NATIONAL DEVELOPMENT BANK OF PALAU
(A COMPONENT UNIT OF THE REPUBLIC OF PALAU)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2009 AND 2008

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INDEPENDENT AUDITORS' REPORT

Board of Directors
National Development Bank of Palau:

We have audited the accompanying statements of net assets of the National Development Bank of Palau (the Bank), a component unit of the Republic of Palau, as of September 30, 2009 and 2008, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. 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 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 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 Bank as of September 30, 2009 and 2008, 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.

As discussed in note 10 to the financial statements, the Bank has deposits in an uninsured bank that is in receivership. Realization of these deposits is currently not determinable. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Management's Discussion and Analysis on pages 3 through 10 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 Bank's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Member of
Deloitte Touche Tohmatsu

In accordance with *Government Auditing Standards*, we have also issued our report dated March 11, 2010, on our consideration of internal control over financial reporting and our tests of its compliance with certain provisions of 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.

Deloitte & Touche LLC

March 11, 2010

NATIONAL DEVELOPMENT BANK OF PALAU
Financing the Future of Palau

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2009

This Management Discussion and Analysis (MD&A) of the National Development Bank of Palau's (the Bank) financial performance and condition for the fiscal year ended 2009 is intended to contribute to the reader's better understanding of the Bank's structure and activities. The report should be read in conjunction with the audited financial statements and associated reports.

Note that this report may at times anticipate future events that are based upon current assumptions subject to risk and uncertainties. Actual events may differ materially from these expectations.

Organization of the Bank

The Bank is a corporation established to initiate and promote economic development in the Republic of Palau (ROP). The Bank was created in February 1982 by Public Law Number 1-27 as codified in Title 26 of the Palau National Code, as amended. It is wholly owned by ROP and operates independently under its own Board of Directors. Its main goals are to promote economic development by providing financing for new enterprise, industry, exports and housing.

The President of ROP appoints six of its seven Board members for three-year terms subject to Senate confirmation. These six Board members appoint the seventh Board member and the President of the Bank. The Board of Directors elects their own officers to the posts of Chairman, Vice Chairman and Secretary/Treasurer, to serve the length of their terms. The Bank began 2009 with one vacancy which was filled by the end of first quarter. Subsequently, two new members replaced an outgoing member and another vacancy. The Bank operated with a full Board from January 2009 to year end.

The Bank achieves its mission and goals by relending funds obtained from lenders, donors and the government. Its financial objective is not to maximize profit but to attain sufficient financial strength to achieve its objectives. Therefore, the Bank functions as a development financial institution and not a commercial or central bank. It is exempt from banking supervision by ROP's Financial Institutions Commission (FIC) as long as it does not take in deposits; however, it is subject to prudential and reporting guidelines established by its Act and is subject to oversight hearings by either house of Congress at any time.

The Bank's Act has changed little since its last major revision. The most recent amendment was to increase the Bank's single borrower lending limit from 15% to 20%. Several amendments were entertained by Congress both directly and indirectly related to the Bank. For instance, Congress entertained measures to control the Bank's interest rates and terms, prohibit further borrowing, prohibit who the Bank can lend to, and to allow the government to borrow from the Bank. Measures proposed or supported to Congress included bills to allow Net Metering in support of renewable energy use in ROP, to allow for condominiums in Palau, and to allow the Bank to provide tuition loans. The Bank also requested Congress to approve a resolution to allow the Bank to borrow the balance of the 5 million Euros granted by contract from the European Investment Bank in 2006.

The Bank's policies and strategies are implemented through the Bank's President and management. Management consists of three managers organized by the functional areas of the Bank - Finance, Lending, and Special Assets. These managers answer directly to the Bank's President. The Board of Directors authorized funding for two positions in 2009. One position was not filled due to concerns over availability of space. A total of fourteen management and staff positions were filled during the year.

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All Bank operations were conducted from its two offices on leased premises in Medalaii Hamlet, Koror State at the beginning of the year. Towards the end of the year, several staff were moved, while renovation and expansion of the Bank's new building in Ngetkib Village, Airai State was in progress. By the end of the year, the Bank was actively in the process of moving all remaining staff, equipment, and furniture to its new building in Airai State. The move was completed in November 2009. Aside from this activity, no branches or subsidiaries were operated in 2009. The Bank's new building represents the growth strategy for the Bank and its business. The Airai State location was chosen to recognize the growth of the housing and business community in the State and to the north while staying close to Koror, which is still the economic capitol of Palau.

Significant Events in 2009

The major economic event in 2009 was the effect of the global financial and economic crisis and the stabilization of energy prices in the country. The weakened dollar also increased prices in Palau which imports an estimated 90% of what it consumes. Differences in recovery around the world through the year were also reflected in higher borrowing costs from the European Investment Bank. Higher prices and a noticeable decline in tourist arrivals and dollars are partly attributed to the decline in new loan applications from the Bank. The major local events of interest to the Bank and Palau's economic development were the new government taking office, discussions for additional funding from the United States (U.S.) through the Compact of Free Association, build-up of government debts and the decline in tourist arrivals and government revenues. Recovery is expected to trail economic growth in the U.S. market.

The Bank's reaction was to develop and implement a global temporary restructuring policy to assist businesses and homeowners affected by poorer economic conditions. With this temporary assistance, Bank clients would be able to keep their businesses in operation, sustain employment levels and maintain payments to the Bank. The Bank also adopted new credit guidelines to limit its credit risk exposure by creating a Pre-development short-term loan program to help businesses and homeowners finance their equity investment in their projects. Borrowers would pay off up to 15% of these project costs within five years and still borrow 85% over an even longer loan term. The longer term was intended to reduce the impact of tighter credit guidelines on customers.

Other steps taken during 2009 included the launch of the Bank's Energy Efficiency Subsidy Program (EESP) in January. The program provides subsidies applied against borrower loans when energy efficiency measures are included in new home construction. The program is funded by an Italian grant for $500,000. The Bank also retained a consultancy to strengthen its loan operations in conjunction with formal training that was offered through the year. The consultancy was approved in February 2009 and lasted throughout the year. Administrative improvements included the approval of accounting, procurement and employment policies worked on in 2008.

Funding for Operations

Historically, the Bank has funded its operations from three main sources: paid-in capital, accumulated retained income and borrowed funds. The most recent paid-in capital received from ROP was in the year 2000 for $3 million to fund a first-time homeowner program. New ROP externally funded capital has proven to be unattainable since. The Bank has relied upon accumulated retained income since 2002, and borrowed funds since 2003, to fund loan operations and the Bank's growth. Additional borrowed funds, loan sales and possibly debt through bond issuance are considered to be likely future funding sources for relending in the future. Deposit liabilities are considered a less likely source in the future unless political positions change.

