

FSMDB 20
07

A N N U A L

REPORT



FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK



Vision Statement

The FSM DEVELOPMENT BANK is a key player in the development of the private sector in the Federated States of Micronesia that enjoys the confidence of the national and state leaders, its customers, regulators and stakeholders.

FSMDB's services and performance are comparable to the best-managed development financial institutions in the Pacific region.

Mission Statement

FSM Development Bank actively promotes the growth of micro, small and medium enterprises in the Federated States of Micronesia and supports programs designed to help business achieve greater efficiency in their operations.

The policies of the FSMDB are constantly aligned with the overall socio-economic goals of the nation and it continues to coordinate closely with the governments and community leaders in defining its strategic directions.

FSMDB processes are designed to deliver efficient and timely services to its customers, and ensure effective exchange of information at all levels of the organization.

The FSMDB organization is characterized by a high level of teamwork and morale.

FSMDB supports its people with appropriate equipment and technology, ensures that its compensation and reward program are competitive within the industry, and implements a conscious program for the continuous professional growth and personal development of its people.

FSMDB maintain a consistently healthy and growing financial portfolio and continues to earn the respect and support of the general public, the various governments, donor agencies and the international financial community.



CONTENTS

INTRODUCTION	
6	Letter to Shareholders
THE BANK AND ITS OPERATION	
7	Shareholders and Board of Directors
8	About the Bank
9	Organizational Chart
10	Management Staff
MANAGEMENT REPORT	
11	Overview of Financial Performance
	Loan Portfolio
	Approvals
	Loan Delinquency
	Administered Funds
	Loans to Women
	Personnel
	Training
	Update on the management Information System
	Update on the Strategic Plan
	Bank Facilities and Equipment
	Programs
	Associations and Memberships
	Acknowledgements
	Special Acknowledgement
20	2007 STATISTICS REPORT
21	FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT
37	TRUST FUNDS ADMINISTERED BY THE FEDERATED STATES OF MICRONESIA DEVELOPMENT BANK
47	Staff Listing and Bank's Addresses

LETTER TO SHAREHOLDERS



Anna Mendiola
President & CEO



Ihlen Joseph
Chairman

Dear Shareholders:

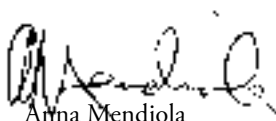
We are pleased to submit the Annual Report for the year ended December 31, 2007 and Audited Financial Statement of the FSM Development Bank (FSMDB) for the years 2007 and 2006.

We are happy to report that the FSM DEVELOPMENT BANK continues to report record profits despite FSM's slow economy. The favorable financial performance during the year is attributable to growth in the loan portfolio and high returns on the Bank's investment portfolio.

We remain committed in carrying out the mandates of the Bank. As an indication of our commitment, we've introduced and have availed Lines of Credit Facilities to our established borrowers. Furthermore, the Bank is seriously considering diversifying to include consumer products such as Residential Home Loans as part of the products and services it offers to the FSM people. We expect to launch the Home Loan program in 2008.

All in all, the Bank is doing well. Looking ahead however, we expect further slowing of the FSM economy due to the high cost of fuel and food prices. Though early economic indications suggest that the FSM's economic condition will likely worsen in 2008, we are confident that the Bank is positioned to weather these looming adverse economic conditions because of its healthy capital position.

In closing, we wish to acknowledge and extend our sincere gratitude and appreciation for your continued support and confidence in the FSMDB. We further extend the same to our esteem colleagues, the members of the Board of Directors, for their unwavering commitments and valuable insights that they have contributed throughout the years toward the advancement of this institution. We wish to also thank our employees for their hard work and their firm commitments to put our words into actions. And finally, we thank our customers for their continued loyalty and confidence in the FSMDB. We thank you for giving us the opportunity to serve you. We hope that you will continue to allow us to be a part of your future business endeavors. As always, we shall remain your partner in business.



Anna Mendiola
President CEO



Ihlen Joseph
Chairman

SHAREHOLDERS AND THE BOARD OF DIRECTORS



Director Ihlen Joseph
Chairman
FSM National Government



Director Hilary Tacheliol
Vice Chairman
Yap State



Director Ramon Falcam
FSM National Government



Director Sisinio Willy
Chuuk State



Director John Sohl
Pohnpei State



Director Wilson Waguk
Kosrae State



Anna Mendiola
President & CEO

OWNERSHIP

The FSM National Government owns the majority of the share that were issued when the Bank was created. It currently owns 98.7% of the Bank's outstanding shares. The States of Chuuk and Kosrae are minor shareholders with 1.0% and 0.3% interest in the remaining shares respectively. The States of Pohnpei and Yap presently are not shareholders but they are given representation on the Bank's Board of Directors as a courtesy.

The Bank's fiscal year runs on a calendar year basis. The shareholder meets annually normally during the second Quarter of the Bank's fiscal year usually during the month of April.

BOARD OF DIRECTORS

Because of the need to run the Bank in a commercial manner, the Bank was restructured to create a Board of Directors to oversee the overall affairs of the Bank. The Board is comprised of seven members, whereby six of them are elected by the shareholders. Being the major shareholder, the FSM National Government is represented with two slots on the board while four slots are given to each of the States more so as a courtesy. The seventh board member is the President and Chief Executive Officer (CEO), who serves as the Ex-Officio to the board. Despite the ownership make-up, all of the Board members have equal voting rights. Aside from the Ex-Officio, all Board members serve a term of 3 years on a staggered basis. Regular board meetings are held four times a year on a quarterly basis. Special meetings can be held at the discretion of the Board.

