



OFFICE OF THE FSM PUBLIC AUDITOR

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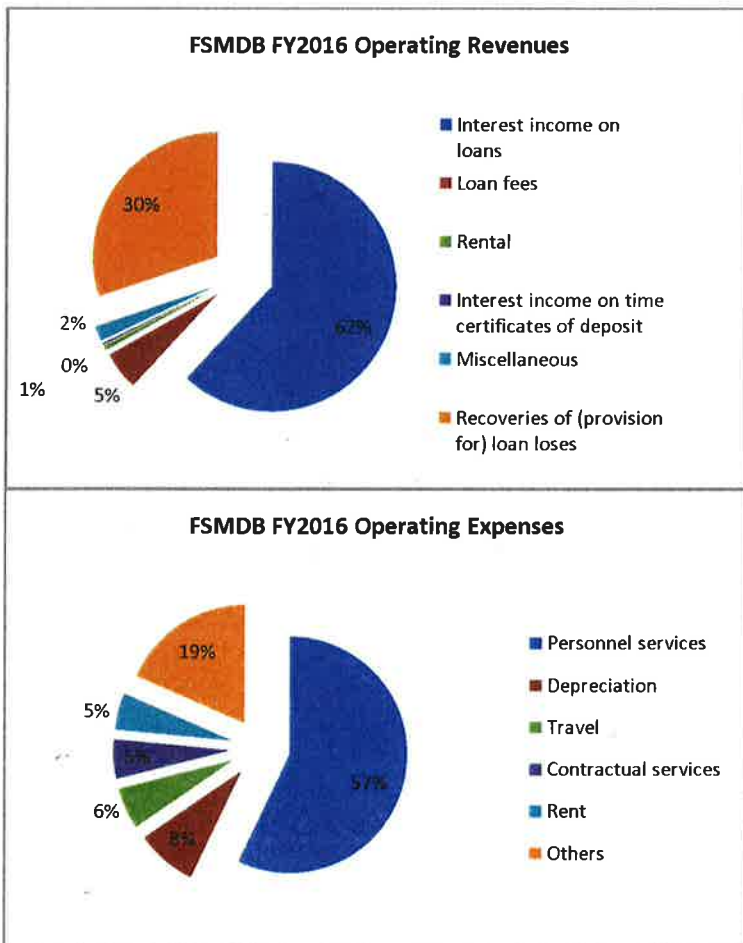
Annual Financial Audit on the FSM Development Bank for Fiscal Year 2016

The Office of the National Public Auditor (ONPA) announces the release of the financial audit on the FSM Development Bank for the fiscal year ended September 30, 2016. This is a part of the Single Audits for the FSM Government, which is outsourced to Deloitte & Touche under the oversight of the ONPA. A digital copy of the audit is available for public review online at www.fsmopa.fm and printed copies are available at the ONPA in Palikir, Pohnpei.

Background

The Federated States of Micronesia Development Bank (FSMDB), a component unit of the FSM National Government was established by the 1st Congress of the Federated States of Micronesia in 1979. Its operation began on October 1, 1980, but lending did not start until 1982. In 1994, the enabling law that created the bank was amended to reorganize the structure of the bank to reflect that of a normal corporation with shareholders. The bank's current shareholders are the FSM National, Chuuk State and Kosrae State governments.

Financial Results



The Bank in 2016 approved \$22.8 million for 463 loans. Business loans represented 87% consumer loans at 11% and the remaining 2% for residential loans. The loans portfolio at year end stood at \$28.4 million; loans to the tourism sector constituted 23% followed by wholesale/retail sector at 17%, real estate development sector at 12% and agriculture/fisheries sector at 5%. In terms of loan approvals for 2016, over 70% was approved for loans in the commercial, tourism, and agriculture/fisheries sectors. A total of \$13.5 million was undisbursed at year end. No contributions or subsidies from the government were received in 2016.

At the end of 2016, the Bank had \$1.6 million invested in capital assets. In 2016, the lone long-term liability the Bank has with the European Investment Bank (EIB) was reduced to \$1.2 million compared to \$1.3 million in 2015. Borrowed funds represent only 2.0% of total assets. Leverage is very low providing ample room for the bank to borrow funds for its lending activities should the need arise.

From operations, the Bank earned \$2,126,856, which represents a 537% increase comparing to last year's result of \$333,852. The Bank's return on equity remained positive and increased from 1.4% in 2015 to 6.1% in 2016. In 2016, the Bank's investments in

the financial markets earned a significant turn-around of 63% growth compared to 2015. The total ratio of non-performing loans to total assets at the end of 2016 approximated 6%. As of December 31, 2016, total loan loss provision for total non-performing loans (those defined as aggregate principal and interest are past due 90 days and above) was at 101%. Based on the loan classification policy and review of individual loans, the Bank is adequately reserved for loan losses.