Borrowed funds currently outstanding are from signed notes with the Mega International Commercial Bank or MICB (previously the International Commercial Bank of China), the Republic of Palau Social Security Administration (ROPSSA), the European Investment Bank (EIB) and a cash secured revolving line of credit with the Bank of Hawaii (BOH). The first three notes are for long-term intermediary relending funds. The BOH line of credit facility was opened as a short-term funding instrument. Cash security allows the Bank to reduce its cost of funds from this commercial facility. Towards the end of the year, the Bank received a positive response from the U.S. Department of Agriculture (USDA) for its $750,000 Intermediary Relending Program Loan application. The Bank is required to match these funds in a revolving fund. The funds are to be used to support micro, small and medium sized business projects. The Bank was still in the process of complying with terms and conditions as of the end of the year.

Retained earnings of the Bank are reinvested in loan operations each year. The timing and extent to which borrowed funds are utilized for lending activities is determined mainly by cost. The MICB loan proceeds represent the least costly funds available at a 3.5% fixed interest rate charged per annum. All proceeds from the MICB loan have been drawn.

A finance contract for 5 million Euros was signed with the EIB prior to the end of the 2006 calendar year. The Bank made two draws from these EIB funds in 2009. The actual dollar amount provided for the first draw was $3 million at a 3.679% fixed interest rate while the second draw was $1.4 million at a 5.175% fixed interest rate. The draws were denominated in US dollars under a contract amounting to $4.4 million. Only 50% of approved business or housing loan amounts can be funded by these monies. As contemplated, the other 50% of project costs were matched by either the Bank's cash flows or ROPSSA funds. The contract ended in 2009 and a request for extension is planned to utilize the available balance.

A new loan agreement with ROPSSA, which was entered into in August 2008, increased the loan amount to $6 million. The interest rate for the new note is based on the annual variable prime rate plus 0.5% provided that the interest rate charged and paid shall not be less than 4.5% or more than 7.5% and be fully amortized over 17 years. A total of $4.5 million has been drawn from ROPSSA at a 4.5% interest rate. A total of $3 million in investment accounts at the end of 2009 were proceeds of EIB and ROPSSA and are available for lending activities in 2010.

The Finance section of the Bank is accountable for accounting and financing activities including liquidity management. Liquidity management for the Bank includes segregation of bank accounts and transfers from general accounts to support disbursements. Disbursements are generally planned through the annual budget process. Forward estimates for loan disbursements are provided by line officers each month. Proceeds from loans to the Bank for intermediary re-lending are requested based on forward estimates and, where necessary, cash flows from operations, non-restricted investments and short-term credit line facilities are used if those proceeds are not immediately available. Management is mindful to minimize any additional interest costs in these decisions.

Financial Policies

The Bank's financial policies follow accounting principles generally accepted in the United States of America (GAAP) applicable to governmental entities and specifically proprietary funds. Management is required to make estimates, disclosures and assumptions in preparation of financial statements in conformity with GAAP and actual results may differ from amounts reported during the reporting period. The basis of accounting used is the flow of economic resources measurement focus, which means all assets and liabilities are included within the statement of net assets. The accrual basis of accounting is utilized whereby revenues are recorded when earned and expenses recorded when liabilities are incurred.

Significant financial policies of the Bank include a 10% reserve requirement for the Bank's loan guarantees. These reserves are held in time certificate of deposits (TCDs) with commercial banks. The Bank maintained cash reserves of at least 10% for commercial bank guarantees throughout the year. This cash account was reduced from 2008 as part of the Bank's liquidity management strategy. Restricted deposits are also held as part of requirements for the USDA Rural Development (USDA RD) for loans guaranteed by the Bank. These requirements are for fixed dollar and ratio amounts. The total reserve for commercial banks and USDA RD loans for 2009 was 17%.

All current guarantees are granted under recourse. The Bank offers 90% loan guarantees to local banks but the Bank may also guarantee up to 100% of select home loans from commercial banks made to Palauan citizens. The total amount for which the Bank was contingently liable in 2009 for commercial bank and USDA RD loans guaranteed by the Bank was $3.6 million. A small discrepancy over guarantees of several USDA RD loans is being resolved.

Other financial policies include ROP's full faith and credit guarantee backing for Bank loans up to $15 million in the aggregate subject to specific purpose limitations. Maximum Bank external borrowing authorized by ROP is $100 million. The maximum single exposure to a single borrowing entity was recently increased from 15% to 20% of the Bank's unimpaired paid-up capital, earned surpluses and reserves. Specific targets for exposure to industry are not formally established but concentrations are monitored on a regular basis. Loan maturities are monitored to match borrowings, operation costs and long outstanding loan commitments. In September 2009, maturities were concentrated in the 15-year range.

Operations

Financial assistance is provided by the Bank for projects involving housing, agriculture, marine resources, commerce and industry. Emphasis is given to new enterprises or ventures that promote import substitution. Authorized financing schemes include guarantees, direct loans and direct investment. The Bank is also required to provide technical assistance services as part of its operations. Currently, the Bank's financial activities are limited to projects within ROP. All financial transactions are US dollar denominated.

Direct Loans. Short to medium term financing are extended to new business startups or existing businesses to fund short-term working capital and equipment acquisitions. Longer term financing is extended to individuals for housing and businesses for facilities. Rates are fixed depending on the type of financing provided. Interest rates range from 6% to 12%. Rates are considered to include cost of funds and a lending spread to cover cost of operations, a risk component and a small return for growth purposes. Fees are usually 2% of financing extended. Costs of originating and closing the loan are also charged to borrowers. Specific programs offered under direct financing are agriculture loans, fishing loans, small business loans, housing loans and business loans. In 2009, the Bank approved 129 loan applications amounting to $10 million. This includes renewals, extensions, performance bonds, cancelled loans and guarantees. Total direct loans approved were 125 loans valued at $8.9 million (excluding renewals, extensions, and guarantees).

In the category of small business loans, the Bank offers customers four (4) programs: Small Business, WEDAP, Microfinance and its newest program, Pre-development Loan. All of these loans can be approved by the Bank's President. The Bank's general policy is all loans are fully secured. The Bank's Microfinance program and Pre-development Loan are small loans for housing or business purposes at a 6% interest rate targeting those borrowers able to secure their loan with an assignment of income. No collateral is required and turnover is intended to be quick. Success of these programs has yet to be determined although there has been a noticeable interest in Microfinance Loans in 2009, many for small home projects including renovations.

Direct housing loans are provided in two categories, the first-time homeowner program which offers an 8% interest rate and all other housing loans at a 10% interest rate. Owner contribution to the projects is required at 15% of project cost with a maximum amount of $10,000 under the Pre-development Loan and a loan term not to exceed 5 years. The purpose of the Pre-development Loan is to help borrowers pay for a plan design, appraisal, title search and all related fees associated with packaging loans and cash equity contribution. Eligible purposes for housing loans include new construction, renovation and extension. Most loans granted are for new construction. The Bank experienced an increase in applications for purchases of existing homes over the past two years as more people are relocating outside of Palau or joining the U.S. Armed Forces.

