

NATIONAL DEVELOPMENT BANK OF PALAU
(A Component Unit of the Republic of Palau)

REPORTS ON THE AUDIT OF FINANCIAL STATEMENTS
IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

Years Ended September 30, 2015 and 2014

(As Restated)

NATIONAL DEVELOPMENT BANK OF PALAU
(A Component Unit of the Republic of Palau)

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September 30, 2015 and 2014

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
National Development Bank of Palau

Report on the Financial Statements

We have audited the accompanying financial statements of National Development Bank of Palau (a component unit of the Republic of Palau), which comprise the statements of net position as of September 30, 2015 and 2014, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of National Development Bank of Palau as of September 30, 2015 and 2014, and the changes in its net position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, the National Development Bank of Palau implemented Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement 68* during the year ended September 30, 2015. As a result of adopting these standards, the Bank has restated its net position as of October 1, 2014 to reflect the adoption of these standards. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to my inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 24, 2016, on our consideration of National Development Bank of Palau's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering National Development Bank of Palau's internal control over financial reporting and compliance.

A handwritten signature in black ink, reading "Benigno Comen Maglisa". The signature is written in a cursive style with a large initial "B".

Koror, Republic of Palau
June 24, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED SEPTEMBER 30, 2015

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 end 2015 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) and was created in February 1982 by Public Law Number 1-27 as codified in Title 26 of the Palau National Code Annotated (PNCA), as amended. The Bank 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 The Republic of Palau (ROP) appoints six of its seven Board members for a three-year terms subject to Senate confirmation. The seventh member is the President of the Bank who shall serve as an ex-officio member of the Board. 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 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.

The Bank's policies and strategies are implemented through the Bank's President and management. The Bank is organized by three functional areas: Finance, Lending and Risk & Compliance. The NDBP Board of Directors approves the hiring of candidates for the manager of each functional area. The Bank President has the authority over all the other positions of the Bank. Staff levels and funding are determined against strategic, corporate and budget plans proposed by management and approved by Board. At fully staffed capacity, the Bank has seventeen full time equivalent employees, including the President / CEO.

All Bank operations are conducted from its main office in Ngetkib Village, Airai State. There are no branches, other offices or subsidiaries operating in 2015. Plans for expansion of the Bank's building are set forth in the Bank's ten-year Strategic Plan.

Economic Outlook

Asian Development Bank (ADB) Outlook for 2015 states, “Growth accelerated in Fiscal Year 2015 (ended 30 September 2015) to an estimated 6.7% in Palau. The improvement in growth from 4.7% in FY2014 reflected strong performance of tourism. Tourism receipts in FY2015 were equivalent to 54.8% of the gross domestic product (GDP), up from 39.7% in FY2010. Visitor arrivals grew by 32.5% in FY2015, reaching 166,136 - more than twice the number in FY2010. The increase in arrivals has been driven by expanded direct charter flights from Hong Kong, China and Macau, China. Arrivals from the People’s Republic of China (PRC) accounted for 54.0% of all arrivals in FY2015, up from just 1.2% in FY2010. Despite a reduction in April of the number of charter flights allowed, from 48 per month to 32, arrivals remained strong as airlines adapted by flying larger aircraft.”

ADB also states that, “The growth outlook remains positive because of tourism. Palau’s economic expansion is expected to fall back to 3.0% in FY2016 as growth in tourist numbers slow. This will be partly offset by growth in construction as hotel rooms are added to improve room availability. The double-digit growth rates for tourist arrivals in the past 2 fiscal years are unlikely to be sustained as hotels and tourist attractions operated nearly at capacity in FY2015. In the first quarter of FY2016, arrivals dropped by 11.7% from a year earlier, including a 13.6% drop in arrivals from the PRC, mainly because an aircraft flying from Hong Kong, China required maintenance. Visitor arrivals from other markets also fell significantly, notably Taiwan was down 22.0% and Japan, down 6.4%. Lower arrivals are expected to persist through FY2016.”

Developing Palau’s private sectors by promoting economic diversification would strengthen economic resilience and enhance growth potential. Diversification within the tourism industry is essential to economic growth as well as diversification outside of tourism. Diversification outside of tourism includes developing agriculture and aquaculture for example, fish and clam farming as well as tapioca and coconut farming. Domestic value would be added if Palau would supply tourism-related products and services.

