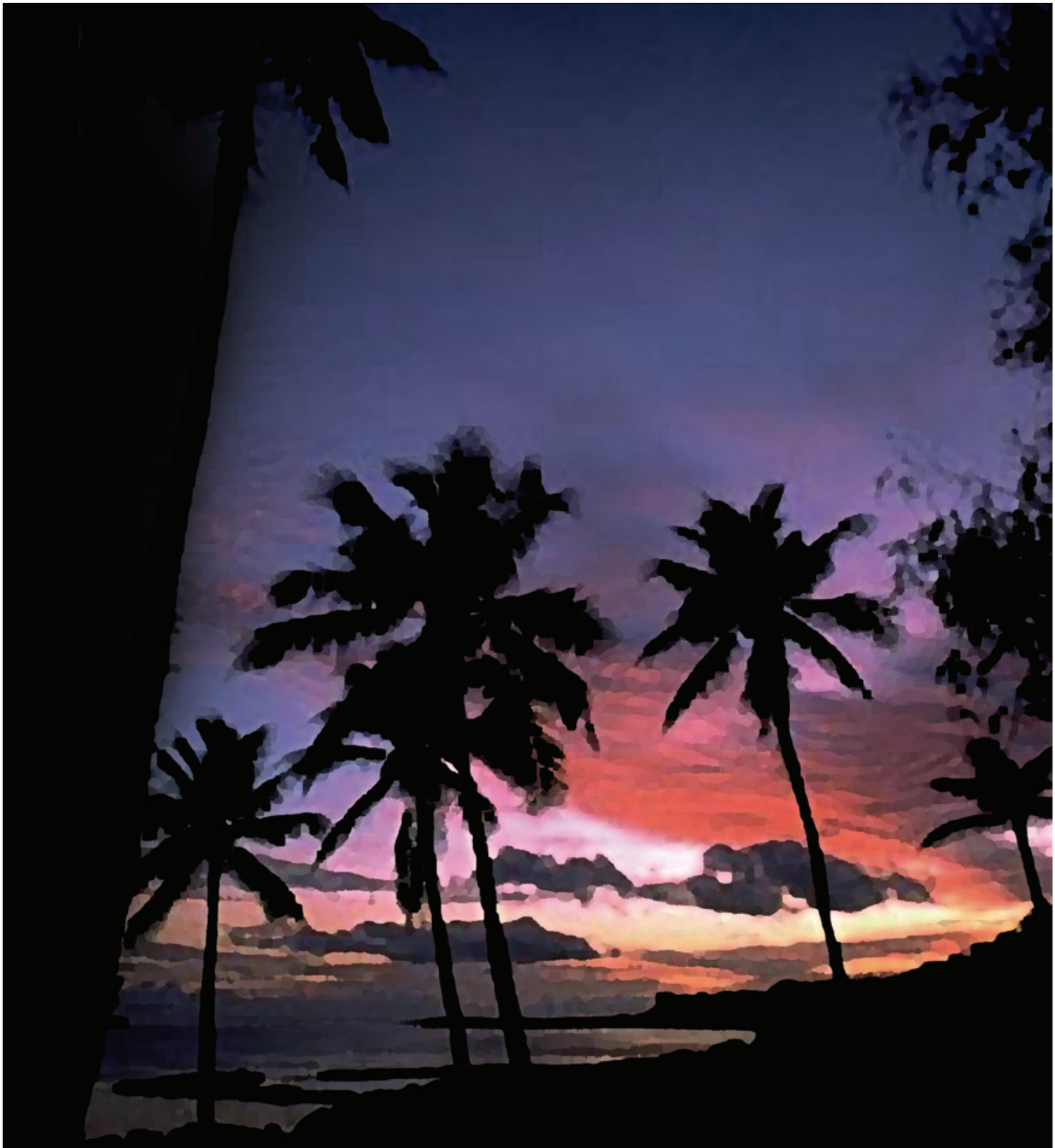


FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

ANNUAL REPORT 2004

BOARD of DIRECTORS

Chairman
Ihlen Joseph

Vice-Chairman
Nakam Sana

Member
Hilary Tacheliol

Member
Ramon Falcam

Member
Reed Nena

Member
John Sohl

Ex-Officio Member
President & Chief Executive Officer
Anna Mendiola

VISION

To strengthen our human

And financial resources

And become a strong

And effective development financing institution

In the Federated States of Micronesia.

OBJECTIVE

To achieve break-even in our operations

And make some profit

To become a viable and self-sustaining financial institution

MISSION

To remain a key development financing institution

In supporting the economy

Of the Federated States of Micronesia.

Our emphasis is in providing loan finance

For development projects in the private sector.

TABLE OF CONTENTS

INTRODUCTION

Letter to Shareholders 6

THE BANK AND ITS OPERATION

Organizational Chart 7

Shareholders and Board of Directors 8

Federated States of Micronesia Development Bank 9

Management and Staff 10

Financial Highlights 11

Lending Operations 13

Administered Funds 18

Other Programs 20

Acknowledgements 21

FINANCIAL SECTION 23

AUDITED FINANCIAL STATEMENTS

STAFF LISTING & BANK'S ADDRESSES

LETTER TO SHAREHOLDERS

With the continued support and contributions, the bank posted a net profit of $821,149.00 for the year ending December 31, 2004. Overall expenses were satisfactorily controlled during the same period and were contained within the budget.

After a sluggish performance early in the year, the investment pool picked up momentum in the latter part of the year and yielded more than expected returns by year end 2004. The improved performance is partly attributable to a new investment policy that was adopted by the Board in 2004 which authorized Management to transfer the Business Development Loan Fund (BDLF) investment portfolio from Merrill Lynch to Smith Barney. At December 31, 2004, the market value of the BDLF stood at $10.2 million.

As of December 31, 2004, the Bank's financial position remained acceptable showing increased stockholder's equity, high liquidity and adequate capitalization.

Much of the lending activity during the year was focused in assisting existing borrowers restructure their loans. Many accounts were restructured to accommodate requests by borrowers to reduce monthly payments to more manageable debt servicing levels. This assistance was especially needed in the Yap portfolio due to typhoon Sudal that hit the island in April 2004. As a development bank, it is essential that we work out solutions for our problem clients rather than closing down their businesses.

Going forward, we anticipate 2005 to be another challenging year. The operational environment is faced with a stagnant economy coupled with the restrictions on the usage of the Compact II funds and the uncertainty of continued stockholder's financial contributions. Amidst these challenges, we remain committed to the Bank's mandate which is to stimulate economic development in the FSM by assisting private sector development through financing of new and existing business enterprises. Furthermore, we will continue to strive to be the dominant lending institution in the FSM that is technically excellent and efficient and highly responsive to needs of our borrowers.

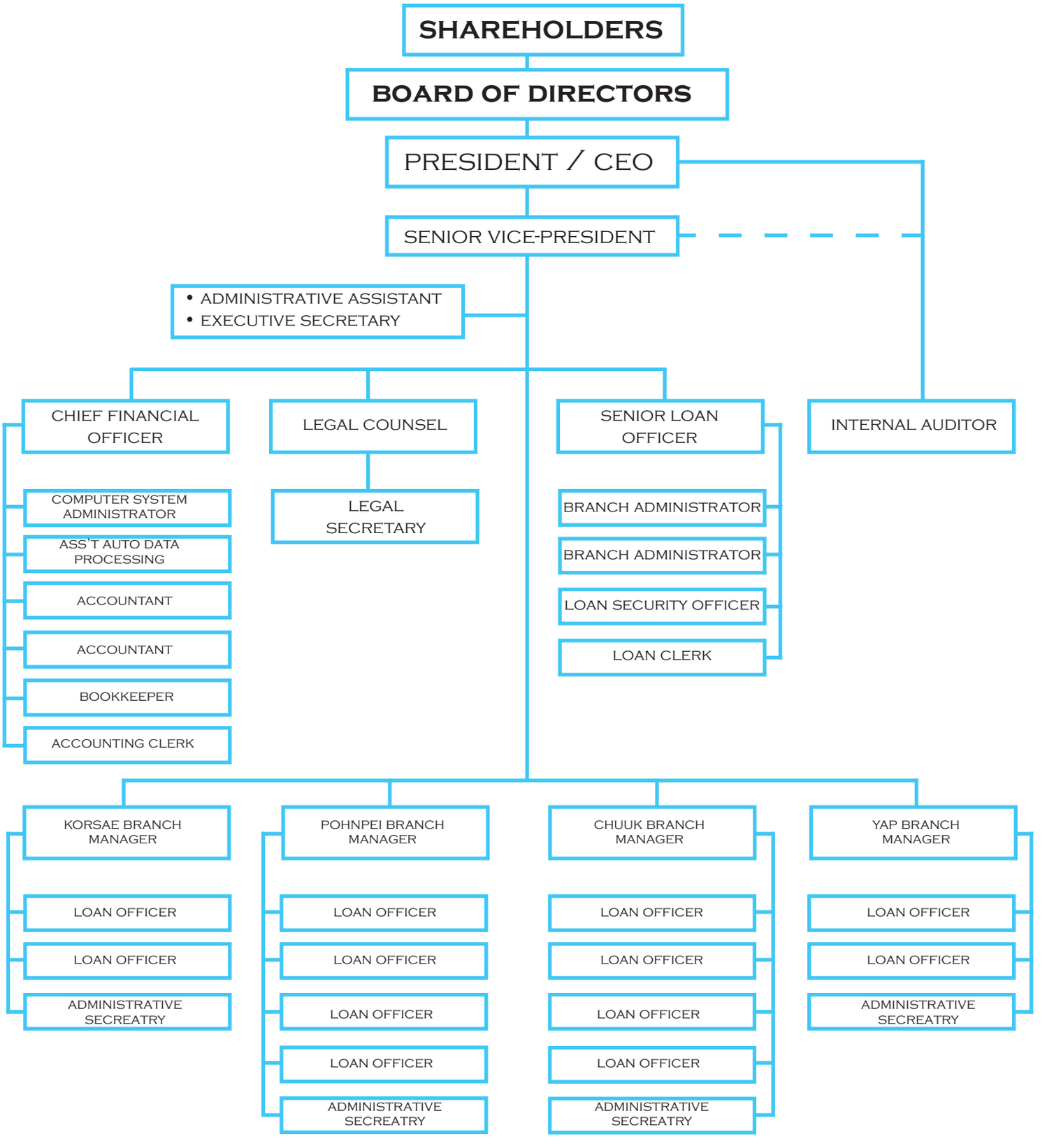
In closing, we wish to extend our deepest appreciation to our shareholders and the Board of Directors for the unwavering commitment and support to the Bank throughout the years. We further thank our employees for their hard work and perseverance. And finally we thank our customers for their continued loyalty and confidence in the FSMDB. We remain your partner in development.