Guarantees. The Bank offers guarantees either backed by the Bank or ROP to commercial banks and other institutions. Commercial banks, government authorities and the regional development financial institution, Pacific Island Development Bank (PIDB), either currently accepts or holds guarantees from the Bank. The majority of guarantees outstanding from the Bank are to the USDA RD loans. In addition to the USDA RD Section 502 and 504 loans guaranteed by the Bank, there are leveraged loans which are co-financed by both the Bank and the USDA RD. No new developments occurred in 2009 regarding loan guarantees with the USDA.

Investments. In 2004, the Bank invested in a sizable share of common stock in a regional airline venture. The airline failed early in 2005 and efforts to rehabilitate the airline were pursued through 2009 with no success. In 2009, the Bank approved the last of the five loans to rewrite the $1 million share repurchase equally among the five principals. There were no further investments made by the Bank since.

Approval Process. All requests for financing are reviewed by loan officers who recommend approval or declination of a loan based on review of business and other plans, income and credit verifications and collateral. A normal approval cycle from application to approval can be obtained within three months with the exception of small loans approved by the President that can be approved within three weeks. The use of outside professionals to research land title, provide valuations on collateral, review and certify plans and conduct progress inspections is an integral part of loan origination. The Bank advocates building codes and requires the use of a recognized code in the design of all construction projects. The Bank utilizes a dual approval process whereby the next higher approval authority reviews loan decisions. The Board holds meetings of no less than three times per month to approve loans. Loan disbursements are made according to progress payments against approved loan purposes. Any deviation requires an amendment to the loan.

Loan Management. The Bank monitors payment performance and contacts clients on a seven, thirty, sixty and ninety days schedule with the degree of reporting based on each borrower's circumstance. Officers also conduct account reviews whenever a weakness becomes evident in a loan. As loans approach ninety days delinquency, the Special Asset Manager intervenes and assists the Account Officer with recovery or rehabilitation of the loan.

Financial Reporting. Financial reporting is made by each of the Bank's three sections and the President on a monthly basis. These reports include financial, loan and collection information as well as administrative, industry and economic environment information. Monthly and quarterly reports are provided to the Board of Directors and annual reports provided to lenders and ROP.

Overview of Financial Performance

Revenue. 2009 revenue, including loan fees and interest income on interest bearing accounts, increased 14% from 2008 in large part due to an increase in Pre-development and Microfinance loans. Revenue yield decreased despite increased activity due to lower rates offered. In addition, restructuring of the $1 million airline investment into several loans was given at the existing rate of investment. The Bank also lent to a high end resort at a lower rate to finance soft costs also adversely affecting the Bank's interest yield. Overall revenues achieved exceeded the Bank's budget estimates due to larger lending volumes. Revenues and yields going forward are expected to be stronger as the Bank subsequently disbursed $3.6 million of loans approved but undisbursed at the end of September 2009. The targeted level of undisbursed loans for the Bank is around $1.8 million.

Revenues in 2009 were supported by interest income on interest bearing accounts and from loan fees and charges. Cash was used during the year to fund loan operations and together with lower interest rates, caused a 36% reduction in income from interest bearing accounts from $122,562 in 2008 to $78,547 in 2009. The Bank amortizes loan fees and the annual portion of loan fees is reported as income in the current period.

Loan Interest Rates. The Bank's interest rates remained fixed according to the type of loan activity funded. Rates ranged from a low of 6% for agriculture, microfinance and pre-development loans to 8% for fishing and other loans such as first-time homeowner loans and 10% for commercial and housing loans. Several problem loan accounts in the process of collection remain priced at 12%. Other accounts in collection continue to be assessed a 9% interest rate as required by court ordered judgment. At the end of this reporting period, the average yield on the Bank's portfolio declined from 9.23% in 2008 to 8.85% in 2009 as loan growth occurred in lower interest rate loan programs.

Grant Requests. The Bank received a $500,000 grant in 2009 for EESP. Energy subsidy assistance is for clients who are building new homes with energy efficient measures. The majority of grant revenues received in 2009 were for this program.

Expenses. The Bank's net provision for loan losses in 2009 was $247,078 as additional provisions and charge-off actions were taken towards the end of fiscal year. This action was taken on loans over 90-days past due that had not shown improvement and where collection action was ineffective. Provisions are net of recoveries for the year. The increase in interest expense for the Bank reflected increased prime rates and higher rates for additional funds from the Bank's EIB loan in 2009.

Total operating expenses for 2009 was 25% more than the 2008 expenses reflecting full staffing levels and a change in expense policy for minor assets acquired (reflected in other expenses). The Bank's commitment for training new and existing staff with internet-based, bank-designed and off-island training continued with mentoring consultancy costs and 2008 policy consultant expenses reported under other expenses. Depreciation costs decreased as no new acquisition of fixed assets occurred during the year. Travel expense was also higher than 2008.

Change in Net Assets. The change in net assets in 2009 was lower by $154,028 due to an increase in provision for loan losses of 109% from 2008. The change in net assets for the year of $598,174 will be used to fund additional loans. A condensed year-to-year comparison of operating activity reflecting the foregoing statements follows:

Statements of Revenues, Expenses and Changes in Net Assets

	2009	2008	$ Change	% Change	2007
Revenues:					
Interest income on loans	$ 1,938,063	$ 1,719,225	$ 218,838	13%	$ 1,620,604
Loan fees and late charges	59,191	30,872	28,319	92%	106,265
Other	6,420	6,724	(304)	-5%	10,858
Total operating revenues	2,003,674	1,756,821	246,853	14%	1,737,727
Provision for loan losses	(247,078)	(118,474)	(128,604)	109%	(448,008)
Operating expenses:					
Salaries, wages and fringe benefits	416,497	358,498	57,999	16%	295,329
Rent	42,568	41,624	944	2%	41,535
Depreciation	35,297	42,115	(6,818)	-16%	35,638
Training	2,065	26,280	(24,215)	-92%	28,825
Other expenses	361,050	215,242	145,808	68%	172,330
Total operating expenses	857,477	683,759	173,718	25%	573,657
Operating income	899,119	954,588	(55,469)	-6%	716,062
Total non-operating revenues (expenses), net	(300,945)	(202,386)	(98,559)	49%	(202,012)
Change in net assets	598,174	752,202	(154,028)	-20%	514,050
Net assets at beginning of year	15,098,873	14,346,671	752,202	5%	13,832,621
Net assets at end of year	$ 15,697,047	$ 15,098,873	$ 598,174	4%	$ 14,346,671