ABOUT THE BANK



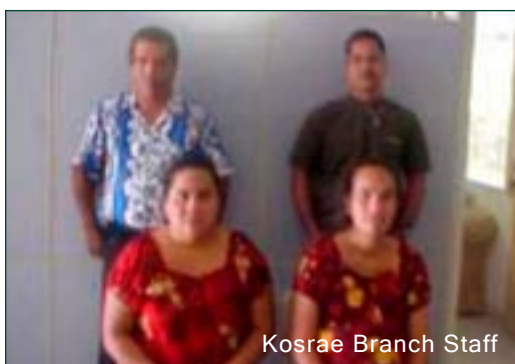
Pohnpei Branch Staff



Chuuk Branch Staff



Yap Branch Staff



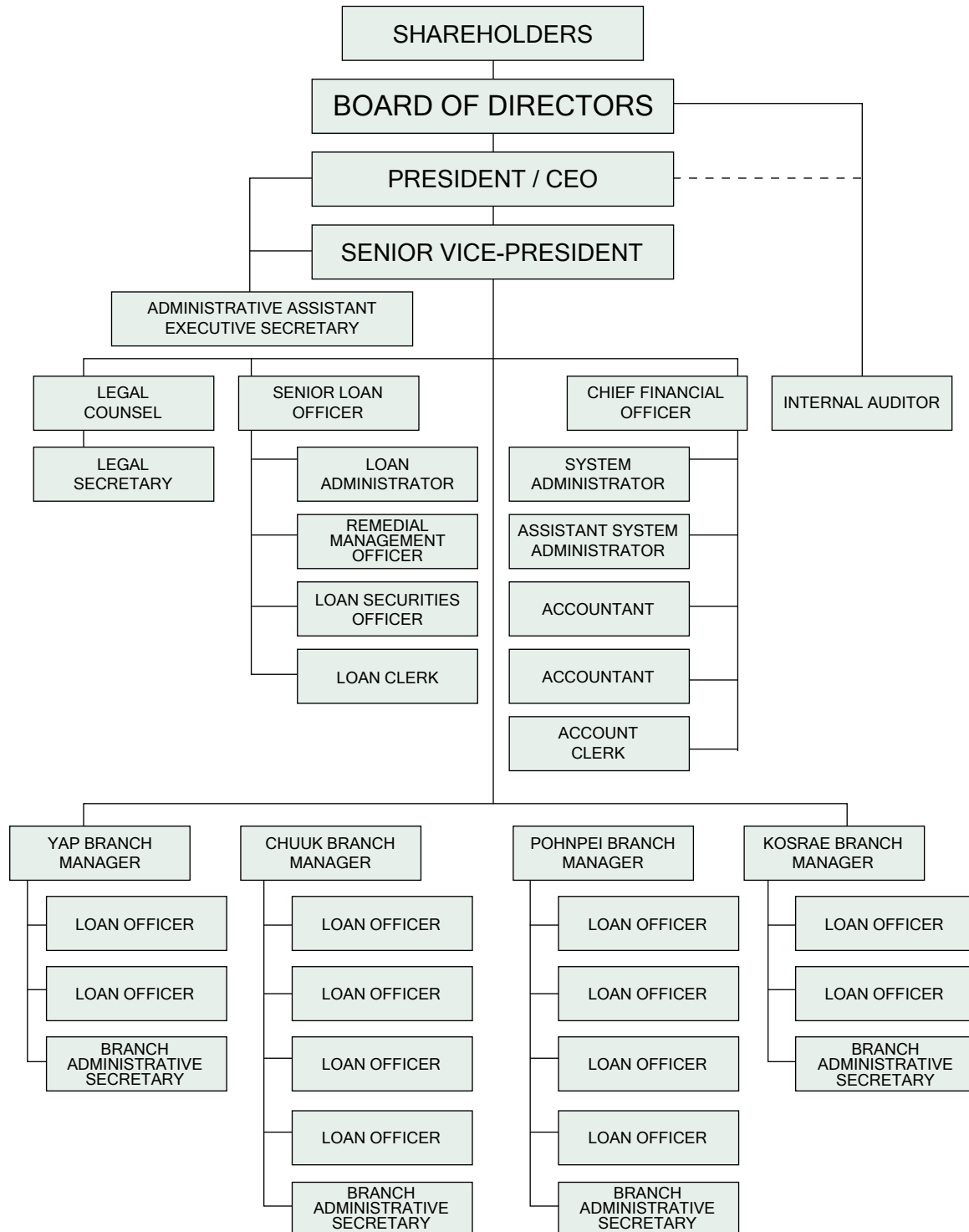
Kosrae Branch Staff

The Federated States of Micronesia Development Bank (FSMDB) is a subcomponent unit of the National Government of the Federated States of Micronesia (FSM). It was chartered in 1979 by the First Congress of the Federated States of Micronesia and commenced operations in 1980. It did not, however, begin lending 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, although it remained a subcomponent unit of the National Government. In addition, within the same amendment referenced above, the Bank was authorized to engage in all banking functions. However, to date the bank remains primarily engaged in providing financing to viable commercial oriented endeavors within the Federated States of Micronesia. Its primary mandate in general is to help develop and strengthen the private sector to ultimately help advance the economic development of the FSM.

To ensure that Bank services are accessible to all FSM citizens, the FSMDB maintains branch offices in all of the four islands (Pohnpei, Chuuk, Kosrae and Yap) that make up the Federated States of Micronesia. The Bank's Head Quarters is located in Pohnpei, the capital of the FSM.

The United States Dollar (USD) is the official currency of the FSM. Therefore all financial reports and transaction are presented in USD.

ORGANIZATIONAL CHART



MANAGEMENT STAFF



Anna Mendiola
President and
Chief Executive Officer



Stevenson Joseph
Senior Vice President



Sihna Lawrence
Chief Financial Officer



Peter Aldis
Senior Loan Officer



Nora Sigrah
Legal Counsel

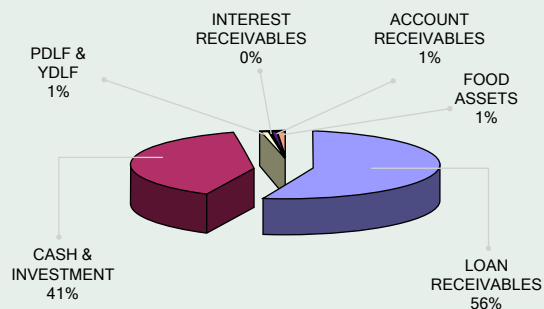
The Senior Management is comprised of President and Chief Executive Officer, A Senior Vice President, A Chief Financial Officer and a Senior Lending Officer. These four positions are charged to implement the mandates of the Board. Assisting the Senior Management and the Board on legal and compliance matters, the bank employs an In-House Legal Counsel and an Internal Auditor respectively. The branch offices each have a Branch Manager who supervises the daily operations of the branches.

MANAGEMENT REPORT

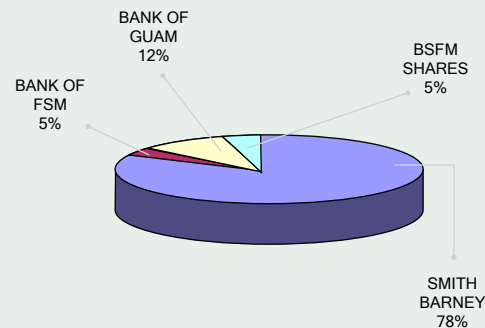
OVERVIEW OF FINANCIAL PERFORMANCE (All figures are in US Dollars)

At year end 2007, the Bank reported \$35.8 million in total assets, an increase of about 4% from the \$34.5 million that was reported at year end 2006. The increase was mainly due to growth in the loan portfolio during the year. The Bank sustained an average growth rate of about 2% in the last five years, suggesting that the Bank is adequately capitalized.

Asset Components as of 12/31/07

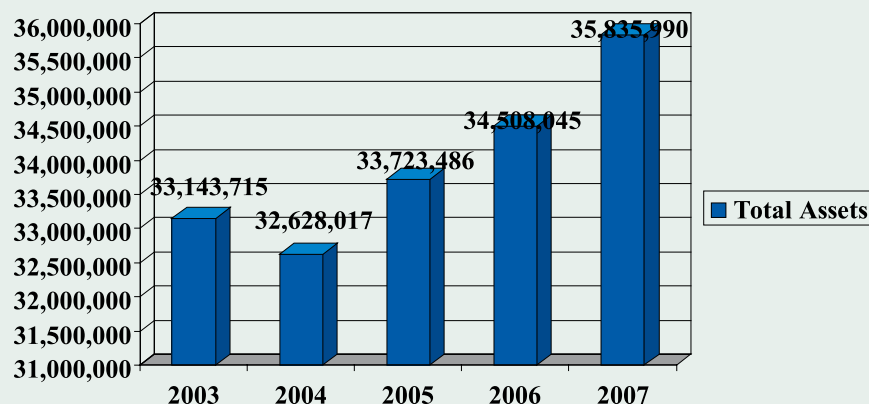


Investment Component as of 12/31/07



The Bank's Assets were largely concentrated in Loans Receivable and Cash which collectively accounted for 97% percent of the Bank's total assets at year end 2007. The loan portfolio accounted for 56% of the Bank's total assets while Cash and Investment 41%. It should be noted that 78% of the cash was invested in the U.S. Securities Market thus making up the Bank's investment portfolio and the rest were kept with the local commercial banks in TCDs and shares. The remaining 3% of the Bank's total assets were distributed evenly amongst the PDF & YDLF funds, Interest Receivable, Accounts Receivable and Fixed Assets.