Sincerely,

Anna Mendiola
President/CEO

Ihlen Joseph
Chairman

ORGANIZATIONAL CHART



SHAREHOLDER and THE BOARD OF DIRECTORS

The FSM National Government is the major shareholder of the FSMDB. It owns 98.7% of the outstanding shares. The states of Chuuk and Kosrae have some interest in the bank but minimal with 1% and 0.3% of the remaining shares respectively. As of this report, the states of Yap and Pohnpei do not have any shares in the Bank.

The Board of Directors comprised of seven (7) members. Six (6) members are selected by the shareholders. As a courtesy, all four (4) states have been and continue to be represented on the Board. Two (2) seats serve the interest of the FSM National Government. The seventh (7th) member is the Chief Executive Officer who serves as an Ex-Officio member of the Board. Board members serve a term of three years on a staggering basis.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

The Federated States of Micronesia Development Bank was created by law in 1979 as a component unit of the FSM National Government. It was later incorporated under the laws of the Federated States of Micronesia and began its lending program on October 1, 1980. It was later reorganized in 1994 by Public Law 8-47 to allow the Bank to engage in all banking functions to assist in the economic advancement of the Nation. The bank remains engaged in lending only. It currently does not accept deposit.

There are four (4) branch offices located in each of the four states (Pohnpei, Chuuk, Kosrae and Yap). The head office, also referred to as the Corporate Head Quarters, is located in Pohnpei, the Nation's capital.

MANAGEMENT STAFF

The FSMDB is managed by a management team comprised of a President/Chief Executive Officer, a Senior Vice President, a Chief Financial Officer and a Senior Loan Officer. Each branch office has a Branch Manager who oversees the day to day branch affairs. Altogether, FSMDB employed 35 people as of December 31, 2004.

Anna Mendiola
President / Chief Executive officer

Stevenson Joseph
Senior Vice President

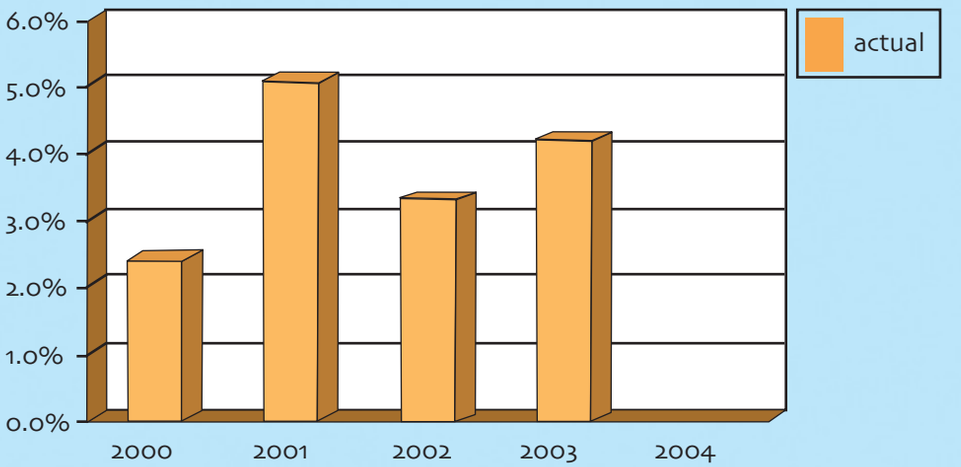
Sihna Lawrence
Chief Financial Officer

Peter Aldis
Senior Loan Officer

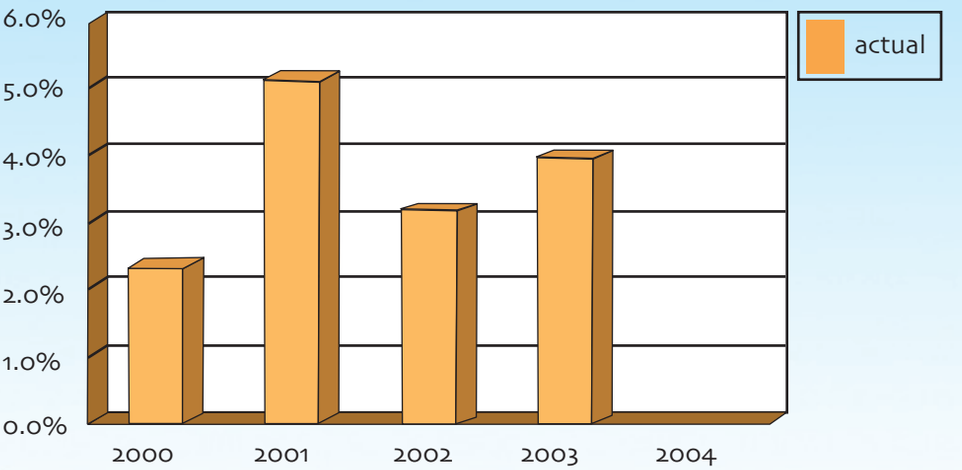
FINANCIAL HIGHLIGHTS

The Bank reported a net income of $821,149 for the year ending 2004, a slight drop from the $1.3 million reported last year, posting return on equity and return on assets of 2.6% and 2.5% respectively. The slight drop in net earnings was due to the slow performance of interest income in the regular loan portfolio coupled with a decline of $250,000 in the National Government's annual contributions.

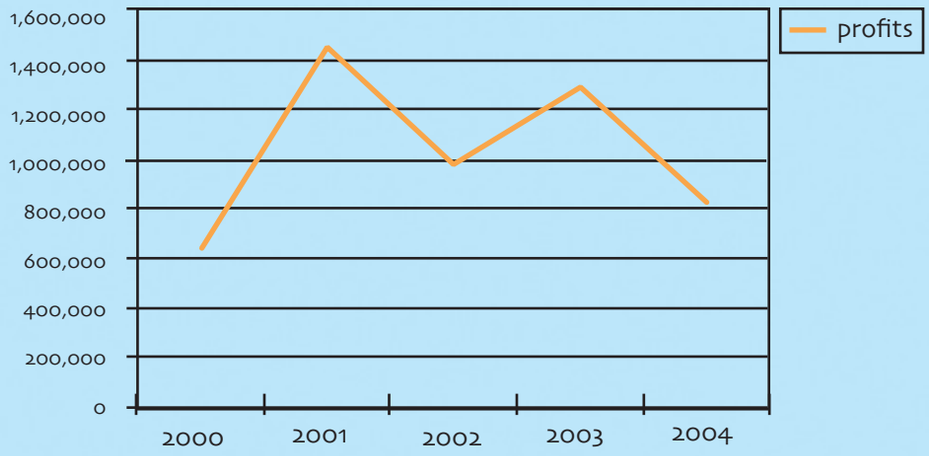
RETURN OF EQUITY 2000-2004



RETURN ON ASSETS 2000-2004

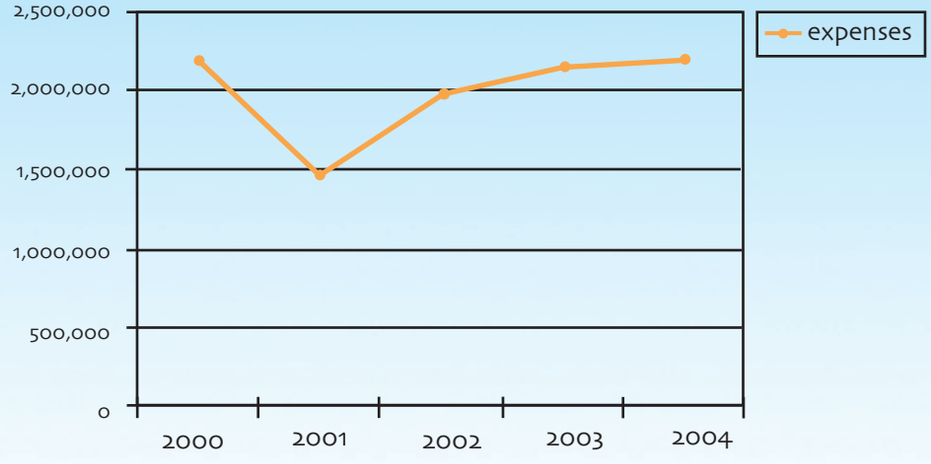


PROFITS 2000-2004



Expenses remained relatively stable and were satisfactorily controlled during the year. Loan provisioning remained high and is a major expense item for the bank along with wages and salaries. These two expense items alone accounted for more than 70% of the bank's 2004 total expenses. After an increase in 2002, the cost of running the bank on an annual basis appears to be tapering off at the $2.0 million mark. We will continue to monitor expenses and eliminate unnecessary costs to maximize the Bank's earning potential.