A condensed year-to-year comparison of the Statements of Cash Flows follows:

Statements of Cash Flows

	2009	2008	$ Change	% Change	2007
Cash flows from operating activities	$ 997,871	$ 948,565	$ 49,306	5%	$ 1,129,857
Cash flows from capital and related financing activities	4,624,569	(292,481)	4,917,050	-1681%	963,136
Cash flows from investing activities	(4,715,723)	(2,283,751)	(2,431,972)	106%	(2,625,615)
Cash flows from noncapital financing activities	(53,828)	317,500	(371,328)	-117%	(303,299)
Net decrease in cash and cash equivalents	852,889	(1,310,167)	2,163,056	-165%	(835,921)
Cash and cash equivalents at beginning of year	848,201	2,158,368	(1,310,167)	-61%	2,994,289
Cash and cash equivalents at end of year	$ 1,701,090	$ 848,201	$ 852,889	101%	$ 2,158,368

Overview of Financial Condition

Loan Portfolio. The Bank approved one hundred and twenty-five loans amounting to $8.9 million in 2009 compared to seventy-one loans amounting to $6.4 million approved in 2008. The larger number of loans extended reflected full staffing in the loan section for the Bank as well as the introduction of the Pre-development program in 2009. The disproportionate dollar increase in loans was due to smaller loans being extended under the Pre-development and Microfinance programs.

The Bank's goal during the year remained growth in income and assets while maintaining credit quality. Emphasis was also made towards growing the commercial sector portfolio which was challenging given less than favorable industry and economic conditions. As the economy weakened, growth in the housing portfolio slowed in comparison to business loan growth which tends to be for larger amounts. Commercial loans as a share of the portfolio has increased reaching 54% of the Bank's loan portfolio. The proportion of loans by major sector follows. Note that Microfinance loans are also included in the housing loan category. Many of these loans were for renovations and improvements to existing dwellings. Outstanding loans by type of loan are as follows:

Sector	Number	Amount	%Value
Agriculture	12	$ 145,323	1%
Fisheries	7	$ 22,375	0%
Commerce	119	$ 13,255,527	54%
Housing	340	$ 11,090,838	45%

The total number of loans on the Bank's books at year end was 479 loans. The Bank did not sell any of its loans in 2009 and no participated loans were made. Discussions were being entertained for a loan purchase of Bank loans in 2010 on a full recourse basis.

Arrears. Total number of accounts with amounts in arrears and notes past maturity (over 30 days) at the end of 2009 was 43 accounts amounting to $165,000. The amount of arrears as a percentage of the value of outstanding notes at the end of 2009 was close to 2.9%.

New Debt. The Bank used and renewed a $300,000 line of credit with a commercial bank to support its liquidity needs. This facility is for a one year term and is renewable. The Bank maintained a deposit of $400,000 with the same commercial bank securing this line of credit.

Net Assets. The Bank's overall change in net assets for 2009 and 2008 was $598,174 and $752,202, respectively. Net increase in capital assets for 2009 was $50,892 reflective of additional improvements of the Bank building in Airai.

Plant and Equipment. At September 30, 2009, 2008 and 2007, the Bank had $579,722, $528,830 and $64,548, respectively, invested in capital assets, net of accumulated depreciation where applicable, including leasehold rights, furniture, fixtures and equipment, vehicles and leasehold improvements and construction in progress, which represents a net increase in 2009 of $50,892 or 10% over 2008 and a net increase in 2008 of $464,282 or 719% over 2007. See note 4 to the financial statements for more information on the Bank's plant and equipment.

The following condensed Statements of Net Assets highlights the aforementioned changes in condition with comparative information from prior years.

Statements of Net Assets

	2009	2008	$ Change	% Change	2007
Current and other assets	$ 28,698,390	$ 23,134,270	$ 5,564,120	24%	$ 22,263,833
Capital assets	579,722	528,830	50,892	10%	64,548
Total assets	$ 29,278,112	$ 23,663,100	$ 5,615,012	24%	$ 22,328,381
Loans payable	$ 13,302,167	$ 8,461,687	$ 4,840,480	57%	$ 7,965,829
Other liabilities	278,898	102,540	176,358	172%	15,881
Total liabilities	$ 13,581,065	$ 8,564,227	$ 5,016,838	59%	$ 7,981,710
Net assets:					
Invested in capital assets	$ 579,722	$ 528,830	$ 50,892	10%	$ 64,548
Restricted	15,117,325	14,570,043	547,282	4%	14,282,123
Total net assets	$ 15,697,047	$ 15,098,873	$ 598,174	4%	$ 14,346,671

Affiliations

The Bank's membership and partnership affiliations locally and abroad include the Palau Chamber of Commerce, American Bankers Association (ABA), Risk Management Association (RMA), various foreign government agencies, the Association of Development Finance Banks (ADFIP) and the Association of Development Finance Institutions in Asia and the Pacific (ADFIAP). Benefits received from these associations include information exchanges, professional networking, and training opportunities.

Risk Management

Primary risks the Bank faces include Strategic/Operational, Credit, Technology, Economic, Reputation/Political, and Climatic/Environmental risks (in no particular order). The Board of Directors manages these risks with the assistance of management.

Monitoring is conducted primarily through management and external audit reporting. Mandatory reporting to the National Government is also provided during the National budget process and through specific reporting requirements under the Bank's enabling legislation.

Loss Provisioning. The Bank provides for loan losses with a general provision of 3% and specific provisions of 20%, 50% and 100% depending on the extent loans are past due and the value of security held as collateral. The Bank manages its loans by assigning credit and security risk ratings to each account.

Loans and associated security are rated on a scale ranging from "A thru F" similar to the World Bank system. All loans are individually managed by this system. Loan accounts are required to be reviewed regularly.

Decisions to place loans on nonaccrual of income status are made according to Bank policy which also provides that loans may be held on accrual if justified by the Bank Officer. As of September 30, 2009, thirty-one loans amounting to $1.3 million (payoff balance) were on nonaccrual status.

Economic Outlook

Activities planned in 2010 of significance include introduction of an energy loan product, receipt of over $500,000 in grants to support that program, finalization of the $750,000 USDA Program Loan and further borrowing from the European Investment Bank from one to five million Euros. Further consideration of a Micro, Small and Medium Enterprise (MSME) loan program, declined in 2009, is also planned. Additional credit training and technical assistance for capacity building and client support are also planned. The development of these activities relies upon improving global economy and reduced uncertainty in the local market.