The Bank manages two trust funds, namely, the Investment Development Fund (IDF) and the Yap Development Loan Fund (YDLF). The total assets for each of these funds at the end of 2016 were \$1,815,618 and \$286,686, respectively. Assets under IDF continue to decrease as all the States have withdrawn their funds from the State sub-accounts. The Bank stopped drawing management fees from the IDF in 2016. YDLF earned \$371 in 2016. Management had resubmitted a request to the FSM National Government to repeal the IDF law as only three loans remain active in the Private Sector sub-account and all loans in the State sub-accounts have defaulted and the projects are defunct.

Economic Outlook

Management anticipates the year 2017 to be better than 2016 in terms of economic activities. The Bank continues to seek out projects that are export oriented or import substituting. The Bank is also looking into helping the construction sector by providing real estate development loans and Surety bonds. The bank was able to start some Home Energy Loan Program (HELP) projects in 2016 to help promote energy efficient homes for lower recurring electricity costs and hopes that this program grows going forward.

In line with the Banks' strategic plans and goals, the Bank's Business Development Office along with the Development Finance Training Institute, the Bank anticipates to be more proactive in developing ideas into viable business proposals and providing entrepreneurial training to help improve the management of successful businesses in the FSM. The Bank is also working on its accreditation to access the Green Climate Fund (GCF) to provide projects to help climate change adaptation and mitigation.

The following table summarizes the net position and results of the Bank for FY2016, FY2015 and FY2014.

	FY2016	FY2015 (As Restated)	FY2014 (As Restated)
Assets:			
Current assets	\$15,373,227	\$15,822,373	\$13,887,315
Noncurrent assets	40,547,568	36,791,039	38,307,488
Total Assets	\$55,920,795	\$52,613,412	\$52,194,803
Liabilities and Net Position:			
Liabilities	\$1,615,233	\$1,627,103	\$1,981,559
Net position:			
Net investment in capital assets	1,624,211	1,633,285	1,657,506
Unrestricted	52,681,351	49,353,024	48,555,738
Total net position	54,305,562	50,986,309	50,213,244
Total liabilities and net position	\$55,920,795	\$52,613,412	\$52,194,803
Revenues, Expenses and Changes in Net Position			
Operating revenues	\$2,736,600	\$2,460,513	\$2,545,945
Reversal of (provision for) loan losses	1,179,871	(286,209)	(72,962)
Operating expenses	(1,789,615)	(1,840,452)	(1,792,313)
Earnings from operations	2,126,856	333,852	680,670
Non-operating revenues, net	1,192,397	439,213	998,783
Change in net position	3,319,253	773,065	1,679,453
Net position at beginning of year	50,986,309	50,213,244	48,533,791
Net position at end of year	\$54,305,562	\$50,986,309	\$50,213,244

Audit Findings and Opinion

Findings: There are no unresolved prior audit findings as of December 31, 2016.

Opinion: The Bank received an **UNMODIFIED** opinion for its Single Audits as of December 31, 2016 and 2015. An unmodified opinion means that the entity's financial statements are fairly and appropriately presented, in all material respects, and in accordance with Generally Accepted Accounting Principles (GAAP).

Deficiencies in Internal Control

Deficiencies in internal control over financial reporting were identified during the course of the audit, which included the following:

1. Loan # D3F-4735, D4F-5114 and D4H-4736: Credit life insurance policy is required but has not been obtained from the borrower.
2. Loan # D4D-4902, D4E4596LC, D4F-5114, D4H-4736, D3D-4766 and D3E3649LS: Hazard/property insurance is required but has not been obtained from the borrower.
3. Loan # D4H-4736: Financial information has not been obtained from the borrower.

There were no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Board of Directors: John Sohl, Chairman; Peter Aten, Vice Chairman; Florian Yatilman, Member; Senny Phillip, Member; Alik Isaac, Member; Maria Laaw, Member; and Anna Mendiola, Member/Ex-Officio.

Management: Ms. Anna Mendiola, CEO/President; Alik Alik, Senior Vice President/Chief Operation Officer; Fabian Nimea, Senior Vice President/Business Development Officer; Brandon Tara, Chief Financial Officer.

The Single Audit for the Bank as of December 31, 2016 and 2015 was conducted by Deloitte & Touche under a contract awarded by the Office of the National Public Auditor. This is a required audit as the Bank is a component unit of the FSM National Government. The CPA firm and the Bank have completed annual audit months before the June 30, 2017 deadline.

For a more detailed discussion and analysis of the Single Audit Report for the Bank, please refer to the full audit report, attached. Soft copies can be accessed by visiting our office website at www.fsmopa.fm.

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