TOTAL EXPENDITURES 2000-2004



LENDING OPERATIONS

When the FSMDB was created, lending was focused in six main economic sectors: 1) Tourism, 2) Fisheries, 3) Agriculture, 4) Commercial, 5) Real-Estate and 6) Manufacturing. Since lending commenced in 1982, the bank has reviewed and approved a total of 1,645 loans valued at $110,646,876 as of December 31, 2004. The statistical breakdown in each sector and by branch is shown in the following table:

Number & Amount of Loans By Sector & Location (Current Year vs. The Overall)

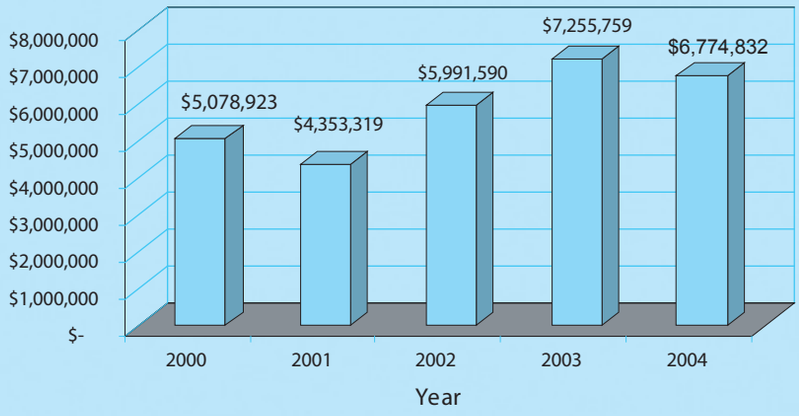
	Chuuk		Kosrae		Pohnpei		Yap		Total	
	1982-2004		1982-2004		1982-2004		1982-2004		1982-2004	
Sector	#	$	#	$	#	$	#	$	#	$
Agriculture	18	$383,257	173	$280,850	136	$1,674,647	7	$183,661	334	$2,522,415
Fisheries	61	$8,569,532	65	$238,670	138	$8,320,500	37	$9,761,921	301	$26,890,623
Manufacturing	145	$5,498,605	48	$1,247,333	55	$9,377,249	10	$552,284	258	$16,675,471
Real Estate	17	$1,918,567	8	$189,986	67	$5,470,589	8	$767,946	100	$8,347,088
Commercial	188	$7,123,681	70	$7,093,385	146	$9,419,211	67	$3,435,890	471	$27,072,167
Tourism	29	$9,329,611	31	$2,448,362	34	$6,418,469	23	$5,582,489	117	$23,778,931
Total	458	$32,823,253	395	$11,498,586	576	$40,680,665	152	$20,284,191	1581	$105,286,695

65 loans were approved in 2004 worth $6.8 million. The commercial and tourism sectors contributed the most loans with $3.2 and $3.4 million respectively. It should be noted that $1.4 million in tourism was a transfer from the direct portfolio into the IDF private reserve sub-account.

Table No. 1 - Loan Approval in 2003 and 2004

	2003		2004	
Sector	#	$	#	$
Agriculture	5	11750	3	30126
Fisheries	34	773983	11	48087
Manufacturing	18	133807	2	17800
Real Estate	1	40000	3	162121
Commercial	48	6152562	42	3159435
Tourism	1	143657	4	1942613
Total	107	7255759	65	5360182

LOAN APPROVAL TREND



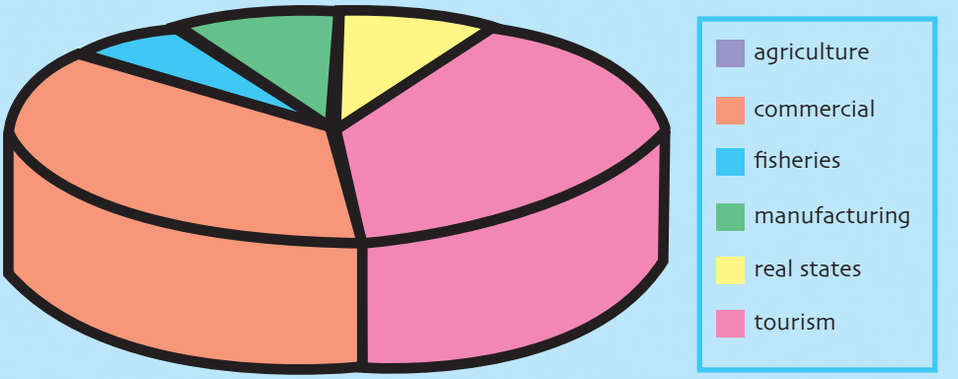
At year end 12/31/04 the gross outstanding loan balance registered at $21.5 million. The following table and chart depicts the make-up of the total outstanding loan balance.

ACTIVE LOAN PORTFOLIO BY SECTOR

As of December 31, 2004

Sector	Outstanding Balance	% of Oustanding Balance
Agriculture	$39,962	0.2%
Commercial	$8,013,408	37.2%
Fisheries	$1,404,067	6.5%
Manufacturing	$1,712,790	8.0%
Real Estate	$1,743,322	8.1%
Tourism	$8,614,926	40.0%
Gross outstanding loan receivables	$21,528,475	100%
Less: Provisions for doubtful loans	($5,124,655)	
Net outstanding loan receivable	$16,403,820	
Add: Staff Loan Program	$147,956	
Net loan receivable, 12/31/2002	$16,551,776	

ACTIVE LOAN PORTFOLIO BY SECTOR AS OF 12/31/04

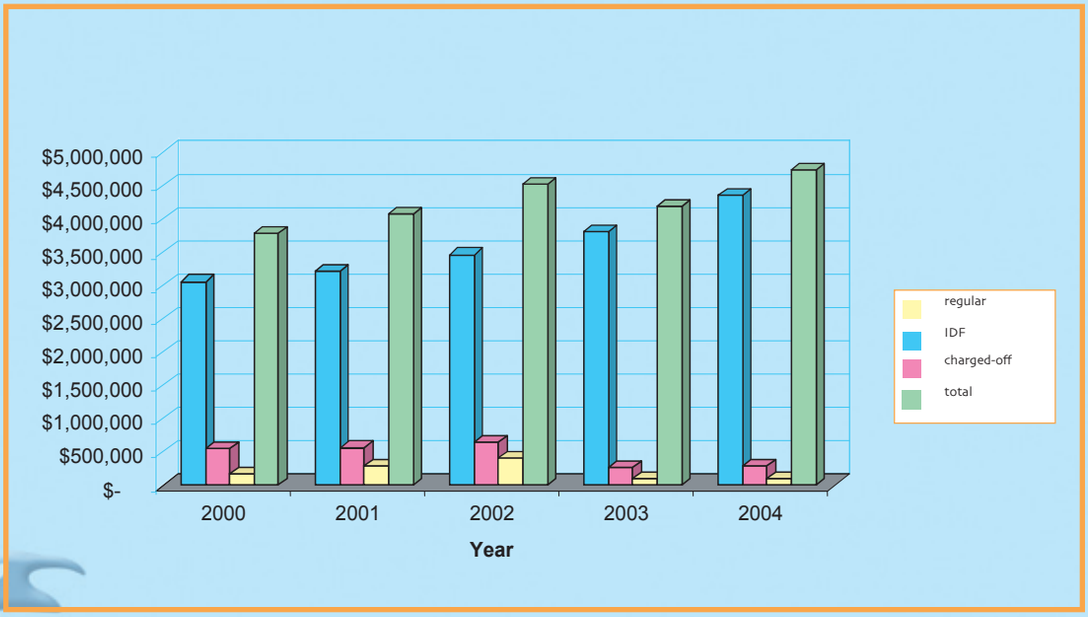


Since 2000, the annual collection from loan repayment has been steadily increasing as depicted in the following table and chart. We expect to maintain the trend in forthcoming years as we beef up our collection on the Charge-Off accounts.

LOAN REPAYMENT

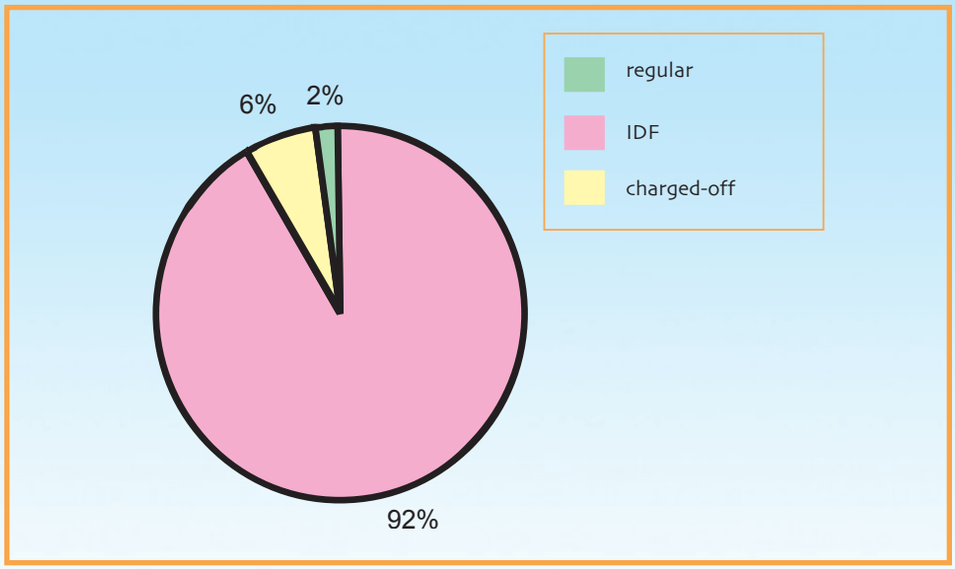
	2000	2001	2002	2003	2004
REGULAR	$3,056,676	$3,218,310	$3,459,834	$3,802,373	$4,343,901
IDF	$566,563	$508,093	$642,129	$272,778	$296,892
CHARGED-OFF	$172,955	$287,833	$406,730	$107,163	$96,773
TOTAL	$3,786,194	$4,074,236	$4,508,693	$4,182,314	$4,737,566

