

May 26, 2020

The Board of Directors
Federated States of Micronesia Development Bank

Dear Members of the Board of Directors:

We have performed audit of the financial statements of the Federated States of Micronesia Development Bank (the Bank) as of and for the year ended December 31, 2019, in accordance with auditing standards generally accepted in the United States of America ("generally accepted auditing standards") and have issued our reports thereon dated May 26, 2020.

We have prepared the following comments to assist you in fulfilling your obligation to oversee the financial reporting and disclosure process for which management of the Bank is responsible.

This report is intended solely for the information and use of the Board of Directors, management, and others within the Bank and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Deloitte & Touche LLP

cc: The Management of Federated States of Micronesia Development Bank

OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS AND GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS

Our responsibility under auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, have been described in our engagement letter dated October 7, 2019. As described in that letter, the objective of a financial statement audit conducted in accordance with the aforementioned standards is:

- To express an opinion on whether the statement of net position of the Bank as of December 31, 2019 and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended (the "financial statements"), are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") and perform specified procedures on the required supplementary information for the year ended December 31, 2019; and
- To report on the Bank's internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended December 31, 2019 based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*.

Our responsibilities under generally accepted auditing standards and generally accepted government auditing standards include forming and expressing an opinion about whether the financial statements that have been prepared with the oversight of management and the Board of Directors are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The audit of the financial statements does not relieve management or the Board of Directors of their responsibilities.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether caused by fraud or error. In making those risk assessments, we considered internal control over financial reporting relevant to the Bank's preparation and fair presentation of the financial statements in order to design audit procedures that were appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control over financial reporting. Our consideration of internal control over financial reporting was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

MANAGEMENT JUDGMENTS AND ACCOUNTING ESTIMATES

Accounting estimates are an integral part of the financial statements prepared with the oversight of management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the Bank's 2019 financial statements include management's estimate of the allowance for loan losses, which is determined by management based upon periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect individual borrowers' ability to repay and estimated value of any underlying collateral. During the year ended December 31, 2019, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

CORRECTED MISSTATEMENTS

Our audit of the financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Included in Attachment I as Appendix A, is a summary of corrected misstatements which were brought to the attention of management as a result of our audit procedures and were corrected by management during the current period.

SIGNIFICANT ACCOUNTING POLICIES

During the year ended December 31, 2019, the Bank implemented the following pronouncements:

- GASB 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.
- GASB Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments.
- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements.
- GASB Statement No. 90, *Majority Equity Interests - an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units.

The implementation of these statements did not have a material effect on the accompanying financial statements, except for GASB Statement No. 84, which resulted in a change in presentation of IDF and YDLF fiduciary trust fund financial statements as supplementary information; and GASB Statement No. 88, which resulted in additional disclosures.

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.

SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*, which clarifies the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. The provisions in Statement No. 91 are effective for fiscal years beginning after December 15, 2020. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 84, 89, 90 and 91 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. Management has yet to ascertain whether implementation of statement no's. 87, 89 and 91 will be postponed as provided in GASB Statement No. 95.

OTHER INFORMATION IN THE ANNUAL REPORTS

When audited financial statements are included in documents containing other information such as the Bank's 2019 Annual Report, we will read such other information and consider whether it, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements audited by us. We will read the other information in the Bank's 2019 Annual Report and will inquire as to the methods of measurement and presentation of such information. If we note a material inconsistency or if we obtain any knowledge of a material misstatement of fact in the other information, we will discuss this matter with management and, if appropriate, with the Board of Directors.

DISAGREEMENTS WITH MANAGEMENT

We have not had any disagreements with management related to matters that are material to the Bank's 2019 financial statements.

OUR VIEWS ABOUT SIGNIFICANT MATTERS THAT WERE THE SUBJECT OF CONSULTATION WITH OTHER ACCOUNTANTS

We are not aware of any consultations that management may have had with other accountants about auditing and accounting matters during 2019.

SIGNIFICANT FINDINGS OR ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT PRIOR TO OUR RETENTION

Throughout the year, routine discussions were held, or were the subject of correspondence, with management regarding the application of accounting principles or auditing standards in connection with transactions that have occurred, transactions that are contemplated, or reassessment of current circumstances. In our judgment, such discussions or correspondence, were not held in connection with our retention as auditors.

OTHER SIGNIFICANT FINDINGS OR ISSUES ARISING FROM THE AUDIT DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT

Throughout the year, routine discussions were held, or were the subject of correspondence, with management. In our judgment, such discussions or correspondence did not involve significant findings or issues requiring communication to the Board of Directors.

SIGNIFICANT DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

In our judgment, we received the full cooperation of the Bank's management and staff and had unrestricted access to the Bank's senior management in the performance of our audit.