Significant Events in 2015

The Energy policy is characterized by renewable energy support; i.e., various solar energy systems installed at the National Hospital parking area, the Ministry of Education head office and the Airport. NDBP supports the national policy and has three Energy Loan Program (ELP) Subsidy programs as follows:

- Energy Efficiency Subsidy Loan Program (EESP)-Program expired on December 31, 2015 and funds have been earmarked for projects under construction.
- Renewable Energy Subsidy Loan Program (RESP)-Program has expired but there are a few remaining On-Grid inventories available for installation. All remaining Off-Grid solar equipment will be turned over to PEO.

UAE Solar program is a continuation of the RESP program with equipments from the United Arab Emirates. The MOU was executed on January 17, 2015 between UAE and the ROP. Under this program, NDBP received 100 On-Grid solar systems to and deadline for the program is December 1, 2016.

- Palau Water Conservation Incentive Program (PWCIP)-The Letter of Agreement was executed on May 22, 2014 with the program expiration date set for September 30, 2015. Deadline was extended to November 30, 2015.
- RETRO-Energy Efficiency Subsidy Loan Program (Retro-EESP) - This program ended December 30, 2014

The subsidy to support the above mentioned programs come from partners and donors. NDBP was announced as a finalist in the 2013 Ashden Awards, the world's leading green energy prize. The Bank was recognized for its programs to encourage energy-efficient households on the island.

RPPL No 9-41 was signed by the Republic of Palau President, Tommy E. Remengesau on December 5, 2014. The Bill amends Title 26 of the Palau National Code to facilitate the National Development Bank of Palau to accept deposits and other related purposes. The Act requires the Bank to take measures to ensure compliance as follows:

1. The supervision of the Financial Institution Commission
2. The application of Chapter 10 of Title 26 of the Palau National Code to the operations of the National Development Bank of Palau
3. The membership of the Board of Directors complies with the law and regulations of FIC. All Board members will be required to hold a B.A/B.S. degree and have at least 2 years of business management experience and have recognized civic leadership qualities. Any Directors who are not qualified must resign no later than one year after the effective date of this Act.

Upon the effective date of this Act, the Bank should also take the following measures to:

1. Plan for and begin taking deposits for savings accounts within two years
2. Issue bonds within two years
3. Plan for and begin taking demand deposits within the next three years.
4. Promulgate regulations to carry out the purposes of this Act
5. Submit reports on October 1 of the years 2015, 2016 and 2017 on the measures taken to carry out the directives as stated above. The report should include the timeline for taking Savings, Demand Deposits and Bonds.

Governmental Accounting Standard Board (GASB) Statement 68 effecting government agencies participating in the Pension plan is implemented this year. "The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pension. It also improves information provided by state and local government employers about financial support for pension that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pension with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency. This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources and expense/expenditures."

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. The Bank has relied on accumulated retained income since 2002, and borrowed funds since 2003, to fund loan operations and the Bank's growth. Additional sources of funds pursued during the year included additional long-term borrowings, loan/asset sales and grants. The Bank's Strategic Plan also considers deposit liabilities as a new source of funds in the future.

Borrowed funds currently outstanding are from signed notes with Mega International Commercial Bank (MICB, previously the International Commercial Bank of China), the Republic of Palau Social Security Administration (ROPSSA), the European Investment Bank (EIB) and the Republic of Palau. All four notes are for long-term intermediary relending funds.

A \$750,000 loan from the U.S. Department of Agriculture (USDA) for an Intermediary Relending Program (IRP) loan agreement was signed on March 27, 2013. The Bank is required to match these funds in a revolving fund at the signing of the loan, which the bank has done so with an account at BOH. The USDA IRP funds are to be used to support businesses that have been turned away from other local banks.

The timing and extent to which borrowed funds are utilized for lending activities is determined mainly by cost and availability. The ROP loan proceeds represented the least costly funds available at a 2.00% fixed interest rate per annum. The highest borrowed funds interest rate is from the European Investment Banking for 5.175% per annum.

For Grants, the Bank continuously works to secure grants to expand its Energy Loan Programs. New solar equipments received in 2015.

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 loan officers each month. Proceeds from loans to the Bank for intermediary re-lending are requested based on forward estimates and, where necessary, cash flow from operations and non-restricted investments 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 commercial guaranteed loans. The reserve is held in a time certificates of deposit (TCDs) with a commercial bank. Only one commercial guaranteed loan remains as of September 30, 2015. All other commercial guaranteed loans have been paid off. USDA RD requirement for their reserve is a fixed amount of \$500,000 maintained at a commercial bank. At end of 2015, the current balance on the account is \$538,559 which includes fees collected and interest earned.

