2,768,019
Less accumulated depreciation	<u>(1,446,029)</u>	<u>(163,474)</u>	<u>16,479</u>	<u>(1,593,024)</u>
	<u>\$1,318,800</u>	<u>\$(141,290)</u>	<u>\$(2,515)</u>	<u>\$1,174,995</u>

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

5. Depreciable Capital Assets, net, continued

	Beginning January 1, 2022	Additions/ Transfers	Deletions/ Transfers	Ending December 31, 2022
Land	\$ 7,889	\$ ---	\$ ---	\$ 7,889
Building	1,674,348	---	---	1,674,348
Computers and software	676,045	140,628	---	816,673
Vehicles	246,934	3,327	---	250,261
Office furniture, fixtures and equipment	15,658	---	---	15,658
	2,620,874	143,955	---	2,764,829
Less accumulated depreciation	(1,280,069)	(165,960)	---	(1,446,029)
	1,340,805	(22,005)	---	1,318,800
Software installation in progress	88,000	---	(88,000)	---
	<u>\$1,428,805</u>	<u>\$ (22,005)</u>	<u>\$ (88,000)</u>	<u>\$1,318,800</u>

6. Related Party Transactions

As of December 31, 2023 and 2022, the Bank has direct loans with outstanding balances of \$1,159,496 and \$358,952, respectively, to Bank employees and family members and project loans extended to three component units of FSM governments totaling \$2,281,127 and \$7,409,317, respectively. These loans were made under similar terms and conditions that exist with other borrowers. Officers and Board members are not eligible to borrow from the Bank.

During the year ended December 31, 2022, the Bank recognized interest income of \$220,411 for eligible loans through the FSM National Government COVID-19 impact fund (see Note 4).

During the year ended December 31, 2021, the Bank received a \$3,000,000 grant from the FSM National Government for the FSM Health Expenditure and Livelihood Support Program which is supported by the Asian Development Bank Group. The grant is for the Bank to launch its micro and small business loans for the program for a total of \$2,500,000. The loans are interest-free for the first two years for loans approved as of September 30, 2021 with subsequent loans bearing an interest of 3%. At December 31, 2023 and 2022, total loans disbursed approximated \$2,250,000 while outstanding balances under the loan program approximated \$797,000 and \$1,986,000 respectively.

7. 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 principal reduction of loans, while the remaining \$18,000 will be used by the Bank for renovations to improve energy efficiency. As of December 31, 2023 and 2022, unearned grant revenue amounted to \$85,010 and \$132,835, respectively.

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

8. Long-Term Debt

Direct Borrowings:

Long-term debt consists of the following at December 31, 2023 and 2022:

	<u>2023</u>	<u>2022</u>
Unsecured loans payable to European Investment Bank (EIB) under an August 2010 master finance contract of EUR 4 million:		
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.	\$ 73,660	\$ 108,093
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.	175,474	257,502
Unsecured loans payable to European Investment Bank (EIB) under a December 2018 master finance contract of USD 4 million:		
Drawn on March 9, 2020; original amount of \$3,193,637, bearing interest fixed at 2.774%, and payable through semi-annual interest payment beginning on September 9, 2020 and principal installments of \$138,854 beginning on March 9, 2021 through maturity on March 9, 2032.	<u>2,360,514</u>	<u>2,638,221</u>
	2,609,648	3,003,816
Less current portion	<u>399,463</u>	<u>394,140</u>
	<u>\$2,210,185</u>	<u>\$2,609,676</u>

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Notes to Financial Statements, continued

8. Long-Term Debt, continued

Direct Borrowings, continued:

Under the 2010 and 2018 Agreements, including Amendments dated November 2023, the EIB (or the “Lender”) loans contain a provision that in an event of default, the timing of repayment of outstanding amounts may become immediately due if:

- a. the Bank fails on due date to repay any part of the loan, to pay interest thereon or to make any other payment to the Lender unless:
 - i. its failure is caused by an administrative or technical error or a disruption event, and
 - ii. payment is made within three (3) business days of its due date;
- b. any information or document given to the Lender by the Bank or on its behalf is or proves to be incorrect, incomplete or misleading in any material respect;
- c. following any default of the Bank in relation to any loan, or any obligation arising out of any financial transaction, other than the loan:
 - i. the Bank is required or is capable of being required or will, following expiry of any applicable contractual grace period, be required or capable of being required to prepay, discharge, close out or terminate ahead of maturity such other loan or obligation, or
 - ii. any financial commitment for such other loan or obligation is cancelled or suspended;
- d. the Bank is unable to pay its debts as they fall due, or suspends its debts, or makes or seeks to make a composition with its creditors, including a moratorium, or commences negotiations with one or more of its credits with a view of rescheduling any of its financial indebtedness;
- e. any corporate action, legal proceedings or other procedure or step is taken in relation to the suspension of payments, a moratorium of any indebtedness, dissolution, administration or reorganization, including in particular without limitation to bankruptcy, controlled management, suspension of payments arrangement with creditors and judicial liquidation proceedings or any analogous procedure or step is taken under any applicable law in any jurisdiction or an order is made or an effective resolution is passed for the winding up of the Bank, or if the Bank takes steps towards a substantial reduction in its capital, is declared insolvent or ceases or resolves to cease to carry on the whole or any substantial part of its business or activities or any situation similar to any of the above occurs under any applicable law;
- f. an encumbrancer takes possession of, or a receiver, liquidator, administrator, administrative receiver or similar officer is appointed, whether by a court of competent jurisdiction or by any competent administrative authority or by any person, of or over, any part of the business or assets of the Bank;
- g. the Bank defaults in the performance of any obligation in respect of any other loan granted by the Lender or financial instrument entered into with the Lender;
- h. the Bank defaults in the performance of any obligation in respect of any other loan made to it from the resources of the Lender or the European Union;
- i. any expropriation, attachment, arrestment, distress, execution, sequestration, or other process is levied or enforced upon the property of the Bank and is not discharged or stayed within 14 days;

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

8. Long-Term Debt, continued

Direct Borrowings, continued:

- j. a material adverse change occurs, as compared to the Bank's condition at the time of the loan agreement;
- k. it is or becomes unlawful for the Bank to perform any of its obligation under the loan agreement or this loan agreement is not effective in accordance with its terms or is alleged by the Bank to be ineffective in accordance with its terms.

At December 31, 2023, no events of default have occurred with respect to the Bank's debt agreements.

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

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2024	\$ 399,463	\$ 73,484	\$ 472,947
2025	405,087	60,214	465,301
2026	277,708	48,148	325,856
2027	277,708	40,444	318,152
2028	277,708	32,740	310,448
Thereafter	<u>971,974</u>	<u>53,925</u>	<u>1,025,899</u>
	<u>\$2,609,648</u>	<u>\$308,955</u>	<u>\$2,918,603</u>

Long-term debt changes during the year ended December 31, 2023 and 2022 are as follows:

	<u>Balance</u> <u>January 1,</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>December 31,</u>	<u>Due Within</u> <u>One Year</u>
2023:					
Loans payable	<u>\$3,003,816</u>	<u>\$ ---</u>	<u>\$(394,168)</u>	<u>\$2,609,648</u>	<u>\$399,463</u>
2022:					
Loans payable	<u>\$3,337,830</u>	<u>\$ ---</u>	<u>\$(334,014)</u>	<u>\$3,003,816</u>	<u>\$394,140</u>

9. 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% of the participant's annual salary, if the participant contributes 3% or more 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, 2023 and 2022 were \$79,842 and \$78,920, respectively. Total Plan assets as of December 31, 2023 and 2022 were \$1,587,397 and \$1,496,980, respectively. Management is of the opinion that the Plan does not represent an asset or a liability of the Bank.