MANAGEMENT'S REPRESENTATIONS

We have made specific inquiries of the Bank's management about the representations embodied in the financial statements. Additionally, we have requested that management provide to us the written representations the Bank is required to provide to its independent auditors under generally accepted auditing standards. We have attached to this letter, as Attachment I, a copy of the representation letter we obtained from management.

EMPHASIS OF MATTERS

As discussed in Note 1 to the financial statements, 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.

As discussed in Note 8 to the financial statements, the Bank is not in compliance with certain loan covenants. Our opinion is not modified with respect to this matter.

CONTROL-RELATED MATTERS

We have issued a separate report to you, dated May 26, 2020, on the Bank's internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, which was based upon the audit performed in accordance with *Government Auditing Standards*. We have communicated to management, in a separate letter also dated May 26, 2020, other matters that we identified during our audit.



**FEDERATED STATES OF MICRONESIA
DEVELOPMENT BANK**

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May 26, 2020

Deloitte & Touche LLP
361 South Marine Corps Drive
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We are providing this letter in connection with your audits of the statements of net position of the Federated States of Micronesia Development Bank (the "Bank"), a component unit of the FSM National Government, as of December 31, 2019 and 2018, 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, for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the Bank in conformity with accounting principles generally accepted in the United States of America (GAAP).

We confirm that we are responsible for the following:

- a. The preparation and fair presentation in the financial statements of financial position of the Bank in conformity with GAAP.
- b. 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
 - To prevent and detect fraud.
- c. The review and approval of the financial statements and related notes and acknowledge your role in the preparation of this information. Specifically, we acknowledge that your role in the preparation of the financial statements was a matter of convenience rather than one of necessity. We have reviewed the financial statement preparation assistance provided by you and acknowledge that the financial statements are prepared in accordance with GAAP. Our review was based on the use of the financial statement disclosure checklist for stand-alone business-type activities obtained from the Government Finance Officers Association. Additionally, we agreed with the adjusting and reclassification entries included in Appendix A.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

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We confirm, to the best of our knowledge and belief, the following representations made to you during your audits.

1. The financial statements referred to above are fairly presented in conformity with GAAP. In addition:
 - a. Net position components (net investment in capital assets; restricted; and unrestricted) are properly classified and, if applicable, approved.
 - b. Deposits and investments securities are properly classified in the category of custodial credit risk.
 - c. Capital assets, including infrastructure assets, are properly capitalized, reported, and, if applicable, depreciated.
 - d. Required supplementary information is measured and presented within prescribed guidelines.
 - e. Revenues and expenses are appropriately classified in the statements of revenues, expenses and changes in net position within operating revenues, non-operating revenues and expenses.
 - f. Interfund, internal, and intra-entity activity and balances have been appropriately classified and reported.
2. The Bank has provided to you all relevant information and access as agreed in the terms of the audit engagement letter.
3. The Bank has made available to you:
 - a. All minutes of the meetings of the Board of Directors or summaries of actions of recent meetings for which minutes have not yet been prepared. Specifically, the following meetings from January 1, 2019 to the date of this letter, have been provided to you:
 - January 28, 2019
 - April 24-25, 2019
 - July 24-25, 2019
 - June 6, 2019
 - June 21, 2019
 - October 30-31, 2019
 - January 27, 2020
 - March 17, 2020
 - March 30, 2020
 - April 22-23, 2020
 - b. All financial records and related data for all financial transactions of the Bank and for all funds administered by the Bank. The records, books, and accounts, as provided to you, record the financial and fiscal operations of all funds administered by the Bank and provide the audit trail to be used in a review of accountability. Information presented in financial reports is supported by the books and records from which the financial statements have

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been prepared.

- c. Contracts and grant agreements (including amendments, if any) and any other correspondence that has taken place with federal agencies.
4. There has been no:
 - a. Action taken by the Bank's management that contravenes the provisions of federal laws and FSM laws and regulations, or of contracts and grants applicable to the Bank and to all funds administered by the Bank. Specifically, the Bank is authorized to undertake loan administrative actions including collections and charge-offs of IDF loans.
 - b. Communications with other regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices or other matters that could have a material effect on the financial statements of the Bank and of the Funds.
 5. The Bank has not performed a formal risk assessment, including the assessment of the risk that the financial statements may be materially misstated as a result of fraud. However, management has made available to you their understanding about the risks of fraud in the Bank and do not believe that the financial statements are materially misstated as a result of fraud.
 6. We have no knowledge of any fraud or suspected fraud affecting the Bank involving:
 - a. Management.
 - b. Employees who have significant roles in internal control over financial reporting.
 - c. Others, where the fraud could have a material effect on the financial statements.
 7. We have no knowledge of any allegations of fraud or suspected fraud affecting the Bank's financial statements communicated by employees, former employees, analysts, regulators, or others.
 8. There are no unasserted claims or assessments that we are aware of or that legal counsel has advised us are probable of assertion and must be disclosed in accordance with GASB Codification of Governmental Accounting and Financial Reporting Standards ("GASB Codification") Section C50, *Claims and Judgments*.
 9. Significant assumptions used by us in making accounting estimates are reasonable.
 10. We are responsible for the compliance with local, state, and federal laws, rules and regulations, and provisions of grants and contracts relating to the Bank's operations. We are responsible for establishing and maintaining the components of internal control relating to our activities in order to achieve the objectives of providing reliable reports, effective and efficient operations, and compliance with laws and regulations. The Bank is responsible for maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.
 11. Management has identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts.