Contacting the Bank's Financial Management

This financial report is designed to provide a general overview of the Bank's finances and to demonstrate the Bank's accountability for the money it receives. The Management's Discussion and Analysis for the year ended September 30, 2008 is set forth in the report on the audit of the Bank's financial statements which is dated April 14, 2009. That Discussion and Analysis explains the major factors impacting the 2008 financial statements. If you have questions about the 2008 or 2007 reports, or need additional information, please contact the Finance Manager at the National Development Bank of Palau, P.O. Box 816, Koror, Republic of Palau 96940, or e-mail frirou@ndbp.com or call 488-2578/3955.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Net Assets
September 30, 2009 and 2008

ASSETS	2009	2008
Current assets:		
Cash and cash equivalents	$ 1,701,090	$ 848,201
Restricted time certificates of deposit	3,061,188	551,773
Receivables:		
Current portion of economic development loans receivable, net	2,707,480	2,655,041
Accrued interest	421,965	339,850
Other receivables	214,130	189,061
Inventory	8,716	7,024
Prepaid expenses	43,216	53,443
Total current assets	8,157,785	4,644,393
Restricted cash and cash equivalents	598,301	779,092
Time certificates of deposit	205,112	205,112
Investments	-	1,000,000
Economic development loans receivable, net	19,466,114	16,179,095
Property and equipment, net	579,722	528,830
Foreclosed real estate	271,078	326,578
	$ 29,278,112	$ 23,663,100

LIABILITIES AND NET ASSETS	2009	2008
Current liabilities:		
Current portion of loans payable	$ 285,716	$ 285,716
Due to grantor	182,456	-
Accounts payable and accrued expenses	96,442	102,540
Interest payable	108,677	90,231
Short-term loan payable	-	300,000
Total current liabilities	673,291	778,487
Loans payable, net of current portion	12,907,774	7,785,740
Total liabilities	13,581,065	8,564,227
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	579,722	528,830
Restricted	15,117,325	14,570,043
Total net assets	15,697,047	15,098,873
	$ 29,278,112	$ 23,663,100

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2009 and 2008

	2009	2008
Operating revenues:		
Interest income on loans	$ 1,938,063	$ 1,719,225
Loan fees and late charges	59,191	30,872
Other	6,420	6,724
Total operating revenues	2,003,674	1,756,821
Provision for loan losses	(247,078)	(118,474)
Net operating revenues	1,756,596	1,638,347
Operating expenses:		
General and administrative expenses:		
Salaries, wages and fringe benefits	416,497	358,498
Professional fees	109,599	49,411
Travel and transportation	102,741	73,259
Rent	42,568	41,624
Depreciation	35,297	42,115
Utilities	28,998	15,157
Supplies, printing, and reproduction	13,917	10,101
Communications	13,102	13,728
Dues and subscriptions	10,347	8,894
Repairs and maintenance	8,151	9,225
Honorariums and meeting expense	7,935	5,920
Insurance	6,559	6,322
Training	2,065	26,280
Miscellaneous	59,701	23,225
Total general and administrative expenses	857,477	683,759
Operating income	899,119	954,588
Nonoperating revenues (expenses), net:		
Interest income on interest bearing accounts	78,547	122,562
Rental income	30,000	12,500
Grant revenues	37,743	17,625
Interest expense and loan fees	(447,402)	(356,359)
Other	167	1,286
Total nonoperating revenues (expenses), net	(300,945)	(202,386)
Change in net assets	598,174	752,202
Net assets at beginning of year	15,098,873	14,346,671
Net assets at end of year	$ 15,697,047	$ 15,098,873

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Cash Flows
Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Cash received from customers	$ 1,842,683	$ 1,701,157
Cash payments to employees for services	(438,628)	(353,207)
Cash payments to suppliers for goods and services	(406,184)	(399,385)
Net cash provided by operating activities	997,871	948,565
Cash flows from capital and related financing activities:		
Proceeds from issuance of long-term debt	5,407,750	500,000
Acquisition of property and equipment	(86,189)	(131,979)
Repayments of long-term debt	(285,716)	(285,716)
Interest paid on long-term debt	(411,276)	(374,786)
Net cash provided by (used for) capital and related financing activities	4,624,569	(292,481)
Cash flows from investing activities:		
Interest received on interest bearing deposits	157,423	59,250
Net change in restricted cash and cash equivalents	180,791	(19,631)
Net change in time certificates of deposit	(2,509,415)	(12,377)
Loan originations and collections, net	(2,544,522)	(2,310,993)
Net cash used for investing activities	(4,715,723)	(2,283,751)
Cash flows from noncapital financing activities:		
Proceeds from short-term borrowings	600,000	300,000
Cash received from grantor	220,199	-
Rental income received	30,000	17,500
Repayments of short-term borrowings	(900,000)	-
Interest paid on short-term borrowings	(4,027)	-
Net cash (used for) provided by noncapital financing activities	(53,828)	317,500
Net increase (decrease) in cash and cash equivalents	852,889	(1,310,167)
Cash and cash equivalents at beginning of year	848,201	2,158,368
Cash and cash equivalents at end of year	$ 1,701,090	$ 848,201
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 899,119	$ 954,588
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation	35,297	42,115
Provision for loan losses	247,078	118,474
(Increase) decrease in assets:		
Interest receivable	(160,991)	(55,664)
Other receivables	(25,069)	(90,979)
Inventory	(1,692)	2,256
Prepaid expenses	10,227	(31,384)
Increase (decrease) in liabilities:		
Accounts payable and other liabilities	(6,098)	9,159
Net cash provided by operating activities	$ 997,871	$ 948,565

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Cash Flows, Continued
Years Ended September 30, 2009 and 2008

	2009	2008
Supplemental schedule of noncash investing activities:		
Investment transferred to loans:		
Increase in economic development loans receivable	$ 1,000,000	$ -
Decrease in investment	(1,000,000)	-
	$ -	$ -
Foreclosed real estate transferred from loans:		
Increase in foreclosed real estate	$ -	$ 72,578
Decrease in economic development loans receivable	-	(72,578)
	$ -	$ -
Acquisition of leasehold rights:		
Increase in plant and equipment	$ -	$ 374,418
Increase in rental income		(12,500)
Increase in accounts payable and accrued expenses		(77,500)
Decrease in economic development loans receivable	-	(284,418)
	$ -	$ -

See accompanying notes to financial statements.

(1) Organization

The National Development Bank of Palau (the Bank), a component unit of the Republic of Palau, was formed on February 24, 1982, under the provisions of Republic of Palau Public Law (RPPL) No. 1-27, as amended by RPPL 3-4, 4-48, 5-37 and 6-18. The law created a wholly-owned government corporation managed by a Board of Directors appointed by the President of the Republic of Palau with the advice and consent of the Olbiil Era Kelulau (OEK - Palau National Congress). The purpose of the Bank is to be the central financial institution responsible for initiating and promoting economic development within the Republic of Palau, and considers all of its net assets, except net assets invested in capital assets, to be restricted for such purposes.