All current guarantees are granted under recourse. The PNCA 26 states, "The Bank may at its discretion provide loan guarantees to another bank in support of a qualified applicant's commercial loan application. No such loan guarantee shall guarantee more than ninety percent (90%) of the outstanding amount of the loan except in the case of the guarantee of a home loan to a citizen of the Republic." USDA RD guaranteed home loan contingent liability is 100%. The total amount for which the Bank was contingently liable in 2015 for commercial banks and USDA RD home loans was \$4 million. The amended MOU with USDA RD provided the requirements for accounts allowable for reserves and several procedural covenants.

A Memorandum of Understanding (MOA) was signed on April 1, 2014, between Bank of Guam (BOG), National Development Bank of Palau (NDBP), and Palau Housing Authority (PHA) pursuant to the Belau Real Estate Financing Program. Some of the roles and responsibilities for BOG, NDBP and PHA include but not limited to:

Bank of Guam:

- Receive all loan applications
- Obtain attorney certification that the mortgaged property for each loan can indeed be mortgaged and certify that there are no restrictions or prior liens against the property.
- Obtain a professional appraisal for each loan with a maximum loan to value ratio not to exceed 75%.
- Not exceed \$100,000.00 for each individual borrower.
- Monitor the loan and collect payments.
- Exhaust all effort to collect on all loans as specified in the Bank procedures.
- Interest rate (APR): 3% + WSJ Prime Rate as specified at the time the loan is granted
- The loan term shall not exceed 25 years.

National Development Bank of Palau (NDBP):

- Collect from BOG a non-refundable guaranty fee in the amount of 2% of the loan amount.
- Review complete loan package and issue a certificate of guaranty if acceptable within 30 days.
- Be assigned the debt, loan, note, obligation and collateral by BOG once the Guaranty is called and BOG is paid up to 80% on the delinquent loan principal only.
- Have the option to credit bid on any collateral on the loan to protect the Government's interest.

Palau Housing Authority:

- Shall be eligible for this guaranty program for loans up to its legal lending limit under the same terms and conditions as NDBP.

There were no completed loan applications received from BOG as of September 30, 2015.

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 is 20% of the Bank's unimpaired paid-in 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. At September 2015, loan maturities remained concentrated in the 15-year range.

Operations

Financial assistance is provided by the Bank for projects involving housing, agriculture, marine resources, commerce and industry. Authorized financing schemes include guarantees, direct loans and direct investment. Further, the Bank is required to provide technical assistance services as part of its operations. The Bank's MOU, financial and logistical support with the Palau Small Business Development Center to assist client with such things as creating business plans; the collaboration with Palau SBDC and the Ministry Natural Resources, Environment and Tourism on the Farm Loan Program; and the MOU with the Palau Housing Authority on providing subsidy on the Energy Efficient Homes are efforts towards this responsibility. Information on other financial and technical service providers including government agencies is also provided for client or applicant consideration. Currently, the Bank's financial activities are limited to projects within ROP. All financial transactions are US dollar denominated.

Direct loans

Short term to medium term financing is extended to new or existing businesses to fund short-term working capital and equipment acquisitions. Longer term financing is extended to individuals for housing and business facilities. Rates are fixed depending on the type of financing provided. Posted interest rates range from 6% to 10%. Rates are considered to include the cost of funds, lending spread to cover the cost of operations, risk component, and a small return for growth purposes. Fees are usually 2% of financing extended. Originating and closing costs are also charged to borrowers. Specific programs offered under direct financing are agriculture, fishing, small business, housing and business loans. In 2015, the Bank approved 145 loan applications totaling \$6.1 million which includes renewals, extensions, performance bonds, and new loans. \$9.5 million remains undisbursed at 2015 fiscal year end. Majority of the undisbursed loans is for LOC and guaranteed bonding of \$4.5 and \$5.0 million for term loans.

In the category of small business loans, the Bank offers customers four programs: Small Business, WEDAP, Microfinance, and its newest program, Pre-Development Loan. The Bank's general policy is all loans are fully secured; except for micro-finance of up to \$10,000. Micro-finance loans are administered like signature loans; however, the Bank may take collateral if it deems necessary for abundance of caution. 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 who are able to secure their loan with an assignment of income. No collateral is required and turnover is intended to be quick. These programs appear to be successful and are popular. Specifically, interests in Microfinance Loans, which are also available for home projects such as extensions and renovations have been popular. This may be due to the postponement of larger investments by borrowers due to the current sentiment regarding a sluggish economy.

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 projects is required at 15% of project cost with a maximum amount of \$10,000 under the Pre-Development Loan not to exceed five years. The purpose of Pre-Development Loan is to help borrowers pay for plan design, appraisal, title search and all related soft costs associated with packaging loans and cash equity contribution. Eligible purposes for housing loans include new construction, renovation and extension.