LOAN REPAYMENT TREND



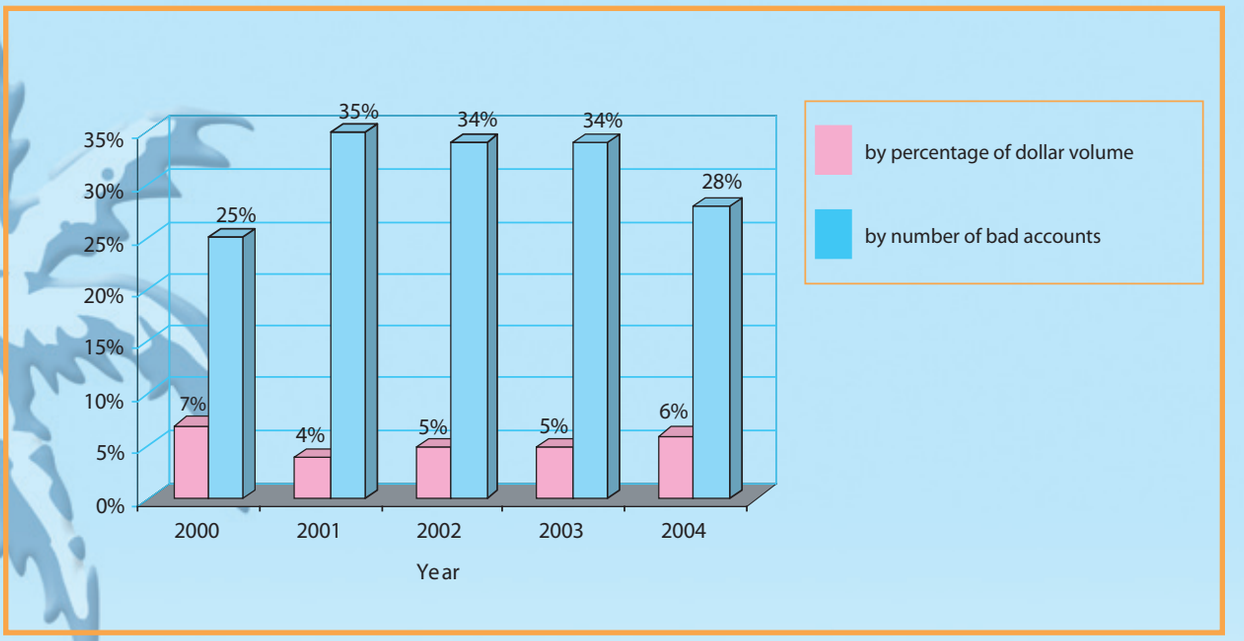
We collected $4.7 million in loan repayment in 2004. 92% of the total collection was in the regular portfolio while 6% and 2% were in the IDF and Charge-Off accounts respectively.

2004 LOAN REPAYMENT



The loan delinquency for the direct loan portfolio is reported by the dollar volume in arrears over the balance of the portfolio and by the number of accounts in arrears over the total number of active loan accounts. The former remained acceptable ending the year with a 6% default ratio well within the 10% target for the year. The latter improved from 34% at year end 2003 to 28% at year end 2004. However, it exceeded the 20% target for the year. At year end 2004 the portfolio risk was registered at 28% default ratio.

LOAN DELINQUENCY TREND



Loan loss provisioning remained quite high ending the year with an accumulated total of approximately $5.1 million. There is some consideration to withhold provisioning in the forthcoming years as the current level is believed to be more than sufficient to absorb future potential loan losses.

ADMINISTERED FUNDS

The Bank administers in trust three non-propriety type funds. They are 1) the Investment Development Fund (IDF), 2) the Pohnpei Loan Development Fund (PDLF) and 3) the Yap Loan Development Fund (YDLF).

The IDF was a special fund established in first Compact agreement between the United States and the FSM. Its primary objective was to finance large-scale development projects through joint ventures between FSM citizens and interested U.S. investors. The fund was pledged $60 million but only $20 million was availed. The $20 million was allocated and divided into five sub accounts. Four sub accounts were established for each of the FSM State and one in a private reserve sub account as follows:

Table No. 4 - IDF Funds Allocation

Chuuk State Sub-Account	$3,000,000
Kosrae State Sub-Account	$2,000,000
Pohnpei State Sub-Account	$3,000,000
Yap State Sub-Account	$2,000,000
Private Reserve Sub-Account	$10,000,000
Total	$20,000,000

Loan decisions on the state sub-accounts rests with a body called the Federal Development Authority (FDA) made up of the executives of the five governments – the President of the FSM and the Governors of the four states. FSMDB's role aside as the custodian of the funds, is limited to reviewing project proposals and presenting its findings to the FDA for final decision. However, the FSMDB maintains approval authority on the Private Reserve sub-account.

The IDF fund balances as of December 31, 2004 are presented in the following table:

Investment Development Fund Sub-Account Balances
As of December 31, 2004

Sub-Account	% Original Amount	Original Amount	Loan Interest Payment	Principal Payment	Budgeted Expenses	Fund Balance $	Fund Balance %
Chuuk State Sub-Acount	14%	2,471,497	237,288	129,211			
Kosrae State Sub-Account	7%	1,219,740	201,695	291,831		115,524	2%
Pohnpei State Sub-Account	14%	2,500,000	128,846	48,628		4,653,182	89%
Yap State Sub-Account	11%	2,000,000	5,149	5,800		380,777	7%
Private Reserve Sub-Account	55%	10,000,000	2,398,733	2,020,706	2,777,500	57,934	1%
Total	100%	18,191,237	2,971,711	2,496,176	2,777,500	5,213,249	100%

The PDLF and the YDLF are administered by the bank in trust. All loan decisions are made by the executives of the respective state governments.

OTHER PROGRAMS

Training - Acknowledging the fact that its human resources are the most valuable resource, continued training of its employees is imperative. We will continue to improve our ability to service the people of the FSM by taking advantage of training opportunities through our associations with various regional organizations and training institutions. In 2004, we availed the Board of Directors a seminar in Board Governance and Financial Management. Additionally, our loan officers were also given an opportunity to sharpen their skills with a two-week training seminar in Basic and Advanced Credit Analysis.

Community Services – Investing back into the community has always been and will continue to be a primary objective for the bank, whether through its lending program or sponsorships and contributions to civic activities such as sports, government sponsored functions and conferences, community programs and so forth.

Scholarship Program - the bank offers scholarships to students pursuing graduate degrees in business, economics, accounting or any related fields. To date the bank has contributed to more than a dozen students. Some of them have completed their studies and have come back to work in the FSM while some remain living abroad. There was no scholarship granted in 2004.

Loan Guaranty Program – the bank has a loan guaranty program which it extends to the commercial banks in which it guarantees loans made through the commercial banks up to 90% of the loan amount, with a maximum of $100,000.

Technical Assistance (TA) – the bank was fortunate to receive two TA's in 2004 through the FSM National Government with a loan from the Asian Development Bank. The TA's included a Banking Advisor (BA) and a computer specialist (IT). The former has made numerous recommendations to improve the efficiency of the loan evaluation process, assisted in formulating a new strategic plan and have provided hands on training to our credit officers. The latter is assisting management to improve the bank's information system.

Regional Associations – the bank is an active member of various regional professional organizations such as the Association of Developmental Financial Instituitions of the Pacific also known as the ADFIP, the Association of the Pacific Island Public Auditor (APIPA) and Asia Pacific Regional Investment Institute (APRII), to name few. The Bank's President/CEO is currently a board member of APRII.

Term Borrowing – with future financial contributions from stockholder's uncertain, we have begun to explore funding sources that will be able to provide loan funds in the event our current loan funds are depleted. Funds may likely come in the form of soft loans from various agencies outside of the FSM.

ACKNOWLEDGEMENTS

We extend our deep appreciation to the FSMDB stockholders for the continued financial support and confidence in us.

We thank our Board of Directors for the steadfast support of our plans, programs and initiatives. Amidst all the challenges in the operating environment, the steadying hand of the Board and its collective wisdom enabled us to stay the course with focus and persistence.

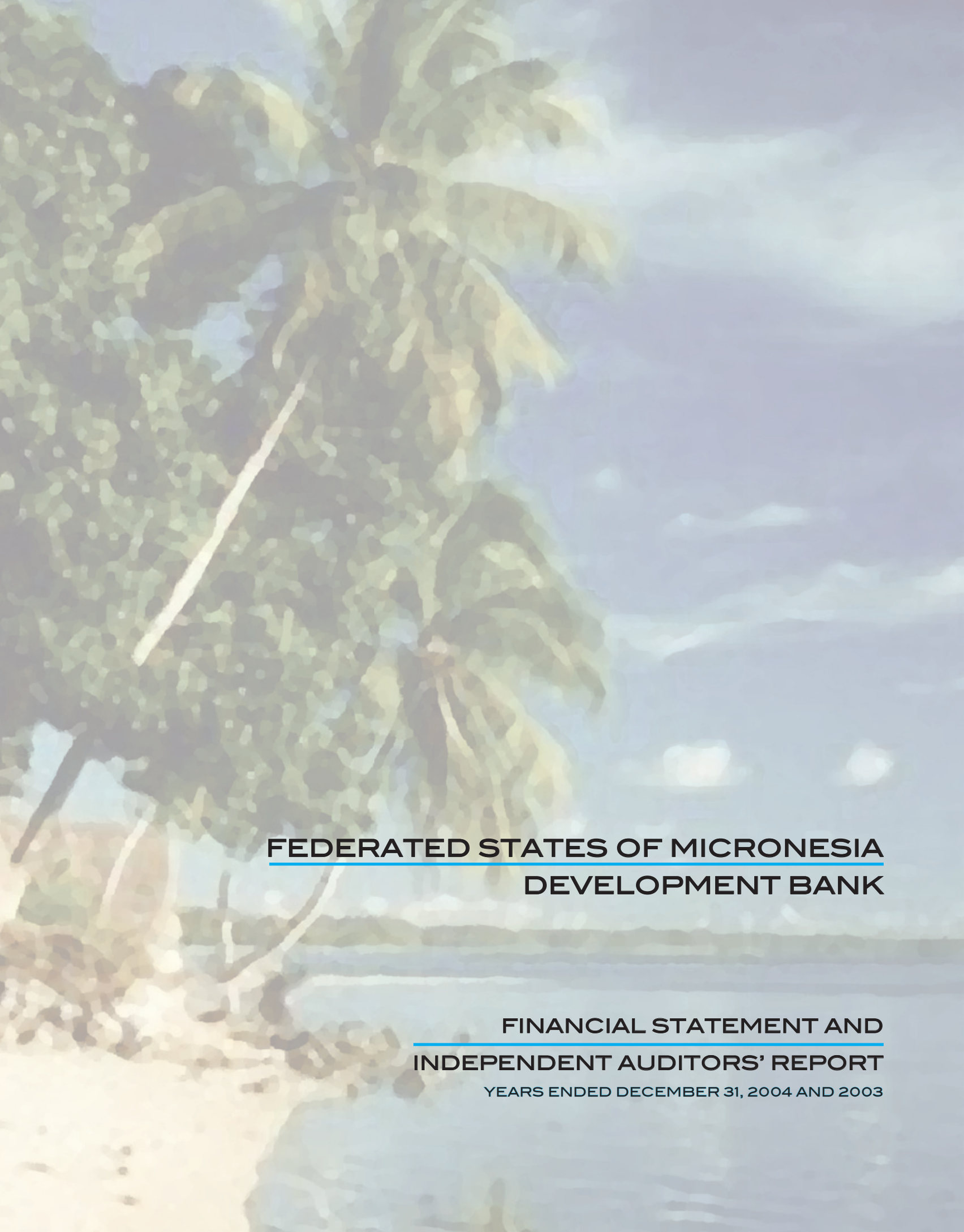
We thank the hard working officers and staff of the FSM Development Bank for their dedication that enabled us to judiciously implement our programs and projects.