(2) Summary of Significant Accounting Policies

The accounting policies of the Bank conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (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 Principles 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 preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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. Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of this fund are included within the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred.

B. Cash and Cash Equivalents and Time Certificates of Deposit

For the purpose of the statements of net assets and cash flows, the Bank considers all highly liquid investments, with maturities of three months or less when purchased, to be cash and cash equivalents. Time certificates of deposit with initial maturities of greater than three months are separately classified. The Bank does not require collateralization of its bank accounts. Cash and cash equivalents and time certificates of deposit maintained in Federal Deposit Insurance Corporation (FDIC) insured banks amounted to $5,297,902 and $1,769,447 at September 30, 2009 and 2008, respectively, with $750,000 and $300,000, respectively, being subject to FDIC insurance coverage.

(2) Summary of Significant Accounting Policies, Continued

B. Cash and Cash Equivalents and Time Certificates of Deposit, Continued

Time certificates of deposit maintained in an uninsured bank amounted to $205,112 at September 30, 2009 and 2008. The Bank does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

RPPL 4-48, Section 126, as amended by RPPL 5-37, stipulates that the Bank shall maintain a reserve account to be applied to all defaults on commercial loans guaranteed by the Bank. The reserve account shall equal ten percent (10%) of the total amount of all loan guarantees on commercial bank loans, whether or not protected by the full faith and credit of the Republic of Palau. The Bank has restricted $50,016 and $235,163 of cash and cash equivalents as of September 30, 2009 and 2008, respectively, to comprise this reserve. The Bank has also restricted cash and cash equivalents held solely for the guarantee of Rural Housing and Community Development Service (RHCDS) loans in the amount of $548,285 and $543,929 as of September 30, 2009 and 2008, respectively.

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 September 30, 2009 and 2008, cash holdings of $53,435 and $453,152, respectively, are held and administered by an investment manager subject to Securities Investor Protection Corporation insurance.

(2) Summary of Significant Accounting Policies, Continued

C. Investments

An investment in the common stock of Palau Rock Island Air, Inc., an airline company, was stated at cost as fair value was not readily determinable. The investment was collateralized by real property owned by certain shareholders in the airline. The airline ceased operations in 2005. In 2009, the Bank liquidated its investment and approved the restructuring of loans of the five principal shareholders of the airline, equivalent to the investment value at the time of liquidation. The liquidation did not result in a gain or loss.

D. Loans and Allowance for Loan Losses

The Bank grants loans to eligible borrowers, including officers and employees, all of which are located in the Republic of Palau. Loans are stated at the amount of unpaid principal and interest, reduced by an allowance for loan losses and deferred loan origination fees.

Loan origination fees are deferred and amortized to income as an adjustment of yield using the straight-line method over the contractual life of the loans. Direct loan origination costs are expensed as incurred. Differences between this method and the method prescribed by SFAS No. 91, *Accounting For Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, are not significant and do not otherwise materially affect the accompanying financial statements.

Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. Interest on loans is accrued and credited to income based on the principal amount outstanding. The accrual of interest on loans is discontinued when principal or interest payments are delinquent ninety days or more, or when, in the opinion of the Bank, there is an indication that the borrower may be unable to meet payments as they become due. Interest income thereafter is recognized only to the extent of cash payments received. Nonaccrual loans approximated $1,305,525 and $887,000 at September 30, 2009 and 2008, respectively.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collection of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may be uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrowers' ability to pay.

E. Inventory

Inventory of commemorative coins is stated at the lower of cost (first-in, first-out) or market.

(2) Summary of Significant Accounting Policies, Continued

F. Property and Equipment

Property and equipment are stated at cost. Beginning in fiscal year 2009, the Bank capitalizes property and equipment with cost exceeding $1,000. Prior to fiscal year 2009, the Bank capitalized property and equipment with cost exceeding $100. Depreciation is provided using the straight-line basis over the estimated useful lives of the respective assets.

G. Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosures are held for sale and are initially recorded at the lower of the carrying amount of the loan or the fair value of the property at the date of foreclosure less estimated selling costs. Write-downs of the asset at, or prior to, the date of foreclosure are charged to the allowance for losses on loans. Subsequent write downs, income and expense incurred in holding such assets, and gains and losses realized from the sales of such assets are included in current operations.

H. Net Assets

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, has required the Bank to establish net asset categories as follows:

- Invested in capital assets; capital assets, net of accumulated depreciation.

- Restricted:

  Nonexpendable - Net assets subject to externally imposed stipulations that the Bank maintains them permanently. At September 30, 2009 and 2008, the Bank does not have nonexpendable net assets.

  Expendable - Net assets whose use by the Bank is subject to externally imposed stipulations that can be fulfilled by actions of the Bank pursuant to those stipulations or that expire by the passage of time. As described in note 1, the Bank considers all assets, except investments in capital assets, to be restricted for economic development.

- Unrestricted; net assets that are not subject to externally imposed stipulations. As the Bank considers all assets, except investments in capital assets, to be restricted for economic development, the Bank does not have unrestricted net assets of September 30, 2009 and 2008.

(2) Summary of Significant Accounting Policies, Continued

I. New Accounting Standards

During fiscal year 2009, the Bank implemented the following pronouncements:

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.

- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.

- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.

- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which 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.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. 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) Summary of Significant Accounting Policies, Continued

I. New Accounting Standards, Continued

In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* for calculating the annual required contribution (ARC) adjustment. The provisions of this statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

J. Off-Balance Sheet Financial Instruments

In the ordinary course of business, the 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. At September 30, 2009 and 2008, the Bank had no such off-balance sheet financial instruments.

K. Reclassifications

Certain 2008 balances in the accompanying financial statements have been reclassified to conform to the 2009 presentation.

(3) Economic Development Loans and Allowance for Loan Losses

The components of loans receivable as of September 30, 2009 and 2008 are as follows:

	2009	2008
Loans receivable	$ 24,178,921	$ 20,439,433
Less:		
Allowance for loan losses	(1,889,054)	(1,546,992)
Deferred loan origination fees	(116,273)	(58,305)
	22,173,594	18,834,136
Current portion of economic development loans receivable	(2,707,480)	(2,655,041)
	$ 19,466,114	$ 16,179,095

(3) Economic Development Loans and Allowance for Loan Losses, Continued

Maturities of the above principal balances subsequent to September 30, 2009, will be as follows:

Fully matured and others	$ 197,684
1 - 6 months	268,205
7 - 18 months	788,393
19 months - 3 years	3,557,510
After 3 years	19,367,129
	$ 24,178,921

An analysis of the change in the allowance for loan losses is as follows:

	2009	2008
Balance - beginning of year	$ 1,546,992	$ 1,281,248
Recoveries of loan previously charged-off	94,984	218,211
Provision for loan losses	247,078	118,474
Loans charged-off	-	(70,941)
Balance - end of year	$ 1,889,054	$ 1,546,992