Most loan applications are granted for new constructions. The Bank has observed more loans being approved under the first-time homeowner program than the standard housing program.

Guaranteed Loans

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, the Pacific Island Development Bank, either currently accept or hold guarantees from the Bank. The majority of guarantees outstanding from the Bank are to USDA RD loans. In addition to the USDA RD Section 502 and 504 housing loan guaranteed by the Bank, they are the leveraged loans which are co-financed by both the Bank and the USDA RD. Popularity is low with these programs as they often take months to receive approval and are stricter in terms and loan covenants. Belau Real Estate program through Bank of Guam is a new addition to our guaranteed loans program. As of September 30, 2015, no completed loan packages from BOG received by NDBP.

Investments

There are no further investments made by the Bank since its initial investment in Palau Micronesia Air which has been repurchased by other stockholders. However, the Bank took a note assignment of \$820,000 between ROP and the Receivership of the failed Pacific Savings Bank (PSB) for the purpose of assisting certain classes of depositors in the lower bracket. The assignment of the note bears no interest and the monthly payments of \$10,000 previously paid to ROP was directed and assigned to the Bank. The Bank disbursed \$320,000 in 2011 and \$500,000 in 2012 for a total of \$820,000. The PSB Receiver now Creditors Trust will continue paying the \$10,000 monthly payment until the balance of the note is satisfied. Creditors Trust paid off the note on April 2015.

Approval Process

All requests for financing are reviewed by loan officers who recommend approval or declination of a loan application 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 have approval cycle 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 but also delays loan approvals. 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 Bank's Board of Directors holds meetings of no less than three times per month to approve loans and review other business. Loan disbursements are made according to progress payments against approved loan purposes. Any deviation requires an amendment to the loan and approval by original approving authorities.

Loan Management

The Bank monitors payment performance and contacts client on a seven, thirty, sixty and ninety day schedule with the degree of reporting based on each borrowers' circumstance. Additionally, Loan Officers conduct account reviews and site visits whenever a weakness becomes evident in a loan. Once a loan is determined by the Loan Officer that it is uncollectible, the loan is placed in non-accrual status. The Compliance Officer takes over the account and work with the Bank's attorneys to cure, recover, or liquidate the collateral.

Financial Reporting

Financial reporting is made by each of the Bank's three sections to the President / CEO of the Bank, who in turn reports to the Board of Directors on a monthly basis. These reports include financial, loan and risk & compliance information as well as administrative, industry and economic environment information. Monthly reports are provided to the Board of Directors and annual reports are provided to the Bank's lenders and ROP.

Overview of Financial Performance

The following are the basic financial statements of the Bank:

The statement of net position presents information on all of the Bank's assets and deferred outflows of the resources, and liabilities and deferred inflows of resources with the difference between them presented as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Bank is improving or deteriorating.

The statement of revenues, expenses and changes in net position presents information showing how the Bank's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing and related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g. interest owed but not due until a future year and earned unused vacation leave).

The statement of cash flows reports inflows and outflows of cash, classified into four major categories:

- Cash flows from operating activities include transactions and events reported as components of operating income in the statement of revenues, expenses and changes in net position.
- Cash flows from non-capital financing activities include operating grant proceeds.
- Cash flows from capital and related financing activities include the borrowing and repayment (principle and interest) of capital-related debt, the acquisition and construction of capital assets, and the proceeds of capital grants and contributions.
- Cash flows from investing activities include proceeds from sale of investment, receipt of interest and changes in the fair value of investments subject to reporting as cash equivalents. Outflows in this category include the purchase of investments

Notes to the Financial Statement

Various notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements and are found immediately following the financial statements to which they refer.

Overview of Financial Performance

Condensed Statements of Revenues, Expenses and Changes in Net Position

Change in Net Assets

The change in net assets increased from a loss of \$382 thousand to a net income of \$1.4 million in 2015 due to a decrease in provisions for loan losses and the adjustments for Pension as required by GASB 68. A condensed year-to-year comparison of operating activity reflecting the foregoing Statement follows:

	2,015	2014-Restated	Changes	
			Amount	Percent
Operating revenues:				
Interest income on loans	\$1,661,610	\$1,902,707	\$(241,097)	-13%
Loans fees and late charges	90,417	90,933	(516)	-1%
Other	41,128	61,409	(20,281)	-33%
Total operating revenues	1,793,155	2,055,049	(261,894)	-13%
Recovery of (provision for) loan losses	411,892	(1,138,980)	1,550,872	136%
Net Operating revenues	2,205,047	916,069	1,288,978	141%
General and administrative expenses	(754,161)	(829,380)	75,219	-9%
Operating Income	1,450,886	86,689	1,364,197	1574%
Non-operating revenues (expenses), net	(19,765)	(468,689)	448,924	-96%
Change in net position	1,431,121	(382,000)	1,813,121	475%
Net Position at beginning of year	15,618,953	16,000,953	(382,000)	-2%
Net position at end of year	\$17,050,074	\$15,618,953	\$1,431,121	9%