Finally, we thank our clients for the trust and confidence they have in us and for allowing the FSMDB the opportunity to serve and assist in their business ventures.

A special "Thank You" goes how to the family of the late Director Reed Nena of the state of Kosrae, whose untimely passing during the year was a sad point for all of us here at the bank. We will be forever grateful for his service to the bank not only as a director but also as a member of the senior management for many years as the bank's Senior Vice President.

We wish to also thank the following former staff members who have left us to pursue other careers. Their contributions to the bank will be forever appreciated.

> Mr. James Woodruf, Legal Counsel
> Mr. Weslon Panuel, Loan Officer Pohnpei Branch
> Mr. Adelino Lorens, Director.



FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

FINANCIAL STATEMENT AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2004 AND 2003

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Table of Contents
Years Ended December 31, 2004 and 2003

I. FINANCIAL STATEMENTS

Federated States of Micronesia Development Bank

Independent Auditor's Report	25
Management's Discussion and Analysis	26
Statements of Net Assets	28
Statements of Activities and Changes in Net Assests	29
Statements of Cash Flows	30
Notes to Financial Statements	31

Trust Funds Administered by the Federated States of Micronesia

Independent Auditors' Report	40
Statement of Assests	41
Statement of Activities and Net Assets	42
Notes to Financial Statements	43

II. INDEPENDENT AUDITORS' REPORTS ON COMPLAIN
LAWS AND REGULATIONS

Independent Auditors' report on Complaiance and on Internal Control Over Finanacial Reporting Based Upon an Audit of Finanacial Statements Performed in Accordance with *Goverment Auditing Standards*	44
Independent Auditors' Report on Complaince with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A - 133	46
Schedule of Expenditures of Federal Awards	47
Schedule of Findings and Questioned Costs	49
Schedule of Prior Year Finding and Questioned Costs	50

Deloitte & Touche LLP
361 South Marine Corps I
Tamuning, GU 96913-39
USA
Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Chairman
Board of Directors
Federated States of Micronesia
Development Bank:

We have audited the accompanying statements of net assets of the Federated States of Micronesia Development Bank, a component unit of the National Government of the Federated States of Micronesia, as of December 31, 2004 and 2003, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Federated States of Micronesia Development Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Federated States of Micronesia Development Bank as of December 31, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management Discussion and Analysis on pages 3-4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Federated States of Micronesia Development Bank's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 15, 2005, on our consideration of the Bank's internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

April 15, 2005

Member of
Deloitte Touche Tohmatsu

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Management Discussion and Analysis
Year Ending December 31, 2004

The year 2004 brought about changes for FSMDB, both in terms of lending and collection. The newly signed compact agreement between the FSM and the United States along with its restrictions, the slow economy, and natural disasters hitting FSM such as Typhoon Sudal were all hardships that in one way or another affected FSMDB. However, FSMDB responded positively to these challenges by focusing our attention on assisting our clients. As a development bank, it is essential that we try to work out solutions for our clients rather than closing down their businesses. Without jeopardizing the long-term sustainability of our clients' businesses, many accounts were restructured to accommodate requests by borrowers to reduce monthly payments to more affordable monthly payments.

Summary Statement of Net Assets

	2004	2003
Assets:		
Current assets	$ 9,508,499	$ 8,278,999
Noncurrent assets	23,119,518	24,864,716
Total Assets	$ 32,628,017	$ 33,143,715
Liabilities:		
Current liabilities	$ 938,599	$ 2,275,445
Total Liabilities	938,599	2,275,445
Net assets:		
Investment in fixed assets	107,588	74,073
Unrestricted	31,581,830	30,794,197
Total Net Assets	31,689,418	30,868,270
Total Liabilities and Net Assets	$ 32,628,017	$ 33,143,715

Earnings from 2004 decreased from $1,296,581 in 2003 to $821,149. Provision for doubtful loans this past year was one of the Bank's major expenses. Management felt it was prudent to be conservative given the number of loan-restructures and the amount of loans that fell under the substandard category. Additionally, the uncertainty reflected in the economy as a result of the amended Compact has led management to be very conservative in its economic outlook. This conservatism has been reflected in the loan loss reserve. All other expenses remained at levels consistent with 2003 expenses.

Changes in the Investment Policy during the year 2004 and improved interest rates for the Company brought some improvement in our Investment Income. In August 2004, management of our Business Development Loan Fund (BDLF) investment portfolio was transferred from Merrill Lynch to Smith Barney. At December 31, 2004, the market value of the BDLF stood at $10.221 Million.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Management Discussion and Analysis
Year Ending December 31, 2004

Summary Statement of Revenues, Expenses and Changes in Net Assets

	2004	2003
Operating revenues	$ 1,991,153	$ 2,175,469
Operating expenses	2,206,190	2,157,583
(Loss)/Earnings from operations	(215,037)	17,877
Non-operating revenues	1,036,186	1,278,694
Increase in net assets	821,149	1,296,581
Net assets at beginning of year	30,868,270	29,571,689
Net assets - end of year	$ 31,689,419	$ 30,868,270

The Bank manages three trust funds, namely the Investment Development Fund (IDF), Pohnpei Development Loan Fund (PDLF) and Yap Development Loan Fund (YDLF). The total net assets for each of these funds at the end of 2004 were $14,311,998, $787,319, and $321,751 respectively. IDF ended the year with a loss of $1,584,930 whereas PDLF broke even, and YDLF earned income of $5,031. The Federated Development Authority (FDA) approved a total of $1,103,082 to be transferred to three of the State Governments. Kosrae State received $151,292. Pohnpei State received $500,000. Chuuk State received $528,503.

A total of 64 loans were approved in 2004 totaling $5,360,182. Loans for start up businesses were very limited due to the many debt-servicing difficulties for similar start-up business clients. The Bank was able to collect about $4.3 million in loan repayments in 2004.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Statements of Net Assets
December 31, 2004 and 2003

	(Proprietary Fund Type) FSMDB	
	2004	2003
ASSETS		
Current assets:		
Cash and equivalents	$ 7,541,541	$ 5,233,281
Accounts receivable	15,392	20,561
Receivable from trust funds	180,045	168,818
Prepaid expenses	1,000	1,000
Interest and other receivables	142,008	345,603
Current portion of loans receivable	1,628,513	2,509,736
Total current assets	9,508,499	8,278,999
Noncurrent assets:		
Fixed assets, net	107,588	74,073
Investments	7,699,921	9,772,044
Equity investment, at cost	662,188	662,188
Loans receivable, net of current portion	14,649,821	14,356,411
Total noncurrent assets	23,119,518	24,864,716
Total assets	$ 32,628,017	$ 33,143,715
LIABILITIES		
Current liabilities:		
Accounts payable	$ 70,318	$ 42,639
Credit life payable	61,869	62,889
Payable to trust funds	806,412	2,169,917
Total liabilities	938,599	2,275,445
Commitments and contingencies		
Net assets:		
Invested in fixed assets	107,588	74,073
Unrestricted	31,581,830	30,794,197
Total net assets	31,689,418	30,868,270
Total liabilities and net assets	$ 32,628,017	$ 33,143,715

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Statements of Activities and Changes in Net Assets
Years Ended December 31, 2004 and 2003

	(Proprietary Fund Type) FSMDB	
	2004	2003
Operating revenues:		
Loan interest	$ 1,634,986	$ 1,758,767
Investment income	307,754	285,387
Loan fees	22,964	109,997
Miscellaneous	25,449	21,318
Total operating revenues	1,991,153	2,175,469
Operating expenses:		
Provision for doubtful loans	860,000	860,000
Personnel services	858,561	815,772
Rent	113,067	113,770
Travel	98,540	83,957
FSM retirement plan	44,273	11,236
Training	38,156	51,119
Contractual services	34,687	26,497
Communication	32,406	31,575
Depreciation	28,771	55,515
Supplies	17,871	17,195
Printing	7,432	9,058
Insurance	4,060	3,644
Miscellaneous expenses	68,366	78,244
Total operating expenses	2,206,190	2,157,582
(Loss) earnings from operations	(215,037)	17,887
Non-operating revenues:		
IDF reimbursement	250,000	250,000
Allocations from managed funds	21,846	27,976
Contributions	750,000	1,000,000
Other income	14,340	718
Total non-operating revenues	1,036,186	1,278,694
Increase in net assets	821,149	1,296,581
Net assets at beginning of year	30,868,270	29,571,689
Net assets at end of year	$ 31,689,419	$ 30,868,270

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Statements of Cash Flows
Years Ended December 31, 2004 and 2003