Total Assets — Year End
2003-2007



The Bank's overall financial condition at year end 2007 remained acceptable. The Bank

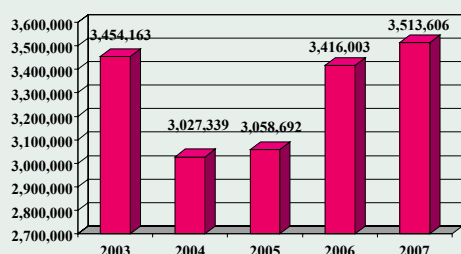
MANAGEMENT REPORT

posted improved returns on its total assets and equity of 4.7% and 4.8% respectively compared to 2.4% and 2.5% at year end 2006.

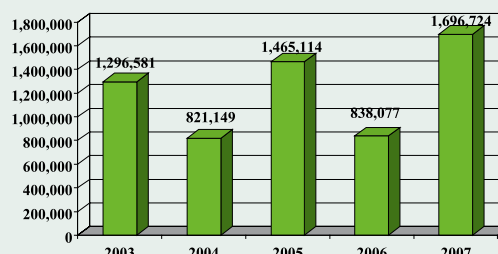
Contributing to FSMDB's favorable financial condition as illustrated above, the Bank posted a net income of \$1.6 million for the twelve months ended December 31, 2007, a significant improvement from the \$838 thousand that was posted for 2006. The major contributing factors to the favorable results were:

- Total Operating Revenues posted an overall increased of 9% in 2007.
- Expenses were reported to have declined by 30% in 2007 from the 2006 level largely as a result of a significant drop in the Loan Loss provisioning for the year as compared to the previous year. The reason for the drop was management felt that the accumulated provisions were adequate to cover likely loan losses; therefore, loan provisioning was not realized in the latter half of 2007.

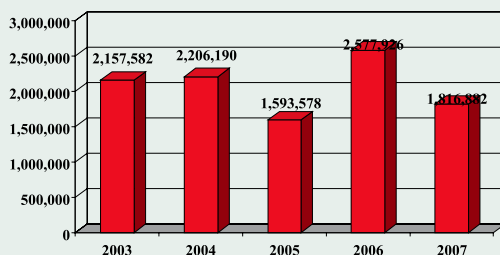
Total Revenue
2003-2007



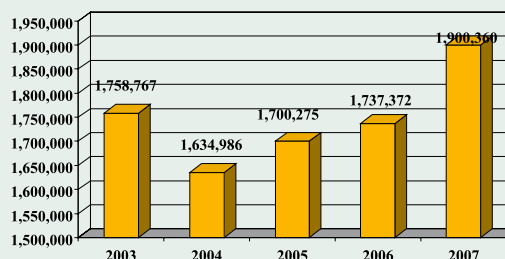
Net Profits
December 31, 2003-2007



Total Expenditure
2003-2007



Loan Interest Income
2003-2007



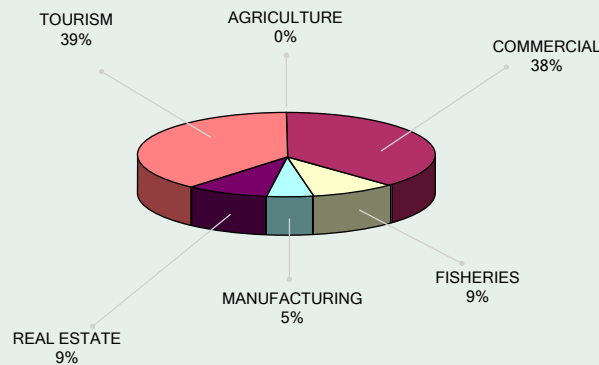
LOAN PORTFOLIO

The loan portfolio experienced a slight growth of about 15% to close the year with a gross portfolio balance of \$26 million as compared to \$22 million at year end 2006. This was a significant increase since 2003 and was largely the result of a large loan that was reactivated and transferred under the Bank's direct loan portfolio from the IDF private reserve sub account. As illustrated in the pie chart that follows, more than 75% of the outstanding portfolio was concentrated in the tourism and commercial sectors with 39%

MANAGEMENT REPORT

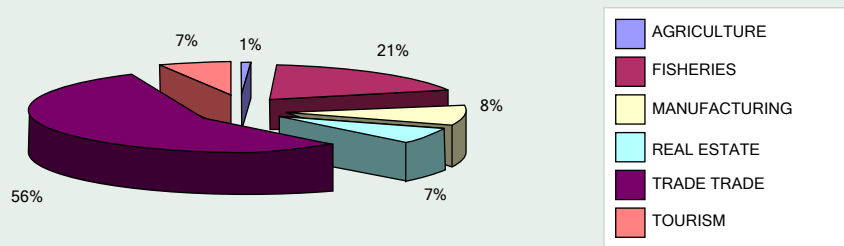
and 38% of the total portfolio respectively. The remaining 23% was divided almost evenly amongst the remaining Fisheries, Real Estate, Manufacturing and Agriculture.

Outstanding Loan Portfolio as of 12/31/07 by Sector



APPROVALS

37 loans were approved in 2007 totaling \$6.6 million as compared to 71 loans for \$9.5 million in 2006. Most of the loans that were approved during the year in terms of amount were in the Commercial Sector particularly the Trade Sector which accounted for 56% of the approvals. The Fisheries Sector was the second most active portfolio with 21%. The remaining were evenly divided amongst the other sectors with exception to the Agriculture sector which showed little activity with only 2 loans being approved during the year for \$50,500.



LOAN DELINQUENCY

The Bank monitors and manages the loan arrearages on three fronts: 1) by number of accounts, 2) by payments in arrears and 3) by outstanding balance. The Bank remained within the 5% target by payment in arrears at year end 2007, though it was slightly increased from 3% that was reported at year end 2006. It was, however, not as fortunate in the number of account and by outstanding balance fronts with both ratios reported to have exceeded the 20% target at year end 2007 with 35 and 33 percents respectively. Management shall continue to exert its efforts in reducing these ratios in the forthcoming years.

MANAGEMENT REPORT

SECTOR DEVELOPMENT

The Bank remains committed to developing the following economic sectors; 1) Tourism, 2) Fisheries, 3) Agriculture, 4) Commercial, 5) Real Estate and 6) Manufacturing. During the year, the Commercial sector was reclassified and broken down into two sectors; 1) Trade and 2) Transportation. The former covers general merchandise wholesale and retail operations while the latter sea, air and land transport services.



For a better understanding of the market of which the Bank is mandated to operate, the Bank contracted the University of Guam Small Business Development Center (SBDC) and hired a consultant to assist management to physically map out the market and reclassify the economic sectors. A pilot project commenced in Chuuk and is expected to be completed early next year 2008. Depending on how useful and successful the pilot project will be, the same process will be conducted on the remaining States so that the Bank can have an overall picture of the Market it operates.

To facilitate the development of the Trade sector especially with respect to the wholesale and retail operations, the Bank is now extending short term financing in the form of lines of credits to finance working capital needs. As of year end 2007, the Bank had extended 4 lines of credits valued at over \$1 million. This facility is also available to construction companies, manufacturing operations or any other business operations that may have insufficient working capital.

The bank entered into an MOU with the U.S. Department of Agriculture to engage in residential home financing under its Rural Economic Community Development Agency housing programs. The Bank views this as an opportunity to expand the real estate sector to perhaps someday include the residential home financing as a new product to offer the FSM people. There are plans to commence a Residential Home Loan program in 2008 that will be funded by the Bank.

FUNDING SOURCES

Internally generated funds from loan repayments continued to be the Bank's main funding source. The Bank did not receive any funding from the FSM National Government in 2007, therefore, the Bank had to compensate by aggressively pursuing other funding sources.