Except where otherwise stated below, immaterial matters less than \$123,000 collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to, or disclosure in, the basic financial statements.

12. There are no transactions that have not been properly recorded and reflected in the financial statements.
13. The Bank has no plans or intentions that may affect the carrying value or classification of assets and liabilities.
14. Regarding related parties:
 - a. We have disclosed to you the identity of the Bank's related parties and all the related-party relationships and transactions of which we are aware.
 - b. To the extent applicable, related parties and all the related-party relationships and transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral) have been appropriately identified, properly accounted for, and disclosed in the financial statements.
15. To the extent applicable, guarantees have been appropriately identified, properly recorded and disclosed in the financial statements, whether written or oral, under which the Bank is contingently liable. 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, 2019 and 2018.
16. In preparing the financial statements in conformity with GAAP, management uses estimates. All estimates have been disclosed in the financial statements for which known information available prior to the issuance of the financial statements indicates that both of the following criteria are met:
 - a. It is reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events
 - b. The effect of the change would be material to the financial statements.
17. There are no:
 - a. Instances of identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing the financial statements
 - b. Known actual or possible litigation and claims whose effects should be considered when preparing the financial statements that have not been disclosed to you and accounted for and disclosed in accordance with GAAP
 - c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by GASB Codification Section C50, *Claims and Judgments*.

18. The Bank has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral, except as disclosed in the financial statements.
19. At December 31, 2019, the Bank is not in compliance with the ratios of nonperforming loans to total loans and provision for loan losses to nonperforming loans requirements in the August 2010 Finance Contract with the European Investment Bank (the EIB Finance Contract). The Bank will be working with the EIB to obtain a waiver.
20. No department or agency of the Bank has reported a material instance of noncompliance to us.
21. There were no control deficiencies in the design or operation of internal control over financial reporting that could adversely affect the Bank's ability to initiate, record, process and report financial information.
22. No evidence of fraud, possible irregularities, or dishonesty in fiscal operations of programs administered by the Bank has been discovered.
23. Regarding required supplementary information:
 - a. We confirm that we are responsible for the required supplementary information.
 - b. The required supplementary information is measured and presented in accordance with GASB Codification Section 2200, *Comprehensive Annual Financial Report*.
 - c. The methods of measurement and presentation of the supplementary information have not changed from those used in the prior period, except for the supplementary information relating to trust fund financial statements, due to the implementation of GASB Statement 84.
24. Regarding supplementary information:
 - a. We are responsible for the fair presentation of the supplementary information in accordance with GAAP and the EIB Finance Contract.
 - b. We believe the supplementary information, including its form and content, is fairly presented in accordance with GAAP and the EIB Finance Contract.
 - c. The method of measurement and presentation of the supplementary information has not changed from those used in the prior period.
25. With regard to the fair value measurements and disclosures of certain assets, we believe that:
 - a. The measurement methods, including the related assumptions, used in determining fair value were appropriate and were consistently applied in accordance with GAAP.
 - b. The completeness and adequacy of the disclosures related to fair values are in conformity with GAAP.

26. During the year ended December 31, 2019, the Bank implemented the following pronouncements:
- GASB 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.
 - GASB Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments.
 - GASB Statement No. 88, *Certain Disclosures Related to Debt*, including Direct Borrowings and Direct Placements, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements.
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The implementation of these statements did not have a material effect on the accompanying financial statements, except for GASB Statement No. 84, which resulted in a change in presentation of IDF and YDLF fiduciary trust fund financial statements as supplementary information; and GASB Statement No. 88, which resulted in additional disclosures.

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In May 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 84, 89, 90 and 91 by one year and GASB Statement No. 87 by 18 months; however, earlier application

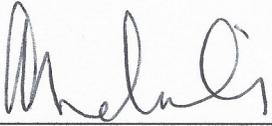
of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. Management has yet to ascertain whether implementation of Statement No's 87, 89 and 91 will be postponed as provided in GASB Statement No. 95.