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

10. 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, 2023 and 2022.

Loan Commitments

Undrawn balances on lines of credit and loan commitments for loans approved but undisbursed approximated \$6,748,00 and \$6,339,000 at December 31, 2023 and 2022, respectively, of which \$5,029,000 and \$3,410,000, respectively, represent undisbursed funds on five loans.

Litigation

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

Insurance

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

Lease Commitments

The Bank has three operating leases for its State operating locations. These leases expire at varying dates through May 2031. Several of these leases provide options to renew upon expiration, based on renegotiated rates. Future minimum annual lease payments payable under the noncancellable leases are as follows:

Year ending December 31,

2024	\$ 53,220
2025	53,220
2026	56,720
2027	55,770
2028	27,600
Thereafter	<u>66,700</u>
	<u>\$313,230</u>

Federated States of Micronesia Development Bank
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Notes to Financial Statements, continued

10. Commitments and Contingencies, continued

Lease Commitments, continued

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

Year ending December 31,

2024	\$20,700
2025	<u>15,525</u>
	<u>\$36,225</u>

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

Total recorded lease expense and income under the aforementioned agreements amounted to \$72,420 and \$29,700, respectively, for the year ended December 31, 2023 and \$85,020 and \$29,700, respectively, for the year ended December 31, 2022.

Supplementary Information

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Schedule of European Investment Bank
December 2018 and August 2010 Finance Contract Ratios,
as Amended November 2023

December 31, 2023

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

Total net position	\$69,757,509
Total assets	<u>\$72,717,683</u>
	<u>96%</u>

- 2) Ratio of non-performing loans, as defined, to total loans do not exceed 40%:

Total non-performing loans	\$15,462,679
Total loans	<u>\$42,445,264</u>
	<u>36%</u>

- 3) Ratio of open exposure (non-performing loans less allowance for loan losses) to total net position should not exceed 15% as of December 31, 2023:

Total non-performing loans	\$15,462,679
Less: allowance for loan losses	<u>\$ 7,352,128</u>
	\$ 8,110,551
 Total net position	 <u>\$69,757,509</u>
	<u>12%</u>

Report of Independent Auditors 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, 2023, 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 May 13, 2024.

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a certain deficiency in internal control, described in the accompanying Schedule of Findings and Responses, that we consider to be a significant deficiency as item 2023-001.

Report on 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*.

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.

Ernst + Young LLP

May 13, 2024

Federated States of Micronesia Development Bank
(A Component Unit of the Federated States of Micronesia National Government)

Schedule of Findings and Responses

December 31, 2023

Finding No.: 2023-001
Area: Interest Income on Loans Receivable

Criteria: Interest income should be recognized based on actual loan terms and repayment histories of loans. Errors caused by the systematic issues need to be investigated by management and corrected in the loan subsidiary ledger and the general ledger.

Condition: The loan system does not accurately reflect past due dates of certain active loans beyond maturity dates due to systematic errors that have not been corrected. As a result, the Bank has to manually determine the proper past due dates for those loans but has not been able to perform such manual tracking and recalculations for all affected loans.

Cause: The cause of this condition is primarily due to systematic errors in the loan system which were not investigated or corrected. An implemented manual workaround is time consuming and as such, is not implemented for all affected loans.

Effect: The effect of this condition is the potential understatement of interest income and accrued interest receivable.

Recommendation: We recommend that the Bank determine the root cause of the systematic errors in the current loan system and establish formal procedures to review and manually correct interest income and accrued interest receivable manually for all loans, if such systematic errors cannot be corrected.

Auditee View of the Finding: Management agrees with the finding. Due to systematic errors, management purchased a new loan management system out of Manila in 2021, which was implemented in 2022. After migration of historical data and training of the new system in 2023, the bank ran parallel the old and new systems in October 2023 and finally began using the new loan management system in full on January 1, 2024.