	(Proprietary Fund Type) FSMDB	
	2004	2003
Increase (decrease) in cash and equivalents		
Cash flows from operating activities:		
Cash received from customers	$ 3,089,349	$ 2,624,776
Cash paid to suppliers and employees for goods and services	(2,682,364)	(659,922)
Cash paid to employees	(858,561)	(815,771)
Net cash (used for) provided by operating activities	(451,576)	1,149,083
Cash flows from capital and related financing activites:		
Acquisition of fixed assets	(62,286)	(15,080)
Net cash (used for) capital and related financing activities	(62,286)	(15,080)
Cash flows from investing activities:		
Increase in investments	2,072,122	345,532
Net cash provided by investing activities	2,072,122	345,532
Cash flows from noncapital financing activities:		
Cash contribution from the FSM National Government	750,000	1,000,000
Net increase in cash and equivalents	2,308,260	2,479,535
Cash and equivalents at beginning of year	5,233,281	2,753,746
Cash and equivalents at end of year	$ 7,541,541	$ 5,233,281
Reconciliation of operating (loss) earnings to net cash (used for) provided by operating activities:		
(Loss) earnings from operations	$ (215,037)	$ 17,887
Other earnings from merged funds and other	286,186	278,694
Adjustment to reconcile (loss) earnings from operations to net cash (used for) provided by operating activities:		
Depreciation	28,771	55,515
(Increases) decreases in assets:		
Accounts receivable	785,350	1,007,099
Prepaid expenses	-	(1,000)
(Decrease) in liabilities:		
Accounts payable and other liabilities	(1,336,846)	(209,112)
Net cash (used for) provided by operating activities	$ (451,576)	$ 1,149,083

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies

Reporting Entities

The Federated States of Micronesia Development Bank (FSMDB) was created in 1979 by Public Law 1-37 of the First Congress of the Federated States of Micronesia. The FSM Development Bank began its operations on October 1, 1980. The FSMDB was reorganized in January 1994 by Public Law 8-47 of the Eighth Congress of the Federated States of Micronesia. The purpose of the FSM Development 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 FSMDB's repayment terms tend to be longer than those offered by commercial banks.

The Investment Development Fund (IDF) was established by Public Law 5-122 in January 1989. The purpose of the IDF is to finance projects which will (1) have their operations primarily located within the FSM; (2) improve the balance of payments position of the FSM; (3) increase the value of visible and invisible exports or result in import substitutions; (4) demonstrate positive economic returns; (5) contribute to the furtherance of close economic relations with the USA.

The Pohnpei Development Loan Fund (PDLF) and the Yap Development Loan Fund (YDLF) are administered by the Bank in a Trust capacity. All loan decisions are made by executives of the respective state governments.

The FSMDB is a component unit (a discretely presented proprietary fund type) of the FSM National Government. The financial statements in this report do not represent the financial position, results of operations or cash flows of the FSM National Government as a whole. The financial statements of the FSMDB 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 Bank has opted to establish itself more in line with a corporate model. The Bank, through this process, hopes to be able to attract additional capital through non-FSM sources. To that end, the Bank as of December 31, 2004, has issued 2,997,883 shares to the FSM National Government (98.7%), Kosrae State (.3%) and Chuuk State (1.0%).

Fund Structure and Basis of Accounting

The accounts of the FSMDB are organized as a discretely presented component unit - proprietary fund of the FSM National Government. Proprietary funds are used by governmental units to account for operations that are financed and operated in a manner similar to a private business. This accounting is appropriate when costs of providing goods or services to the general public are to be financed primarily through user charges or where the periodic determination of net income is appropriate for accountability purposes. The accrual basis of accounting is utilized by proprietary funds. Under the accrual basis, revenues are recorded when earned, and expenses are recorded at the time the liabilities are incurred.

The accounts of the IDF, PDLF and YDLF are accounted for as governmental fund types (capital projects funds) as the amounts are to be reported on the respective entities' financial statements (the FSM National Government, Pohnpei State and Yap State, respectively).

(1) Summary of Significant Accounting Policies, Continued

Fund Structure and Basis of Accounting, Continued

The Bank utilizes the flow of economic resources measurement focus. Its financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units using the accrual basis of accounting. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting" requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Bank has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The Bank has adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement No. 37. GASB Statement No. 34 established standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following four net asset categories:

- Invested in capital assets, net of related debt:

  Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:
  - Nonexpendable – Net assets subject to externally imposed stipulations that require the Bank to maintain them permanently. For the years ended December 31, 2004 and 2003, the Bank does not have nonexpendable net assets.
  - Expendable – Net assets whose use by the Bank is subject to externally imposed stipulations that can be fulfilled by actions of the Bank pursuant to those stipulations or that expire by the passage of time.

- Unrestricted:

  Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Net assets represent the residual interest in the Bank's assets after liabilities are deducted and consist of three sections: invested in capital assets, net of related debt; restricted and unrestricted. Net assets invested in capital assets, net of debt include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. The Bank's restricted assets are expendable. All other net assets are unrestricted.

(1) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents

For the purposes of the statements of net assets and the statements of cash flows, cash and equivalents are defined as cash in bank checking and savings accounts, money market funds, and commercial paper with original maturities of three months or less from the date of acquisition. The Bank does not require collateralization of its cash in excess of FDIC limits; therefore, any amounts in excess of those limits are uncollateralized. At December 31, 2004 and 2003, $200,000 of cash and cash equivalent balances is subject to FDIC insurance coverage while the remaining balances are uninsured and uncollateralized. 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, 2004 and 2003.

Loans and Allowance for Loan Losses

Loans are stated at unpaid principal balance less the allowance for loan losses.

Management maintains the allowance for loan losses at a level adequate to absorb probable losses. Management determines the adequacy of the allowance based upon reviews of individual loans, recent loss experience, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. Loans deemed uncollectible are charged to the allowance. Provisions for losses and recoveries on loans previously charged off are added to the allowance.

Interest on loans is accrued and credited to income based on the principal amount outstanding. The accrual of interest on loans is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payments as they become due. Upon such discontinuance, all unpaid accrued interest is reversed.

Fixed Assets

Fixed assets are stated at cost, less accumulated depreciation. Depreciation is based on the straight-line method over the estimated useful lives of the respective assets. All of the assets have an estimated useful life of three to five years.

The Bank’s policy on fixed assets requires that assets with a purchase value of $5,000 and over are capitalized and depreciated based on its useful life. Any asset with purchase value below $5,000 is expensed fully in the year of purchase.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the FSM Development Bank has entered 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.

(1) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses.

(2) Investments

FSM National Government statutes permit the FSMDB to invest in shares, stocks, mortgages, bonds, obligations, securities and investments of all kinds. IDF funds must be invested in short-term, readily marketable, investment grade nonconvertible bonds, guaranteed investment contracts issued by an insurance company with over $1 billion in assets, or shares in a money market, open-ended, mutual fund.

GASB Statement No. 3 requires government entities to categorize investments in the following categories to give an indication of the level of risk assumed by the entity at year end.

Category 1 - Securities insured or registered and held by the FSMDB or IDF or its agent in the FSMDB's or IDF's name.
Category 2 - Securities uninsured and unregistered and held by a party other than the FSMDB or IDF or its agent, in the FSMDB's or IDF's name.
Category 3 - Securities uninsured and unregistered and held by a party other than the FSMDB or IDF and not in the FSMDB's or IDF's name.

Investments as of December 31, 2004 and 2003, carried at cost, which approximates market value, and are comprised of the following:

	2004	2003
Time certificates of deposit with original maturities of greater than ninety days	7,699,921	9,772,044
	$ 7,699,921	$ 9,772,044

The difference between book and market value is not material. Management is of the opinion that it has the intent and ability to hold all of the securities to maturity and, therefore, no losses will be incurred. The investments have been classified as category 1 investments in accordance with the GASB Statement No. 3 as all investments are held in the name of FSMDB by Citigroup Global Markets Inc.

(3) Equity Investment, at Cost

Equity investment in Bank of the FSM, carried at cost, represents 100,000 common shares and approximately 11% interest. Since the book value of the shares exceeds the carrying value, management believes that the equity investment has not become impaired.

(4) Loans Receivable

A summary of loans receivable at December 31, 2004 and 2003 follows:

	2004	2003
Unpaid principal balance	$ 21,402,989	$ 20,996,506
Allowance for loan losses	(5,124,655)	(4,130,359)
	$ 16,278,334	$ 16,866,147

Movements in the allowance for loan losses during the years ended December 31, 2004 and 2003, are as follows:

	2004	2003
Balance at beginning of year	$ 4,130,359	$ 3,393,283
Provision for loan losses	860,000	860,283
Loans charged off	(302,689)	(287,490)
Loan recoveries from previously charged off loans	436,985	107,163
Loan reactivations from previously charged off loans	-	57,120
Balance - December 31, 2004	$ 5,124,655	$ 4,130,359

(5) Fixed Assets

A summary of fixed assets as of December 31, 2004 and 2003, is as follows:

	Beginning Balance January 1, 2004	Additions	Deletions	Ending Balance December 31, 2004
Office furniture, fixtures and equipment	$ 180,472	$ 11,500	$ -	$ 191,972
Home furniture, fixtures and equipment	13,608	-	-	13,608
Vehicles	122,286	48,675	-	170,961
Computers and software	266,096	2,111	-	268,207
	582,462	62,286	-	644,748
Less accumulated depreciation	(508,389)	(28,771)	-	(537,160)
Net fixed assets	$ 74,073	$ 33,515	$ -	$ 107,588

(5) Fixed Assets, Continued

	Beginning Balance January 1, 2003	Additions	Deletions	Ending Balance December 31, 2003
Office furniture, fixtures and equipment	$ 165,392	$ 15,080	$ -	$ 180,472
Home furniture, fixtures and equipment	13,608	-	-	13,608
Vehicles	122,286	-	-	122,286
Computers and software	266,096	-	-	266,096
	567,382	15,080	-	582,462
Less accumulated depreciation	(452,874)	(55,515)	-	(508,389)
Net fixed assets	$ 114,508	$ (40,435)	$ -	$ 74,073

(6) Related Party Transactions

As of December 31, 2004 and 2003, the Bank has direct loans with an outstanding balance of $147,956 and $131,827, respectively to employees of the Bank and project loans extended to businesses owned by or affiliated with the employees with an outstanding balance of $3,067,455 and $3,793,631, respectively. These loans are made under similar terms and conditions as exist with other borrowers. Officers and Board members are not eligible to borrow from the Bank.

(7) Commitments and Contingencies

Guaranty

The Bank is contingently liable on loan guarantees to the Bank of Guam, 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, 2004.