(4) Plant and Equipment

A summary of plant and equipment as of September 30, 2009 and 2008, is as follows:

	Estimated Useful Lives	Balance at October 1, 2008	Additions	Deletions	Balance at September 30, 2009
Depreciable assets:					
Leasehold rights	39 - 50 years	$ 493,206	$ -	$ -	$ 493,206
Furniture, fixtures and equipment	2 - 20 years	171,796	12,952	-	184,748
Vehicles	5 years	63,495	-	-	63,495
Leasehold improvement	5 years	2,164	-	-	2,164
		730,661	12,952	-	743,613
Less accumulated depreciation		(201,831)	(35,297)	-	(237,128)
		528,830	(22,345)	-	506,485
Non-depreciable assets:					
Construction in progress		-	73,237	-	73,237
		$ 528,830	$ 50,892	$ -	$ 579,722

(4) Plant and Equipment, Continued

	Estimated Useful Lives	Balance at October 1, 2007	Additions	Deletions	Balance at September 30, 2008
Depreciable assets:					
Leasehold rights	39 - 50 years	$ -	$ 493,206	$ -	$ 493,206
Furniture, fixtures and equipment	2 - 20 years	159,475	13,191	(870)	171,796
Vehicles	5 years	63,495	-	-	63,495
Leasehold improvement	5 years	2,164	-	-	2,164
		225,134	506,397	(870)	730,661
Less accumulated depreciation		(160,586)	(42,115)	870	(201,831)
		$ 64,548	$ 464,282	$ -	$ 528,830

(5) Foreclosed Real Estate

A summary of the changes in foreclosed real estate as of September 30, 2009 and 2008 is as follows:

	2009	2008
Balance at beginning of year	$ 326,578	$ 254,000
Additions	-	72,578
Disposals	(55,500)	-
Balance at end of year	$ 271,078	$ 326,578

As of September 30, 2009 and 2008, title to foreclosed real estate of $160,000 is in the Bank's name.

(6) Short-Term Loans Payable

The Bank entered into a $300,000 revolving credit line (credit line) with a local bank on October 27, 2007 for the purpose of supplementing disbursements of approved loans and temporary cash requirements to fund operations. On October 21, 2008, the Bank renewed the credit line under essentially the same terms and conditions. Repayment of the credit line is due one year from the initial drawdown with interest at the time certificate of deposit (TCD) rate, plus 1.50% (2.5% and 4.10% at September 30, 2009 and 2008, respectively). The credit line is collateralized by an assignment of $446,172 and $438,817 in TCDs as of September 30, 2009 and 2008, respectively.

Changes in short-term loans payable for the years ended September 30, 2009 and 2008, are as follows:

	Balance October 1, 2008	Additions	Reductions	Balance September 30, 2009	Due Within One Year
Short-term loans payable	$ 300,000	$ 600,000	$ (900,000)	$ -	$ -

(6) Short-Term Loans Payable, Continued

	Balance October 1, 2007	Additions	Reductions	Balance September 30, 2008	Due Within One Year
Short-term loans payable	$ -	$ 300,000	$ -	$ 300,000	$ 300,000

(7) Loans Payable

On August 28, 2003, the Bank entered into a loan with the Republic of Palau Social Security Retirement Fund (the Fund), an affiliated entity and a component unit of the Republic of Palau. The loan was for $3,000,000 with a subsequent $2,000,000 line of credit to be made available with terms and conditions to be agreed to by the parties at that time.

On August 7, 2008, the Bank entered into a new loan agreement to restructure the existing loan with the Fund. The loan ceiling increased to $6,000,000 which will be disbursed in increments of $500,000, bearing interest at a variable annual rate equal to the Fund's Fixed Income Fund Return Rate as reported monthly by Fund's investment consultant, plus 0.5%; provided, however that the interest rate to be charged and paid shall not be less than 4.5% nor more than 7.5% after addition of the 0.5% to the prime rate. Outstanding principal plus all unpaid interest are to be paid semi-annually, on or before June 30 and December 31 of each year, effective June 30, 2011 up to December 31, 2025. Expected annual principal repayment in 2011 amounts to $150,000.

The loan balance was $4,500,000 and $3,500,000 with interest at 4.5% as of September 30, 2009 and 2008, respectively. The loan is collateralized by the full faith and credit of the Republic of Palau Government.

On March 5, 2004, the Bank entered into a loan with Mega International Commercial Bank Co., Ltd. (formerly the International Commercial Bank of China) for $5,000,000 to be used as capital funds for the Bank. The note is uncollateralized and is due on July 1, 2024, with interest fixed at 3.5% per annum, payable in semi-annual installments of $142,858, and guaranteed by the Republic of Palau. Interest is payable semi-annually and commences six months after the advance of proceeds. Expected principal repayments amount to $285,716 annually.

On December 5, 2006, the Bank entered into an agreement with the European Investment Bank (EIB) to borrow up to 5,000,000 euros, which will be converted to U.S. dollars at the effective exchange rate upon disbursement. The available credit shall be drawn in tranches upon written request by the Bank. Loan proceeds may be used for purposes of financing 50% of the total cost of projects and portfolio projects of the Bank. The agreement is backed by the full faith and credit of the government of the Republic of Palau. As of September 30, 2009, the Bank has drawn down two tranches of $3,016,465 and $1,391,285 with interest rates of 3.679% and 5.175%, respectively. Interest and principal are payable semi-annually until October 9, 2021 with expected annual principal repayment in 2011 of $290,273.

(7) Loans Payable, Continued

Principal payments for subsequent years ending September 30 and applicable interest due, are as follows:

Year ending September 30,	Principal	Interest	Total
2010	$ 285,716	$ 500,075	$ 785,791
2011	725,989	509,928	1,235,917
2012	888,084	476,300	1,364,384
2013	900,698	439,405	1,340,103
2014	913,852	402,476	1,316,328
2015 - 2019	4,787,251	1,437,692	6,224,943
2020 - 2024	4,242,370	465,905	4,708,275
2025	449,530	12,501	462,031
	$ 13,193,490	$ 4,244,282	$ 17,437,772

Changes in loans payable for the years ended September 30, 2009 and 2008, are as follows:

	Balance October 1, 2008	Additions	Reductions	Balance September 30, 2009	Due Within One Year
Republic of Palau Social Security Retirement Fund	$ 3,500,000	$ 1,000,000	$ -	$ 4,500,000	$ -
Mega International Commercial Bank	4,571,456	-	(285,716)	4,285,740	285,716
European Investment Bank	-	4,407,750	-	4,407,750	-
	$ 8,071,456	$ 5,407,750	$ (285,716)	$ 13,193,490	$ 285,716

	Balance October 1, 2007	Additions	Reductions	Balance September 30, 2008	Due Within One Year
Republic of Palau Social Security Retirement Fund	$ 3,000,000	$ 500,000	$ -	$ 3,500,000	$ -
Mega International Commercial Bank	4,857,172	-	(285,716)	4,571,456	285,716
	$ 7,857,172	$ 500,000	$ (285,716)	$ 8,071,456	$ 285,716

(8) Related Party Transactions

The Bank grants loans to officers and employees. Loans made to related parties were extended in the normal course of business and at prevailing interest rates. Loans receivable from officers and employees are $162,090 and $174,374 as of September 30, 2009 and 2008, respectively, and are included within economic development loans receivable in the accompanying statements of net assets.