Management signed off a \$2 million dollar loan from the China Export & Import Bank for on lending towards the end of the year. The loan is to be repaid in five years with an interest rate of 7.38% per annum. As of year end 2007, the Bank had yet to draw on the loan. There are no restrictions on the on lending. It could be lent for any commercially viable projects.

Management is also pursuing a line of credit in the amount of \$2 million from the European Investment Bank (EIB).

As of year end 2007 the bank had slightly over \$3 million available for lending.

MANAGEMENT REPORT

ADMINISTERED FUNDS

Aside from the Direct Loan Portfolio, the Bank manages three non-proprietary type funds: 1) the Investment Development Fund (IDF), 2) the Pohnpei Loan Development Fund (PDLF) and 3) the Yap Loan Development Fund (YDLF). The fund status and balances for each of the funds types mentioned above are reported in the financial section of the report.

The IDF was a special fund established during the first Compact Agreement with the United States. The main purpose of this fund was to finance large-scale development projects through joint ventures between citizens of the FSM and United States investors. The fund was pledged \$60 million but only \$20 million was availed. The \$20 million was allocated and divided into five sub accounts. The table below shows the fund status as of 12/31/07.

Loan decisions for the states' IDF sub-accounts are made 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. The FSMDB has sole approval authority on the Private Reserve sub-account. FSMDB's role on the sub-accounts aside from being the custodian of the funds is limited to reviewing project proposals and presenting its findings to the FDA for its decision.

Similarly, the PDLF and the YDLF are set up the same as the IDF. All loan decisions are made by the Governors of the respective States.

LOANS TO WOMEN

The Bank's total lending to loans classified as loans to women since 2000 totaled 299 loans with a total value of \$9.6 million. These are loans with women being the principal borrowers. It should be noted, however, that a good majority of the projects under the current portfolio is either co-owned or managed by a woman.

PERSONNEL

The number of employees for the Bank remained at 35 as of December 31, 2007. Though the number remained the same, there were some changes in personnel during the year. At the Corporate Office, Lucille Martinez, Loan Security Officer resigned to pursue other opportunities. She was replaced by Marlyn Tom. At the Pohnpei Branch, Lenster Donre was hired as a loan officer. And finally at the Chuuk Branch, Curley Sos was promoted to Branch Manager and Anselmo Daniel who was the Branch Manager assumed the Loan Officer position.

TRAINING

Staff development and training continues to be a priority for the Bank. The Bank expended more than 90% of its training budget during the year. Most of the trainings were conducted off-island in the Philippines. The rest were conducted in-house. Listed below are the training programs and names of the staff that attended:

MANAGEMENT REPORT

Off-Island Trainings

1. Corporate Social Responsibility & Governance Workshop sponsored by ADFIAP
 - Stevenson Joseph, Senior Vice President
2. Project Finance & Investment Appraisal by DFI
 - Sihna Lawrence, Chief Financial Officer
 - Alik Alik, Loan Administrator
 - Franky Edward, Loan Officer
 - Curley Sos, Loan Officer
3. Project Appraisal, Supervision and Remedial Management by Planters Bank
 - Augustin Loyola, Loan Officer
 - Yoster Johnny, Loan Officer
 - Ricky Jano, Loan Remedial Officer
 - Christopher Buchun, Loan Officer

In House Trainings

1. Administrative Support Training, in house conducted by Senyorina Yang, Administrative Assistant
 - Sonia Kehpas, Branch Administrative Secretary
 - Jacinta Aisek, Branch Administrative Secretary
 - Wennifred Faimmau, Branch Administrative Secretary
2. On the Job Training (OJT) @ the Corporate Office
 - Teroa George, Loan Officer
 - Evelyn Paul, Loan Officer
3. Power Point Training provided by COM Pohnpei Campus Training Institute (PCTI)
 - Senior Staff
 - Pohnpei Branch Manager
 - Loan Administrator
 - Remedial Officer
 - Administrative Assistant

UPDATE ON THE MANAGEMENT INFORMATION SYSTEM

As part of an ADB loan to the FSM National Government to facilitate private sector development, the FSMDB was fortunate to receive funds to upgrade its Management Information System. The project began in 2005, but unfortunately as of year end 2007 the project remained unimplemented due to serious problems related to the functionality of the software that was procured. The vendor was asked to work on resolving the problems while Management worked with a local consultant to assess the project's viability going forward due to problems that had transpired in the system implementation process. As

MANAGEMENT REPORT

of year end 2007, the problems with the software remain unresolved and Management as yet to make a decision on a way forward with the project. It should be noted, however, that with the serious delay in the implementation of the project coupled with the vendor's inability to simply make the software function in accordance to the needs of the FSMDB, it is likely that Management may opt to cancel the project altogether and indefinitely.

UPDATE ON THE STRATEGIC PLAN

2007 is the third year of operations under the new 10-year strategic plan. With the exception of loan disbursements and the portfolio growth, the Bank's financial achievements up to year end 2007 were observed to be fairly inline with the objective set forth in the strategic plan. A 3-year review will be conducted in 2008 to realign the objectives and to make adjustments where needed.

BANK FACILITIES AND EQUIPMENT

Part of the new 10-year strategic plan was to relocate all Branch Offices to the ground level. We are happy to report that as of December 31, 2007 all Branch Offices have all been relocated to the ground level.

During the year, the Bank purchased 3 new vehicles to replace the existing ones in Chuuk, Pohnpei and Kosrae.

PROGRAMS

Community Services - Investing back into the community has always been and will continue to be an important role 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. During the year the Bank extended both financial and in-kind contributions to various civic activities and programs through out the communities.

Scholarship Program - Every year for the last five years, the FSMDB budgets \$10,000 to fund this program. The scholarship is primarily intended for those pursuing graduate degrees in business, economics, finance, accounting and/or related fields. In 2007 the Bank awarded two scholarships in the amount of \$5,000 each.



President & CEO, Anna Mendiola giving scholarship check to Naiten Phillip, Jr. working on his Master Degree in Marine Biology.

MANAGEMENT REPORT

ASSOCIATIONS AND MEMBERSHIPS

The Bank continued to be an active member of the following regional professional associations.

- Association of Development Financial Institution of Asia and the Pacific known as ADFIAP.
- Association of Developmental Financial Institutions of the Pacific known as ADFIP. This is an association of Development Banks of the Pacific Island Nations.
- Association of the Pacific Island Public Auditor (APIPA)
- Asia Pacific Association for Fiduciary Studies (APAFS)

ACKNOWLEDGEMENTS

We extend our sincere appreciation to the FSMDB stockholders for the continued 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 staff for their perseverance and patience and for their judicious implementation of their assigned tasks. Without them nothing would have happened.

Finally, we extend appreciation and thanks to those we serve for the trust and confidence they have in us and for allowing the FSMDB the opportunity to serve and assist in their business ventures. We shall always remain your partner in business.

SPECIAL ACKNOWLEDGEMENTS

We would like to take this opportunity and extend our appreciation and thanks to the following staff who left the Bank to pursue other career opportunities:

- Lucille Martinez, Loan Security Officer, Corporate Office

Likewise, we welcome the new additions to the FSMDB Team:

- Marlyn Tom, Loan Security Officer, Corporate Office
- Lenster Donre, Loan Officer Pohnpei Branch

Finally, we thank Anselmo Daniel for his many years of productive service as the Chuuk Branch Manager and we welcome Curley Sos to the Management Team.