Loan Commitments

The FSMDB have made loan commitments for loans approved but undisbursed in the amount of $5,274,679 at December 31, 2004.

Litigation

FSMDB 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.

Self Insurance

The FSM Development Bank carries insurance to cover its potential risks from fire on its building and the contents and full coverage on property damage. FSM Development 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.

(7) Commitments and Contingencies, Continued

Lease Commitments

The FSM Development has six operating leases as of December 31, 2004. Two are residential real estate leases for contract employees. Four represent leases for the branch offices in each state (one with a lease term of two years, two for five years and one for fifteen years). All leases have an attached option allowing FSMDB to renew the lease upon expiration of the current term. It is likely that these options will be utilized by FSMDB and the leases renewed. The approximate future minimum annual lease payments payable by FSMDB are as follows:

Fiscal year ending December 31,	Total
2005	$ 93,500
2006	89,520
2007	76,320
2008	76,320
2009	66,320
2010 – 2014	321,600
2015 – 2019	49,440
2020 – 2024	30,000
2025 – 2029	30,000
	$ 833,020

(8) Contribution From The FSM National Government

The FSM Development Bank receives periodic subsidies of its operations from appropriations received from the Congress of the FSM. During the years ended December 31, 2004 and 2003, the Bank received $750,000 and $1,000,000, respectively, from the FSM Congress and the Bank was reimbursed for expenses incurred in administering the IDF program from the IDF Private Sub Account for $250,000 in both years.

(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 received from FSM Social Security System. The Plan is a contributory plan in which the Bank contributes 10 percent of the participant's annual salary, and the participant contributes 3 or more percent from his or her annual salary. Participation is optional. The Bank's controller is the designated Plan administrator. Contributions to the Plan during the years ended December 31, 2004 and 2003 were $44,273 and $11,236, 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

FINANCIAL STATEMENT AND INDEPENDENT AUDITORS' REPORT

DECEMBER 31, 2004

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA
Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Chairman
Board of Directors
Federated States of Micronesia
Development Bank:

We have audited the accompanying statement of net assets of the Investment Development Fund (IDF), the Pohnpei Development Loan Fund (PDLF), and the Yap Development Loan Fund (YDLF) (the Funds) as of December 31, 2004, and the related statement of activities and changes in net assets for the year then ended. The Funds are administered by the Federated States of Micronesia Development Bank (FSMDB), a component unit of the National Government of the Federated States of Micronesia. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Funds' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Funds at December 31, 2004, and the changes in their net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have issued our report dated April 15, 2005, on our consideration of the Funds' internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

April 15, 2005

Member of
Deloitte Touche Tohmatsu

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Trust Funds
Statement of Assets
December 31, 2004
(With Comparative Totals as of December 31, 2003)

	Trust Funds			Totals (Memorandum Only)	
	IDF	PDLF	YDLF	2004	2003
ASSETS					
Current assets:					
Cash and equivalents:					
Held by trustee:					
Investments	$ 7,270,802	$ -	$ -	$ 7,270,802	$ 8,570,619
Held by FSMDB:					
Cash in bank and on hand	-	140,441	42,005	182,446	155,196
Time certificate of deposits	-	493,110	126,458	619,568	584,702
Total cash and equivalents	7,270,802	633,551	168,463	8,072,816	9,310,517
Receivable from FSMDB	806,412	-	-	806,412	2,169,917
Interest and other receivables	55,273	4,414	708	60,395	127,655
Loans receivable, net	6,179,511	149,354	152,580	6,481,445	5,381,650
Total receivables	7,041,196	153,768	153,288	7,348,252	7,679,222
	$ 14,311,998	$ 787,319	$ 321,751	$ 15,421,068	$ 16,989,739
LIABILITIES AND NET ASSETS					
Current liabilities:					
Payable to FSMDB	$ -	$ 67,404	$ 112,641	$ 180,045	$ 168,818
Credit life payable	-	-	2,074	2,074	2,074
Total liabilities	-	67,404	114,715	182,119	170,892
Net assets:					
Restricted	6,179,511	149,354	152,580	6,481,445	5,381,650
Unrestricted	8,132,487	570,561	54,456	8,757,504	11,437,197
Total net assets	14,311,998	719,915	207,036	15,238,949	16,818,847
	$ 14,311,998	$ 787,319	$ 321,751	$ 15,421,068	$ 16,989,739

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Trust Funds
Statement of Activities and Net Assets
Year Ended December 31, 2004
(With Comparative Totals for the Year Ended December 31, 2003)

	Governmental Fund Types (Trust Funds)			Totals (Memorandum Only)	
	IDF	PDLF	YDLF	2004	2003
Operating revenues:					
Investment interest	$ 66,095	$ 6,488	$ 1,799	$ 74,382	$ 247,055
Loan interest	127,972	9,837	8,206	146,015	160,266
Miscellaneous	63,266	490	59	63,815	1,391
Total operating revenues	257,333	16,815	10,064	284,212	408,712
Operating expenditures:					
Doubtful loan expense	412,468	-	-	412,468	-
Total operating expenditures	412,468	-	-	412,468	-
Revenues over expenditures	(155,135)	16,815	10,064	(128,256)	408,712
Other sources (uses):					
Investment management fee	(250,000)	-	-	(250,000)	(250,000)
Transfer to Kosrae State Government	(151,292)	-	-	(151,292)	(628,968)
Transfer to Pohnpei State Government	(500,000)	-	-	(500,000)	-
Transfer to Chuuk State Government	(528,503)	-	-	(528,503)	-
Transfers to FSMDB fund	-	(16,815)	(5,032)	(21,847)	(27,976)
Total other uses, net	(1,429,795)	(16,815)	(5,032)	(1,451,642)	(906,944)
Revenues and other sources over expenditures and other uses	(1,584,930)	-	5,032	(1,579,898)	(498,232)
Net assets at beginning of year	15,896,928	719,915	202,004	16,818,847	17,317,079
Net assets at end of year	$ 14,311,998	$ 719,915	$ 207,036	$ 15,238,949	$ 16,818,847

See accompanying notes to financial statements.

TRUST FUNDS ADMINISTERED BY THE
FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2004

(1) Purpose and Summary of Significant Accounting Policies

Purpose

The Investment Development Fund (IDF), the Pohnpei Development Loan Fund (PDLF), and the Yap Development Loan Fund (YDLF), are administered by the Federated States of Micronesia Development Bank (FDMDB). FSMDB utilizes the Funds to carry out its stated purpose of providing loans for the economic development of the FSM. The specific purpose of each fund is as follows:

IDF – IDF was created to finance projects which will (1) have their operations primarily located within the FSM; (2) improve the balance of payments position of the FSM; (3) increase the value of visible and invisible exports or result in import substitutions; (4) demonstrate positive economic returns; (5) contribute to the furtherance of close economic relations with the USA.

The Pohnpei Development Loan Fund (PDLF) and the Yap Development Loan Fund (YDLF) are administered by the Bank in a Trust capacity. All loan decisions are made by executives of the respective state governments.

Fund Structure and Basis of Accounting

The accounts of the IDF, PDLF and YDLF are accounted for as governmental fund types (capital projects funds) as the amounts are to be reported on the respective entities' financial statements (the FSM National Government, Pohnpei State and Yap State, respectively).

Cash and Cash Equivalents

For the purposes of the statement of financial condition and the statement of cash flows, cash and equivalents are defined as cash in bank checking and savings accounts, money market funds, and commercial paper with original maturities of three months or less from the date of acquisition. The Bank does not require collateralization of its cash in excess of FDIC limits; therefore, any amounts in excess of those limits are uncollateralized.

Loan and Allowance for Loan Losses

Loans under the trust funds are reported at gross unpaid principal balances, without an allowance for loan losses. The loans are reserved in fund balance as a reserve for related assets. Loans are written off directly against income based on discussions with the owners of the managed funds.

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.

Totals - Memorandum Only

The "Totals-Memorandum Only" column represents an aggregate of the individual financial statements. The total column is presented only for information purposes and does not represent consolidated financial information.

TRUST FUNDS ADMINISTERED BY THE
FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2004

(1) Purpose and Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(2) Investments

FSM National Government statutes permit the FSMDB to invest in shares, stocks, mortgages, bonds, obligations, securities and investments of all kinds. IDF funds must be invested in short-term, readily marketable, investment grade nonconvertible bonds, guaranteed investment contracts issued by an insurance company with over $1 billion in assets, or shares in a money market, open-ended, mutual fund.

GASB Statement No. 3 requires government entities to categorize investments in the following categories to give an indication of the level of risk assumed by the entity at year end.

Category 1 - Securities insured or registered and held by the FSMDB or IDF or its agent in the FSMDB's or IDF's name.
Category 2 - Securities uninsured and unregistered and held by a party other than the FSMDB or IDF or its agent, in the FSMDB's or IDF's name.
Category 3 - Securities uninsured and unregistered and held by a party other than the FSMDB or IDF and not in the FSMDB's or IDF's name.

Investments as of December 31, 2004, are carried at cost, which approximates market value, and are comprised of the following:

	IDF	PDLF	YDLF
U.S. Government obligations	$ 7,270,802	$ -	$ -
Time certificates of deposit with original maturities of greater than ninety days	-	493,110	126,458
	$ 7,270,802	$ 493,110	$ 126,458

The difference between book and market value is not material. Management is of the opinion that it has the intent and ability to hold all of the securities to maturity and, therefore, no losses will be incurred. The investments held by the FSMDB and IDF have been classified as category 1 investments in accordance with the GASB Statement No. 3 as all investments are held in the name of IDF by Merrill Lynch, Inc.

TRUST FUNDS ADMINISTERED BY THE
FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2004

(3) Loans Receivable

The following is a schedule of loans receivable as of December 31, 2004:

IDF	$ 6,179,511
PDLF	149,354
YDLF	152,580
	$ 6,481,445

Management is of the opinion that since these are trust funds, they are unable to provide against these balances, and therefore these loans have been presented as restricted net assets.