27. Financial instruments with significant individual or group concentration of credit risk have been appropriately identified, properly recorded, and disclosed in the financial statements.
28. Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.
29. The Bank is responsible for determining and maintaining the adequacy of the allowance for doubtful notes, loans, interfund receivables and accounts receivable, as well as estimates used to determine such amounts for the Bank's and the Funds' financial statements. Management believes the allowances are adequate to absorb estimated bad debts in account balances.
30. We believe that all expenditures that have been deferred to future periods are recoverable.
31. The Bank's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees receive from the FSM Social Security System. The Plan is a contributory plan in which the Bank matches 100% of the participants' contributions up to a maximum of 10 percent of the participant's annual salary, if the participant contributes 3 or more percent from his or her annual salary. Employee participation is optional. The Bank's Chief Financial Officer is the designated Plan Administrator. Matching contributions to the Plan during the years ended December 31, 2019 and 2018 were \$66,547 and \$65,239, respectively. Total Plan assets as of December 31, 2019 and 2018 were \$1,353,674 and \$1,140,152, respectively. Management is of the opinion that the Plan does not represent an asset or a liability of the Bank.
32. The Bank has obligated, expended, received and used public funds in accordance with the purpose for which such funds have been appropriated or otherwise authorized by FSM law. Such obligation, expenditure, receipt or use of public funds was in accordance with any limitations, conditions, or mandatory directions imposed by FSM law.
33. The Allowance at December 31, 2019 was estimated based on a range of economic conditions as of that date. Since early January 2020, the coronavirus outbreak has spread across the world, causing disruption to business and economic activity in varying degrees in the FSM and Saipan. The impact on qualitative indicators of the economic environment and an evaluation of individual borrowers' repayment ability will be considered in 2020 when determining the Allowance.
34. Other than the matters noted in the footnote 12, no events have occurred after December 31, 2019, but before May 26, 2020, the date the financial statements were available to be issued that require consideration as adjustments to or disclosures in the financial statements.

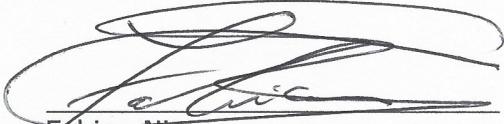
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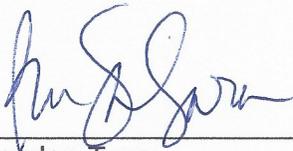
Very truly yours,



Anna Mendiola
President/CEO



Fabian Nimea
SVP/COO



Brandon Tara
Chief Financial Officer

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APPENDIX A

Corrected Misstatements:

Audit Adjustments

#	Name	Debit	Credit
1 AJE To correct value of investment in BFSM stocks.			
10120-001	Investment - BOFSM	545,750	
60100-001	Income/Loss from BFSM Stock - HQ		545,750
To correct value of investment in BFSM stocks accounted using equity method.			
2 AJE To correct investment income			
40500-001	Miscellaneous income - HQ	308,251	
60100-001	Income/Loss from BFSM Stock - HQ		308,251
To correct investment income previously recognized as miscellaneous.			
3 AJE To correct allowance for doubtful accounts – IDF			
10285-006	IDF Allowance for D/L - PSIDF	16,801	
DT4 (IDF TB)	Bad debt expense - IDF		16,801
To record recovery of loan losses – IDF books			
4 AJE To record additional allowance for Loan losses			
71800-001	Provision for D/L -HQ		20,416
71800-002	Provision for D/L -Kosrae	134,201	
71800-004	Provision for D/L -Chuuk		65,591
71800-005	Provision for D/L -Yap	216,504	
10250-001	Allowance for D/L -HQ	20,416	
10250-002	Allowance for D/L -Kosrae		134,201
10250-004	Allowance for D/L - Chuuk	65,591	
10250-005	Bad debt expense - Yap		216,504
To record allowance for loan losses as of December 31, 2019.			
5 AJE To record unreleased check as of December 31, 2019			
10001-001	Cash Escrow (BFSM)	56,034	
10225-001	Undisbursed loans - HQ		56,034
To record unreleased check as of 12/31/2019			

Financial Statement Reclassifications

#	Name	Debit	Credit
1 RJE Investment reclassified into CDs			
DT2 10116-001	TCD – Investment reclass Investments – FSMDB (Abroad)	3,105,219	3,105,219
To record reclassification of TCDs in investment account.			
2 RJE Investment reclassified into cash			
DT1 DT6	Cash & cash equipment – investment reclass Investments – FSMDB (Abroad)	413,240	413,240
To record reclassification of cash in investment account.			
3 RJE To record undisbursed loans			
10200-005 10225-005	Loan receivable - Yap Undisbursed loans - Yap	46,000	46,000
To reclass misposting of loans receivables			