MANAGEMENT REPORT

KEY PERFORMANCE INDICATORS

KEY PERFORMANCE INDICATORS	2003	2004	2005	2006	2007
OPERATIONS					
Loan Interest Income	1,758,767	1,634,986	1,700,275	1,737,372	1,900,360
Investment Income	285,387	307,754	613,309	1,061,913	1,058,722
Non-Operating Revenues	1,278,694	1,036,186	576,054	519,177	368,055
Total Revenue	3,454,163	3,027,339	3,058,692	3,416,003	3,513,606
Total Expenditures	2,157,582	2,206,190	1,593,578	2,577,926	1,816,882
Net Profit/Loss	1,296,581	821,149	1,465,114	838,077	1,696,724
LOAN APPROVALS					
Amount of Approval	7,255,759	6,774,832	6,526,341	9,560,235	6,654,820
Number of Approval	107	65	65	71	33
FINANCIAL RESOURCES					
Net Assets	30,868,270	31,689,419	33,154,533	33,992,610	35,689,333
Total Assets	33,143,715	32,628,017	33,723,486	34,508,045	35,835,890
FINANCIAL EFFICIENCY					
Return on Net Assets	4.2%	2.6%	4.4%	2.5%	4.8%
Return on Assets	3.9%	2.5%	4.3%	2.4%	4.7%
Rate of Return - Loan Portfolio	8.3%	7.6%	7.6%	7.7%	7.3%
Rate of Return - Investment Portfolio	2.9%	4.0%	6.2%	10.0%	9.3%
EARNING ASSETS					
Gross Outstanding Loans	21,214,218	21,402,989	22,424,442	22,694,998	26,020,506
Investments	9,772,044	7,699,921	9,885,832	10,606,544	11,349,641
Managed Funds	7,635,152	6,481,445	7,364,591	7,738,628	8,043,115
Staff Loan	131,827	147,956	173,986	171,605	150,696
LOAN ARREARS					
By Percentage of Dollar Volume	5%	6%	3%	3%	5%
By Number of Bad Accounts	34%	28%	26%	35%	35%
By Outstanding Balance		28%	17%	40%	33%

2007 STATISTICS REPORT

TABLE 1. FSMDB CUMULATIVE LOAN APPROVAL BY STATE AND ENTERPRISE SINCE 1982
As December 2007

AGRICULTURE		FISHERY		MANUFACTURING		REAL ESTATE		TRADING		TOURISM		TRANSPORTATION		TOTAL	
No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
8	187,591	47	12,474,352	11	559,584	9	776,067	96	4,240,697	25	7,416,493	1	9,500	197	25,664,284
18	383,257	61	8,569,532	148	5,560,946	18	1,959,144	216	9,658,318	37	14,097,577	0	0	498	40,228,774
140	1,751,785	164	12,284,662	57	9,379,549	75	6,385,425	200	16,167,352	36	6,853,089	0	0	672	52,821,862
175	300,546	74	273,270	55	1,840,933	10	564,081	108	9,246,161	31	2,448,362	0	0	453	14,673,353
341	2,623,179.00	346	33,601,816.00	271	17,341,012.00	112	9,684,717.00	620	39,312,528.00	129	30,815,521.00	1	9,500.00	1820	133,388,273.00

Note: Total Cumulative Loans Approve for Yap Branch inclusive of ESA IDF loan (\$1,414,650.45) is \$25,667,368.39

TABLE 2. FSMDB CUMULATIVE LOAN APPROVAL BY WOMEN SINCE 2000
As of December 2007

	AGRICULTURE		FISHERY		MANUFACTURING		REAL ESTATE		TRADING		TOURISM		TRANSPORATION		TOTAL	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
YAP	1	3,930	2	7,657	1	5,270	0	0	26	842,772	1	36,000	0	0	31	895,629
CHUUK	0	0	1	25,174	79	199,227	0	0	59	1,265,144	8	907,741	0	0	147	2,397,286
POHNPEI	3	37,713	10	66,332	7	15,146	5	186,968	49	3,972,543	0	0	0	0	74	4,278,702
KOSRAE	4	20,896	6	12,500	10	602,700	4	409,595	23	963,841	0	0	0	0	47	2,009,532
TOTAL	8	\$62,539	19	\$111,663	97	\$822,343	9	\$596,563	157	\$7,044,300	9	\$943,741	0	0	299	\$9,581,149

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

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2007 AND 2006

INDEPENDENT AUDITORS' REPORT

Chairman
Board of Directors
Federated States of Micronesia
Development Bank

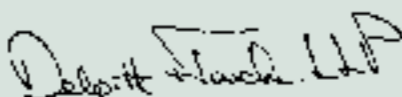
We have audited the accompanying statements of net assets of the Federated States of Micronesia Development Bank, a component unit of the National Government of the Federated States of Micronesia, as of December 31, 2007 and 2006, and the related statements of revenues, expenses and changes in net assets 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, 2007 and 2006, 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 May 29, 2008, 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 considered in assessing the results of our audit.



May 29, 2008

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

Statements of Net Assets
December 31, 2007 and 2006

	(Proprietary Fund Type) FSMIDB	
	2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,890,029	\$ 3,733,002
Time certificates of deposit	300,000	
Accounts receivable	2,638	5,523
Receivable from trust funds	306,908	205,827
Prepaid expenses	2,500	2,500
Interest and other receivables	128,529	122,262
Current portion of loans receivable	1,770,062	782,673
Total current assets	<u>4,390,766</u>	<u>4,851,797</u>
Noncurrent assets:		
Fixed assets, net	259,071	254,438
Investments	11,349,641	10,606,544
Equity investment, at cost	662,188	662,188
Loans receivable, net of current portion and allowance for loan losses	<u>19,165,324</u>	<u>18,133,078</u>
Total noncurrent assets	<u>31,436,224</u>	<u>29,656,248</u>
Total assets	<u>\$ 35,835,990</u>	<u>\$ 34,508,045</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 138,111	\$ 95,318
Credit life payable	8,267	114,396
Payable to trust funds	<u>279</u>	<u>305,721</u>
Total liabilities	<u>146,657</u>	<u>515,435</u>
Commitments and contingencies		
Net assets:		
Invested in capital assets	259,071	254,438
Restricted	500,000	-
Unrestricted	<u>34,930,262</u>	<u>33,738,172</u>
Total net assets	<u>35,689,333</u>	<u>33,992,610</u>
Total liabilities and net assets	<u>\$ 35,835,990</u>	<u>\$ 34,508,045</u>

See accompanying notes to financial statements.

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

Statement of Revenues Expenses and Changes in Net Assets
Years Ended December 31, 2007 and 2006

	(Proprietary Fund Type) FSMDB	
	2007	2006
Operating revenues:		
Loan interest	\$ 1,900,360	\$ 1,737,372
Investment income	1,058,722	1,061,913
Loan fees	111,767	72,649
Miscellaneous	74,702	24,892
Total operating revenues	3,145,551	2,896,826
Provision for doubtful loans	199,890	984,313
Net operating revenues	2,945,661	1,912,513
Operating expenses:		
Personnel services	934,649	850,510
Rent	131,512	119,407
Depreciation	78,141	49,666
Travel	72,304	87,805
Training	69,210	21,623
Contractual services	65,478	94,618
FSM retirement plan	52,733	52,597
Communication	39,303	40,744
Supplies	13,607	16,332
Insurance	4,691	3,296
Printing	1,410	6,067
Miscellaneous expenses	163,955	250,948
Total operating expenses	1,616,993	1,593,613
Earnings from operations	1,328,668	318,900
Non-operating revenues:		
IDF reimbursement	250,000	250,000
Allocations from managed funds	45,130	35,940
Contributions	-	177,721
Other income	72,925	55,516
Total non-operating revenues	368,055	519,177
Increase in net assets	1,696,723	838,077
Net assets at beginning of year	33,992,610	33,154,533
Net assets at end of year	\$ 35,689,333	\$ 33,992,610