(4) Commitments

Loan commitments for loans approved but undisbursed approximated $2,629,000 at December 31, 2004.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA
Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Board of Directors
Federated States of Micronesia Development Bank:

We have audited the financial statements of the Federated States of Micronesia Development Bank, as of December 31, 2004, and for the year then ended, and have issued our report thereon dated April 15, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Federated States of Micronesia Development Bank's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Federated States of Micronesia Development Bank's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Federated States of Micronesia Development Bank's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of Board of Directors and management of the Federated States of Micronesia Development Bank, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be used by anyone other than those specified parties.

Deloitte & Touche LLP

Member of
Deloitte Touche Tohmatsu

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA
Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

The Board of Directors
Federated States of Micronesia Development Bank:

Compliance

We have audited the compliance of the Federated States of Micronesia Development Bank with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its one major federal program for the year ended December 31, 2004. Federated States of Micronesia Development Bank's major federal program is identified in the Schedule of Expenditures of Federal Awards (page 26). Compliance with the requirements of laws, regulations, contracts and grants applicable to its one major federal program is the responsibility of Federated States of Micronesia Development Bank's management. Our responsibility is to express an opinion on Federated States of Micronesia Development Bank's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Federated States of Micronesia Development Bank's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Federated States of Micronesia Development Bank's compliance with those requirements.

In our opinion, the Federated States of Micronesia Development Bank complied, in all material respects, with the requirements referred to above that are applicable to its one major federal financial assistance program for the year ended December 31, 2004.

Internal Control Over Compliance

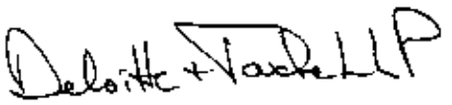
The management of the Federated States of Micronesia Development Bank is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing the audit, we considered the Federated States of Micronesia Development Bank's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Federated States of Micronesia Development Bank, as of and for the year ended December 31, 2004, and have issued our report thereon dated April 15, 2005. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of the management of the Federated States of Micronesia Development Bank. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended for the information of Board of Directors and management of the Federated States of Micronesia Development Bank, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than those specified parties.



April 15, 2005

FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK

Schedule of Expenditures of Federal Awards
Year Ended December 31, 2004
CFDA #15.875 - Department of the Interior

The Bank receives funds in a subrecipient capacity through the FSM National Government. The loan portfolio established through Section 111 of the Compact of Free Association and the loan portfolio established through Section 211 of the Compact of Free Association were selected for detailed compliance testing in accordance with applicable OMB Circular A-133 requirements. The following sets forth these contributions, by Sections, which are administered by the Bank.

Section 211 Compact Capital	Total funding received through December 31, 2004	$ 25,450,000
Section 111 IDF Funds	Total funding available through December 31, 2004	$ 15,896,928
	Amount of revenues and other sources over expenditures and other uses during year ended December 31, 2004	(1,584,930)
	Fund balance as of December 31, 2004	$ 14,311,998

FEDERATED STATES OF MICRONESIA
DEVELOPMENT BANK

Schedule of Findings and Questioned Costs
Year Ended December 31, 2004

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were not identified.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were not identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by OMB Circular A-133.
7. The Organization's major program is:

Name of Federal Program or Cluster	CFDA Number
Compact of Free Association	15.875

8. No Type B programs as those terms are defined in OMB Circular A-133 are administered by the Organization.
9. The Organization did qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

No matters are reportable.

Part III - Federal Award Findings and Questioned Cost Section

No matters are reportable.

FEDERATED STATES OF MICRONESIA
DEVELOPMENT BANK

Schedule of Prior Year Findings and Questioned Costs
Year Ended December 31, 2004

There are no prior audit findings relative to Federal awards.

KOSRAE BRANCH

PO BOX 104 LELU, KOSRAE 96944

Phone : (691) 370-3070 / 2323
Fax : (691) 370-2170
E-mail : KFSMDB@mail.fm

Branch Manager	Ruben Charley
Loan Officer	Larson George
Loan Officer	Andriet Tilfas
Administrative Secretary	Sonia Kehpas

YAP BRANCH

PO BOX 81 COLONIA, YAP 96943

Phone : (691) 350-2165 / 3837
Fax : (691) 350-2249
E-mail : YFSMDB@mail.fm

Branch Manager	Peter Tharngan
Loan Officer	Christopher Buchun
Loan Officer	Robert Finginam
Administrative Secretary	Wenifred Tamangided

POHNPEI BRANCH

PO BOX 648 KOLONIA, POHNPEI 96941

Phone : (691) 320-2624 / 5223
Fax : (691) 320-5798
E-mail : PFSMDB@mail.fm

Branch Manager	Rendy Abraham
Loan Officer	Franky Edward
Loan Officer	Yoster Johnny
Loan Officer	Richard Jano
Administrative Secretary	Peterika White

CHUUK BRANCH

PO BOX 786 WENO, CHUUK 96941

Phone : (691) 330-2760 / 4245
Fax : (691) 330-4149
E-mail : CFSMDB@mail.fm

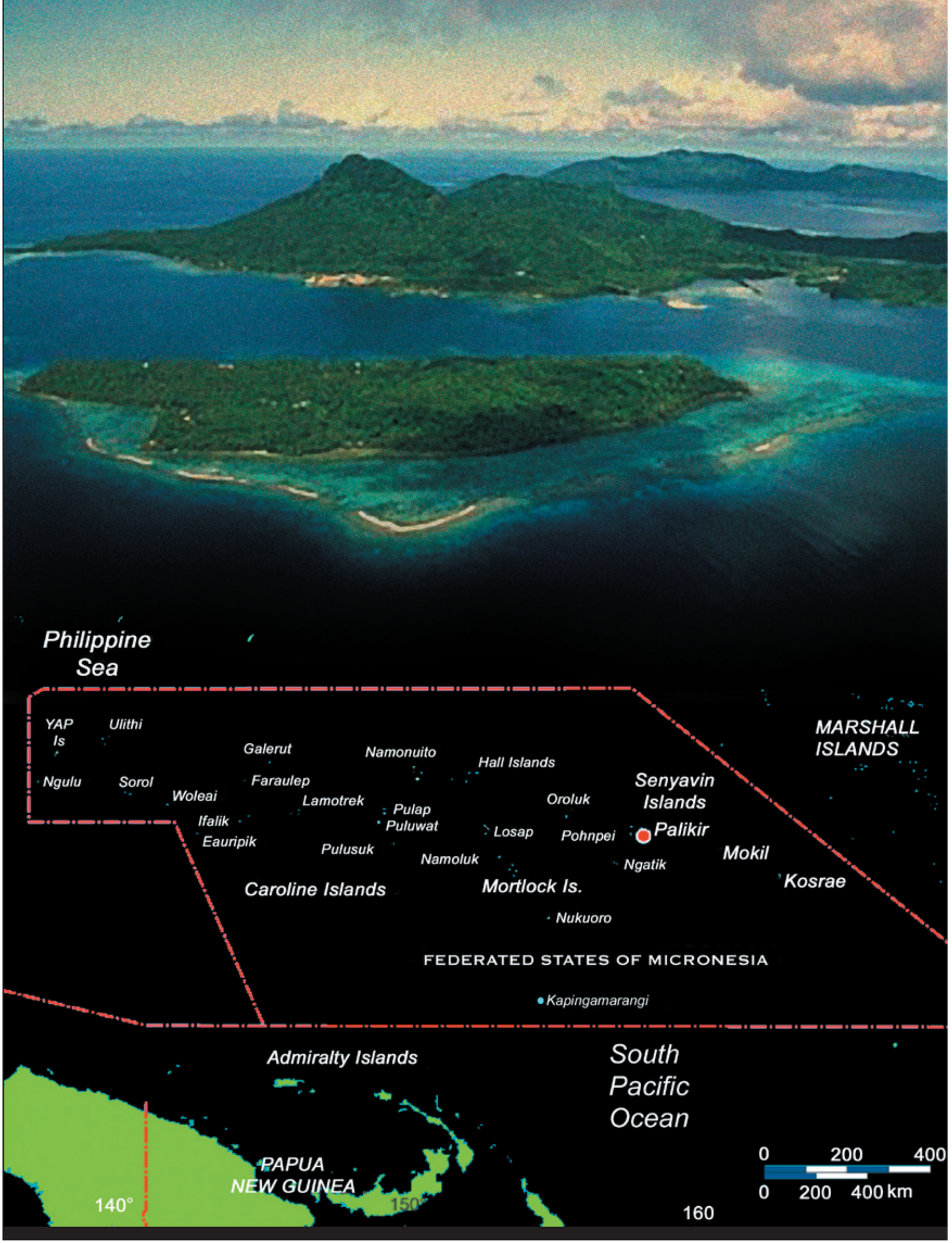
Branch Manager	Anselmo Daniel
Loan Officer	Curley Sos
Loan Officer	Sardis Betwel
Loan Officer	Jonas Paul
Loan Officer	Jayleen Killion
Administrative Secretary	Jacinta Aisek

CORPORATE OFFICE

PO BOX M KOLONIA, POHNPEI 96941

Phone : (691) 320-2840 / 2419 / 5300
Fax : (691) 320-2842
E-mail : FSMDB@mail.fm

President / CEO	Anna Mendiola
Senior Vice President	Stevenson Joseph
Chief Financial Officer	Sihna Lawrance
Senior Loan Officer	Peter Aldis
Internal Auditor	Brandon Tara
Loan Administrator	Alik Alik
System Administrator	Gabriel Ramololiong
Accountant	Kedise Villazon
Accountant	Melshihner Hadley
Loan Security Officer	Lucille Martinez
Asst. System Administrator	Leilani Felix
Administrative Assistant	Senyorina Yang
Legal Secreatary	Rohma Sibanuz
Acount Clerk	Carmihna Abraham
Loan Clerk	Dahlia Phillips
Executive Secretary	Catherine Loanis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Ifalik
Eauripik
Galerut
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Losap
Namoluk
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Pohnpei
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Palikir
Ngatik
Mokil
Kosrae
MARSHALL ISLANDS
Caroline Islands
Mortlock Is.
Nukuoro
FEDERATED STATES OF MICRONESIA
Kapingamarangi
Admiralty Islands
South Pacific Ocean
PAPUA NEW GUINEA
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150°
160
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