(9) Commitments

Loans Approved

The Bank approved loans aggregating $8,903,973 and $6,413,453 of which $3,650,673 and $2,746,256 were undisbursed at September 30, 2009 and 2008, respectively.

Leases

The Bank leased office space in the Republic of Palau under two five-year lease agreements expiring on May 1, 2009 and May 15, 2012. The Bank terminated the lease agreements effective December 2009.

On March 20, 2008, the Bank entered into an agreement with the Airai State Public Lands Authority for the lease of land to be used for bank operations and other related business. The term of the lease is fifty years commencing March 20, 2008.

Total future minimum lease payments for subsequent years ending September 30, are as follows:

Years ending September 30,	
2010	$ 12,440
2011	4,917
2012	4,917
2013	4,917
2014	4,917
2015 - 2019	24,587
2020 - 2024	24,587
2025 - 2029	24,587
2030 - 2034	24,587
2035 - 2039	24,587
2040 - 2044	24,587
2045 - 2049	24,587
2050 - 2054	24,587
2055 - 2058	17,211
Total future minimum payments	$ 246,015

On May 16, 2008, the Bank entered into an agreement with the Pacific Savings Bank Receiver (PSB Receiver) for the lease of office space. The lease is for three years commencing May 16, 2008. The PSB Receiver prepaid $90,000 representing the entire lease obligation for three years. Total rental income recognized for the year ended September 30, 2009 and 2008 amounted to $30,000 and $12,500, respectively. The remainder of the prepaid lease rental is included in accounts payable and accrued expenses in the accompanying statements of net assets.

(9) Commitments, Continued

Others

In January 2008, the Bank entered into a Memorandum of Understanding (MOU) with the ROP Ministry of Commerce and Trade and the University of Guam - Pacific Islands and Small Business Development Center Network for the purpose of implementing and establishing a Palau Small Business Development Center (Palau SBDC). Under the terms of the MOU, the Bank will provide adequate and expert managerial and administrative supervision to Palau SBDC and handle accounting and recording of all funding activities, disbursement of expenditures, purchases, and related activities of Palau SBDC at no cost.

On May 5, 2008, the Bank entered into an agreement with the International Union for Conservation of Nature and Natural Resources (IUCNNR) for the implementation of the Energy Efficiency Home Loan Project. To enable the completion of the project activities, IUCNNR will provide $500,000 in grant funds to the Bank. The project term is for a period of three years commencing October 5, 2008. As of September 30, 2009, the Bank has received $220,199 of the grant funds.

(10) Contingencies

The Bank is authorized to guarantee up to 90% of the principal of loans made by financial institutions to qualified borrowers, in addition to approving direct loans. Eligible principal amounted to $426,146 as of September 30, 2009 of which the Bank was contingently liable for $383,531. Of the total loans made by financial institutions, $386,976 is backed by the Republic of Palau's full faith and credit.

The Bank also guarantees loans made by RHCDS. The Bank has approved guarantees for eighty loans aggregating $3,249,405 at September 30, 2009.

RPPL 5-37 increased the Republic of Palau's full faith and credit backing for loans, loan guarantees, and obligations under recourse loan repurchase agreements made by the Bank to $15,000,000. Of this amount, $2,000,000 shall be for residential housing projects and $5,000,000 for the purpose of satisfying requirements for obtaining loans from a bank.

The Bank maintains depository accounts in a non-FDIC insured financial institution. The financial institution went into receivership in November 7, 2006. The Bank President was appointed by the Palau Financial Institutions Commission (FIC) as the receiver for the financial institution. The Bank deposits in this financial institution amounted to $205,112 as of September 30, 2009 and 2008 which are collateralized by a third party personal guarantee and an asset of the financial institution. Management is of the opinion that transactions with this financial institution are of similar terms and conditions as with unrelated parties. It is uncertain when the Bank will realize the abovementioned deposits and no provision for loss has been made in the accompanying financial statements.

(11) Republic of Palau Civil Service Pension Trust Fund

The Bank contributes to the Palau Civil Service Pension Trust Fund (the Fund), a defined benefit, cost-sharing multi-employer pension plan established and administered by the Republic of Palau (the Republic).

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents of the Republic, Republic State Governments and Republic agencies, funds and public corporations, which are paid monthly and are two percent of each member's average monthly salary. Normal benefits are of credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members who retire at or after age 60, or with 25 years of vesting service, are entitled to retirement benefits. RPPL 2-26 is the authority under which benefit provisions are established. Member contribution rates are established by RPPL 2-26 at six percent (6%) of total payroll and matched dollar for dollar by the employer. The Bank contributed $27,560, $18,695 and $15,329 to the Fund during the fiscal years 2009, 2008 and 2007, respectively.

Under the provisions of RPPL No. 2-26, the Pension Fund's Board of Trustees adopted a Trust Fund Operation Plan which has the force and effect of law, and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code. The Bank's total payroll for fiscal years 2009 and 2008 was covered in total by the Fund's plan.

The Fund utilizes the actuarial cost method termed "aggregate cost method" with actuarial assumptions used to compute the pension benefit obligation as follows: (a) a rate of return of 8.5% per year on the investment of present and future assets, (b) a 3% increase in employee salaries until retirement, and (c) members are assumed to retire at their normal retirement date.

The pension benefit obligation, which is the actuarial present value of credited projected benefits, is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and any step-rate benefits, estimated to be payable in the future as a result of employment service to date. The measure is intended to assist users to evaluate the Fund's funding status on a going-concern basis, and evaluate progress made in accumulating adequate assets to pay benefits when due.

The Fund's October 1, 2007 actuarial valuation determined the unfunded pension benefit obligation as follows:

Participants in pay status	$ 48,968,000
Active participants	46,002,000
Participants with vested deferred benefits	903,000
Total pension benefit obligation	95,873,000
Net assets available for benefits, at market value	48,358,000
Unfunded benefit obligation	$ 47,515,000

The actuarial valuation did not provide a breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net assets available for benefits by sponsor.

(12) Risk Management

The Bank is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. The Bank has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.