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended December 31, 2007 and 2006

	(Proprietary Fund Type) FSMDB	
	2007	2006
Increase (decrease) in cash and cash equivalents		
Cash flows from operating activities:		
Cash received from customers	\$ 3,510,234	\$ 3,207,831
Cash paid to suppliers for goods and services	(1,073,162)	(733,766)
Cash paid to employees	(934,649)	(850,510)
Net cash provided by operating activities	<u>1,502,423</u>	<u>1,623,555</u>
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	(82,774)	(3,256)
Net cash used for capital and related financing activities	<u>(82,774)</u>	<u>(3,256)</u>
Cash flows from investing activities:		
Loan origination and principal collection, net	(2,219,525)	(610,642)
Increase in investments and time certificates of deposit	(1,043,092)	(720,712)
Net cash used for investing activities	<u>(3,262,622)</u>	<u>(1,331,354)</u>
Net change in cash and cash equivalents	(1,842,973)	288,945
Cash and cash equivalents at beginning of year	<u>3,733,002</u>	<u>3,444,057</u>
Cash and cash equivalents at end of year	<u><u>\$ 1,890,029</u></u>	<u><u>\$ 3,733,002</u></u>
Reconciliation of operating earnings to net cash provided by operating activities:		
Earnings from operations	\$ 1,328,668	\$ 318,900
Other earnings from managed funds and other	368,055	541,456
Adjustment to reconcile earnings from operations to net cash provided by operating activities:		
Provision for doubtful loans	199,590	984,313
Depreciation	78,141	49,666
(Increases)/decreases in assets:		
Receivables	(103,553)	(16,762)
Prepaid expenses	-	(500)
(Decrease) in liabilities:		
Accounts payable and other liabilities	(368,778)	(53,518)
Net cash provided by operating activities	<u><u>\$ 1,502,423</u></u>	<u><u>\$ 1,623,555</u></u>

Supplemental disclosure of non-cash financing activity:

During the year ended December 31, 2006, FSMDB received fixed assets valued at \$177,721 as a contribution from the FSM National Government.

During the years ended December 31, 2007 and 2006, the Bank received \$1,916,253 and \$1,698,433, respectively of interest income from loans in cash.

See accompanying notes to financial statements.

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

Notes to Financial Statements
December 31, 2007 and 2006

(I) Summary of Significant Accounting Policies

Reporting Entities

The Federated States of Micronesia Development Bank (the Bank) 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 Bank was reorganized in January 1984 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 Bank's repayment terms tend to be longer than those offered by commercial banks. As of December 31, 2007, the Bank has issued 2,997,883 shares to the FSM National Government (98.7%), Kosrae State (0.3%) and Chuuk State (1.0%).

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 Bank is a component unit (a discretely presented proprietary fund type) of the FSM National Government. The financial statements in this report do not represent the financial position, results of operations or cash flows of the FSM National Government as a whole. The financial statements of the Bank are not obligations of the FSM National Government unless specifically authorized by the FSM National Government. To date, no such authorizations have been made.

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, 2007, has entered into a line of credit agreement with Export and Import Bank of China for \$2 million. As of December 31, 2007, the Bank has not drawn on this line. Additionally, the Bank has entered into a memorandum of understanding with USDA RECD to provide guarantees for housing loans in the FSM. An escrow account amounting to \$500,000 was established for the housing guarantee.

Fund Structure and Basis of Accounting

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

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

Notes to Financial Statements
December 31, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

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).

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, "Basic Financial Statements—Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Disclosures". GASB Statement No. 34 establishes 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, 2007 and 2006, the Bank does not have nonexpendable restricted 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.

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

Notes to Financial Statements
December 31, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

Fund Structure and Basis of Accounting

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash and Cash Equivalents

For the purposes of the statements of net assets and the statements of cash flows, cash and cash equivalents are defined as cash in bank checking and savings accounts, money market funds, and commercial paper with original maturities of three months or less from the date of acquisition.

Time certificates of deposit with original maturities of greater than three months are separately classified.

Investments

Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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 assets have estimated useful lives 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. Assets with a purchase value less than \$5,000 are expensed fully in the year of purchase.

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

Notes to Financial Statements
December 31, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

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.

Reclassification

Certain reclassifications have been made to the 2006 financial statements to correspond with the 2007 presentation.

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.

New Accounting Standards

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement had a material effect on the financial statements of the Bank.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

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

Notes to Financial Statements
December 31, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

In May 2007, GASB issued Statement No. 50, *Pension Disclosures* as an amendment of GASB Statements No. 25 and 27. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe the implementation of this statement will have a material effect on the financial statements of the Bank.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

(2) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

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

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

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

Notes to Financial Statements
December 31, 2007 and 2006

(2) Deposits and Investments, Continued

- (iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the Bank's investment advisor at the time of purchase, that not more than five percent of the market value of its investments shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of its investments shall be invested in any one industry group.
- (iv) Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments.

A. Deposits:

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- | | |
|------------|--|
| Category 1 | Deposits that are federally insured or collateralized with securities held by the Bank or its agent in the Bank's name; |
| Category 2 | Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Bank's name; or |
| Category 3 | Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Bank's name and non-collateralized deposits |

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Bank's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Bank does not have a deposit policy for custodial credit risk.

As of December 31, 2007 and 2006, the carrying amount of the Bank's total cash and cash equivalents was \$1,890,029 and \$3,733,002, respectively, and the corresponding bank balances were not materially different. Of the bank balance amounts, all are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2007 and 2006, bank deposits in the amount of \$200,000 were FDIC insured. The Bank does not require collateralization of its cash deposits, therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. Management's confidence in the financial strength of their banking institutions was the basis of the decision to not require collateralization. No losses as a result of this practice were incurred for the years ended December 31, 2007 and 2006.

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

Notes to Financial Statements
December 31, 2007 and 2006

(2) Deposits and Investments, Continued

B. Investments:

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by the Bank or its agent in the Bank's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the Bank's name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Bank's name

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of December 31, 2007 and 2006, investments at fair value are as follows:

	2007	2006
Fixed income securities:		
Domestic fixed income	\$ 3,859,371	\$ 2,660,969
Other investments:		
Domestic equities	5,347,165	7,945,575
Money market funds	3,143,105	-
	<u>\$ 11,349,641</u>	<u>\$ 10,606,544</u>

As of December 31, 2007 and 2006, the Bank's fixed income securities had the following maturities:

	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Greater Than 10 Years	Fair Value
2007					
U.S. Treasury obligations	\$ 59,576	\$ 451,912	\$ 398,361	\$ -	\$ 1,070,249
U.S. Government agency obligations	5,552	411,413	272,899	-	1,245,024
	<u>\$ 41,328</u>	<u>\$ 1,076,227</u>	<u>\$ 671,260</u>	<u>\$ -</u>	<u>\$ 2,800,357</u>
2006					
U.S. Treasury obligations	\$ -	\$ 428,547	\$ -	\$ -	\$ 928,897
U.S. Government agency obligations	<u>400,388</u>	<u>570,821</u>	<u>458,682</u>	<u>-</u>	<u>1,772,572</u>
	<u>\$ 400,388</u>	<u>\$ 1,099,368</u>	<u>\$ 458,682</u>	<u>\$ -</u>	<u>\$ 2,658,062</u>

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

Notes to Financial Statements
December 31, 2007 and 2006

(2) Deposits and Investments, Continued

B. Investments, Continued

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

The Bank's exposure to credit risk at December 31, 2007 and 2006, was as follows:

2007	<u>Total</u>	<u>Domestic</u>	<u>International</u>
Moody's Rating - AAA	\$ 2,859,371	\$ 2,859,371	\$ -
Total credit risk debt securities	\$ 2,859,371	\$ 2,859,371	\$ -
<u>2006</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
Moody's Rating - AAA	\$ 2,660,969	\$ 2,660,969	\$ -
Total credit risk debt securities	\$ 2,660,969	\$ 2,660,969	\$ -

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Bank will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Bank's investments are held and administered by trustees. Accordingly, these investments are exposed to custodial credit risk. Based on negotiated trust and custody contracts, all of these investments were held in the Bank's name by the Bank's custodial financial institutions at December 31, 2007 and 2006.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Bank. As of December 31, 2007, the Bank's investment in agency obligations of the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association constituted 6% and 7%, respectively, of its total investments. As of December 31, 2006, the Bank's investment in agency obligations of the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association constituted 21% and 27%, respectively, of its total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Bank has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

(3) Equity Investment, at Cost

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

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

Notes to Financial Statements
December 31, 2007 and 2006

(4) Loans Receivable

A summary of loans receivable at December 31, 2007 and 2006 follows:

	<u>2007</u>	<u>2006</u>
Unpaid principal balance	\$ 26,020,506	\$ 22,694,998
Allowance for loan losses	<u>(5,085,120)</u>	<u>(3,779,247)</u>
	\$ 20,935,386	\$ 18,915,751

Movements in the allowance for loan losses during the years ended December 31, 2007 and 2006, are as follows:

	<u>2007</u>	<u>2006</u>
Balance at beginning of year	\$ 3,779,247	\$ 3,135,020
Provision for loan losses	199,890	984,713
Loans charged off	(1,415,881)	(744,149)
Loan recoveries from previously charged off loans	471,415	243,969
Loan reactivations from previously charged off loans	2,050,449	160,094
Balance at end of year	\$ 5,085,120	\$ 3,779,247

(5) Fixed Assets

A summary of fixed assets as of December 31, 2007 and 2006, is as follows:

	Beginning Balance January 1, 2007	Additions	Deletions	Ending Balance December 31, 2007
Office furniture, fixtures and equipment	\$ 144,996	\$ -	\$ -	\$ 144,996
Home furniture, fixtures and equipment	13,608	-	(485)	13,123
Vehicles	171,348	76,762	(16,006)	232,104
Computers and software	<u>472,537</u>	<u>6,012</u>	-	478,549
	802,587	82,774	(16,491)	868,870
Less accumulated depreciation	<u>(548,049)</u>	<u>(78,142)</u>	<u>16,491</u>	<u>(609,699)</u>
Net fixed assets	\$ 254,538	\$ 4,633	\$ -	\$ 259,071

	Beginning Balance January 1, 2006	Additions	Deletions	Ending Balance December 31, 2006
Office furniture, fixtures and equipment	\$ 140,265	\$ -	\$ (45,269)	\$ 144,996
Home furniture, fixtures and equipment	13,608	-	-	13,608
Vehicles	191,558	-	(20,510)	171,048
Computers and software	<u>294,782</u>	<u>180,997</u>	<u>(43,244)</u>	472,537
	600,513	180,997	(69,023)	802,487
Less accumulated depreciation	<u>(547,386)</u>	<u>(49,666)</u>	<u>69,023</u>	<u>(548,049)</u>
Net fixed assets	\$ 123,127	\$ 131,331	\$ (20)	\$ 254,438

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

Notes to Financial Statements
December 31, 2007 and 2006

(6) Related Party Transactions

As of December 31, 2007 and 2006, the Bank has direct loans with outstanding balances of \$150,696 and \$171,605, respectively, to employees of the Bank and project loans extended to businesses owned by or affiliated with employees of \$2,802,120 and \$3,268,519, respectively. These loans were made under similar terms and conditions as exist with other borrowers. Officers and Board members are not eligible to borrow from the Bank.

(7) Commitments and Contingencies

Guaranty

The Bank, from time-to-time, is contingently liable on loan guarantees ranging from 50% to 90% of the outstanding loan balances for commercial projects within the FSM. There were no outstanding guaranteed loan balances as of December 31, 2007 and 2006.

Loan Commitments

The Bank has entered into loan commitments for loans approved but undischursed in the amount of \$6,382,254 at December 31, 2007.

Litigation

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

Self Insurance

The FSM Development Bank carries insurance to cover its potential risks from vehicle usage. 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.

Lease Commitments

The Bank has six operating leases as of December 31, 2007. Two are residential real estate leases for contract employees. Four leases are 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 exercised by the Bank and the leases renewed. The approximate future minimum annual lease payments payable by the Bank, assuming all options are exercised, are as follows:

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

Notes to Financial Statements
December 31, 2007 and 2006

(7) Commitments and Contingencies, Continued

<u>Fiscal year ending December 31,</u>	<u>Total</u>
2008	\$ 122,016
2009	122,016
2010	122,016
2011	122,016
2012	122,016
2013 - 2017	610,080
2018 - 2022	610,080
2023 - 2027	610,080
2028 - 2032	<u>610,080</u>
	\$ 3,050,400

In September 2007, the Bank entered into a line of credit agreement with Export and Import Bank of China for \$2 million. As of December 31, 2007, the Bank has not drawn on this line. Additionally in 2007, the Bank entered into a memorandum of understanding with USDA RECD to provide a guarantee of housing loans in the FSM. An escrow account amounting to \$500,000 was established for the housing guarantee. Net assets have been accordingly restricted in this amount.

(8) Contribution from the FSM National Government

The FSM Development Bank receives periodic subsidies of its operations from appropriations made by the Congress of the FSM. During the years ended December 31, 2007 and 2006, the Bank received \$0 and \$177,721, 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 each of the 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 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 controller is the designated Plan Administrator. Matching contributions to the Plan during the years ended December 31, 2007 and 2006 were \$52,733 and \$52,597, respectively. Management is of the opinion that the Plan does not represent an asset or a liability of the Bank.

(10) Staff Loan Revolving Fund

In July 2007, the Bank's Board of Directors approved the establishment of a Staff Loan Revolving Fund. In September 2007, a savings account was established for this purpose. As of December 31, 2007, the account has a balance of \$99,383.

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

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT

DECEMBER 31, 2007

INDEPENDENT AUDITORS' REPORT

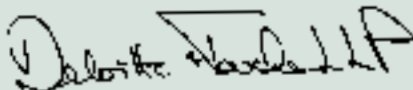
Chairman
Board of Directors
Federated States of Micronesia
Development Bank

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, 2007, 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, 2007, 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 May 29, 2008, on our consideration of the Funds' internal control over financial reporting and our tests of their 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 considered in assessing the results of our audit.



May 29, 2008

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

Trust Funds Statement of Net Assets December 31, 2007
(With Comparative Totals as of December 31, 2006)

	Governmental Fund Types			Totals	
	Trust Funds	YDLT	YDLT	(Memorandum Only)	
	TDJ	PQDI	YDLT	2007	2006
ASSETS					
Current assets:					
Held by FSMDB:					
Cash in bank and on hand	\$ -	\$ 236,898	\$ 70,628	\$ 297,496	\$ 245,852
Time certificates of deposit	592,777	543,013	176,286	1,209,076	1,164,095
Held by trustee:					
Investments	4,627,881	-	-	4,920,881	5,139,752
Total cash and equivalents	4,553,658	769,871	236,914	5,527,443	6,549,699
Receivable from FSMDB	219	-	-	379	355,721
Interest and other receivables	3,895	9,988	377	13,260	6,734
Loans receivable, net	7,858,258	67,003	122,554	8,039,815	7,736,428
Total receivables	7,853,432	76,991	122,931	8,053,354	8,050,883
	<u>\$ 12,407,090</u>	<u>\$ 843,862</u>	<u>\$ 329,845</u>	<u>\$ 12,580,797</u>	<u>\$ 14,650,552</u>
LIABILITIES AND NET ASSETS					
Current liabilities:					
Payable to FSMDB	\$ 87,959	\$ 123,947	\$ 94,112	106,008	\$ 265,827
Credit line payable	-	-	2,074	2,074	2,274
Total liabilities	87,959	123,947	96,186	308,052	268,101
Contributors					
Net assets:					
Restricted	7,858,258	67,003	122,554	8,039,815	7,736,428
Unrestricted	4,468,852	652,917	111,166	5,232,900	6,656,022
Total net assets	12,319,140	719,913	233,660	13,272,715	14,392,451
	<u>\$ 12,407,090</u>	<u>\$ 843,862</u>	<u>\$ 329,845</u>	<u>\$ 12,580,797</u>	<u>\$ 14,650,552</u>

See accompanying notes to financial statements.

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

Trust Funds Statement of Activities and Net Assets Year Ended December 31, 2007
(With Comparative Totals for the Year Ended December 31, 2006)

	Governmental Fund Types (Trust Funds)			Totals (Memorandum Only)	
	IOU	FDLP	YDLP	2007	2006
Operating revenues					
Investment interest	\$ 244,198	\$ 25,114	\$ 4,829	\$ 274,141	\$ 474,402
Loan interest	99,646	6,559	19,483	125,688	122,562
Miscellaneous	1,300	139	278	1,717	5,598
Total operating revenues	344,144	31,812	24,590	400,546	602,562
Operating expenditures					
Provision for loan expense	-	-	-	-	-
Total operating expenditures	-	-	-	-	-
Revenues over expenditures	344,144	31,812	24,590	400,546	602,562
Other uses (asset):					
Investment management fee	(250,000)	-	-	(250,000)	(250,000)
Transfer to Kosrae State Government	(68,000)	-	-	(68,000)	(68,000)
Transfer to Pohnpei State Government	(1,155,571)	-	-	(1,155,571)	-
Transfers to FSM DB	-	(12,833)	(12,297)	(25,130)	(35,940)
Total other uses, net	(1,473,571)	(12,833)	(12,297)	(1,521,701)	(335,940)
Revenues and other increases over expenditures and other uses	(1,129,427)	-	12,302	(1,117,125)	266,622
Net assets at beginning of year	13,451,173	719,915	221,363	14,392,451	14,124,355
Net assets at end of year	\$ 12,321,746	\$ 719,915	\$ 233,665	\$ 13,275,226	\$ 14,390,977

See accompanying notes to financial statements.

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

Notes to Financial Statements
December 31, 2007

(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 (the Bank). The Bank utilizes the Funds to carry out its stated purpose of providing loans for the economic development of the FSM. The specific purpose of each fund is as follows:

IDF 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 IDF is administered by the Bank in a Trust capacity.

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

For the purposes of the statement of net assets, cash is defined as cash in bank checking and savings accounts, and commercial paper with original maturities of three months or less from the date of acquisition. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified.

Investments

Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Loan and Allowance for Loan Losses

Loans under the trust funds are usually reported at gross unpaid principal balances, without an allowance for loan losses. The loans are reserved in net assets as restricted net assets. Loans are written off directly against income based on discussions with the owners of the managed funds. When the loans are recorded in the respective owner's financial statements, the owners of these funds will bear responsibility for establishing the related loan loss reserve.

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.

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

Notes to Financial Statements
December 31, 2007

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

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.

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 these estimates.

(2) Deposits and Investments

CASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. CASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

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

- (i) Government obligations - Obligations issued or guaranteed as to principal and interest by the National Government and/or State governments of the Federated States of Micronesia or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.
- (ii) Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the Federated States of Micronesia or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or other mortgage-backed securities provided that the obligation is an agency of the United States Government, the National Government of the Federated States of Micronesia, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the Funds' investments or ten percent of the outstanding value of the issue at the time of purchase.
- (iii) Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the Funds' investment advisor at the time of purchase, that not more than five percent of the market value of its investments shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of its investments shall be invested in any one industry group.

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

Notes to Financial Statements
December 31, 2007

(2) Deposits and Investments, Continued

- (iv) insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments.

A. Deposits

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- | | |
|------------|---|
| Category 1 | Deposits that are federally insured or collateralized with securities held by the Funds or its agent in the Funds' name; |
| Category 2 | Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Funds' name; or |
| Category 3 | Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Funds' name and non-collateralized deposits. |

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Funds' deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Funds do not have a deposit policy for custodial credit risk.

As of December 31, 2007, the carrying amount of the Funds' total cash and cash equivalents and time certificates of deposits was \$1,506,563 and the corresponding bank balances approximated the same amount. All of the bank balances are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2007, bank deposits in the amount of \$200,000 were FDIC insured. The Funds do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. Management's confidence in the financial strength of their banking institutions was the basis of the decision to not require collateralization. No losses as a result of this practice were incurred for the year ended December 31, 2007.

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

Notes to Financial Statements
December 31, 2007

(2) Deposits and Investments, Continued

B. Investments

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by the Funds or its agent in the Funds' name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the Funds' name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Funds' name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

As of December 31, 2007, investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ 3,187,275
Other investments:	
Money market funds	<u>\$33,606</u>
	\$ 4,020,881

As of December 31, 2007, the Funds' fixed income securities had the following maturities:

	Less Than 1 Year	1 to 5 Years	6 to 10 Years	Greater 10 Years	Fair Value
U.S. Government agency obligations	\$3,187,275	\$ -	\$ -	\$ -	\$3,187,275

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

The Funds' exposure to credit risk at December 31, 2007, was as follows:

Moody's Rating	Total	Domestic	International
AAA	\$ 3,187,275	\$ 3,187,275	\$ -
Total credit risk debt securities	\$ 3,187,275	\$ 3,187,275	\$ -

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

Notes to Financial Statements
December 31, 2007

(2) Deposits and Investments, Continued

B. Investments, Continued

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Funds will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Funds' investments are held and administered by trustees. Accordingly, these investments are exposed to custodial credit risk. Based on negotiated trust and custody contracts, all of these investments were held in the Funds' name by the Funds' custodial financial institutions at December 31, 2007.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Bank. As of December 31, 2007, the Funds' investment in agency obligations of Federal Home Loan Mortgage Corporation and Federal National Mortgage Association constituted 55% and 25%, respectively, of its total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Funds do not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

(3) Loans Receivable

The following is a schedule of loans receivable as of December 31, 2007:

	Loan Balance	Allowance	Net
State Development Funds (Pohnpei and Yap)	\$ 189,557	\$ -	\$ 189,557
IDF	7,853,558	3,300	7,850,258
	\$ 8,043,115	\$ 3,300	\$ 8,039,815

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 undischursed approximated \$99,724 at December 31, 2007.

**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 (the Bank), as of and for the year ended December 31, 2007, and have issued our report thereon dated May 29, 2008. 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 Bank's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Bank's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Bank's financial statements that is more than inconsequential will not be prevented or detected by the Bank's internal control.

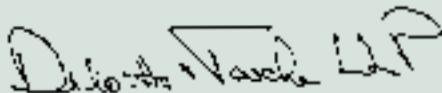
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Bank's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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 the Board of Directors and management of 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.



May 29, 2008

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Peter Aldis	Senior Loan Officer
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Richard Jano	Loan Remedial Officer
Gabriel Ramoloiug	System Administrator
Kedise Villazon	Accountant
Melshihner Hadley	Accountant
Marilynn Tom	Loan Security Officer
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