	2014-Restated	2,013	Changes	
			Amount	Percent
Operating revenues:				
Interest income on loans	\$1,902,707	\$1,937,444	\$(34,737)	-2%
Loans fees and late charges	90,933	110,501	(19,568)	-18%
Other	61,409	6,170	55,239	895%
Total operating revenues	2,055,049	2,054,115	934	0%
Recovery of (provision for) loan losses	(1,138,980)	(341,172)	(797,808)	234%
Net Operating revenues	916,069	1,712,943	(796,874)	-47%
General and administrative expenses	(829,380)	(717,294)	(112,086)	16%
Operating Income	86,689	995,649	(908,960)	-91%
Non-operating revenues (expenses), net	(468,689)	(794,192)	325,503	-41%
Change in net position	(382,000)	201,457	(583,457)	-290%
Net Position at beginning of year	16,000,953	17,384,860	(1,383,907)	-8%
Net position at end of year	\$15,618,953	\$17,586,317	\$(1,967,364)	-11%

Revenue

Operating revenues include all direct revenues such as interest income and fees on loans and other miscellaneous fees (i.e. late charges). Interest income as of September 30, 2015 and 2014 was \$1.7 million and \$1.9 million respectively. Year ending 2015 interest income and bonding fees decreased by 13% and 34% respectively compared to 2014.

Loan Interest Rates

The Bank's interest rates remained fixed according to the type of loan funded. Rates ranged from 6% for agriculture, microfinance and pre-development loans; 8% for fishing, WEDAP and first-time homeowner loans; and 10% for commercial and housing loans. Other accounts in collection continue to be assessed the statutory rate of 9% interest rate as required by a court-ordered judgment. At the end of FY2015, the average yield on the Bank's portfolio decreased from 8.52% in 2014 to 8.40% in 2015 due to increase in micro financing, pre-development loans and non performing loans.

Grants

In 2011, the NDBP implemented the Energy Loan Program (ELP) to provide loans to business and housing customers to acquire renewable energy technology. The Bank currently has three (3) Grant Programs under its Energy Loan Programs (ELP).

Energy Efficiency Subsidy Loan Program (EESP) is from the Government of Italy, Austria, and the Municipality of Milan. The amount of the award is \$500,000 and funds received up to June 30, 2011 were \$438,779. No new funding received in 2012 and 2013. Additional funds received in 2014 for \$34,586. All funds have been earmarked for ongoing projects and the subsidies will be applied once projects are completed. A continuation of this program under Phase II, NDBP was awarded additional fund of \$200,020. We received 80% or \$160,000.00 in July 2014.

Renewable Energy Subsidy Loan Program (RESP) is from Global Environmental Facility (GEF) through UNDP under the Palau Sustainable Economic Development through Renewable Energy Applications (SEDREA) Project. The NDBP received on-grid and off-grid solar photovoltaic systems from the United Nations Development Program through the Republic of Palau Energy Office under the Sustainable Economic Development through Renewable Energy Applications (SEDREA) Program. The dollar value of solar equipment inventory received on March 2011 was for \$402,880. As of September 30, 2015, remaining inventory of \$216,585 consists of \$113,301 Off-Grid and \$103,283 On-Grid. All off-Grid solar inventories will be turn over to Palau Energy Office (PEO).

On January 17, 2015, The Republic of Palau entered into an Agreement with Abu Dhabi Future Energy Company PJSC-Masdar. Under the agreement, the grant is to provide solar equipment and assistance to PPUC and 100 on grid solar home systems to NDBP to continue the RESP program.

RETRO-Energy Efficiency Subsidy Loan Program (RETRO-EESP) is from North Pacific ACP Renewable Energy and Energy Efficiency Project (North-REP). Funds are from the 10th European Development Fund (EDF-10). The Amount of the award is \$454,545 and funds received December 19, 2012 were \$32,537 and \$79,000 on February 14, 2014. Deadline for the project was December 31, 2014. Only loans received by the deadline will be subsidized at completion. Any remaining funds will be returned to Grantor.

Grant from Global Climate Change Alliance: Pacific Small Island States (GCCA: PSIS) project is providing support to help the Republic of Palau in its prioritized water sector climate change adaptation actions. One element of this is the Palau Water Conservation Incentive Program.

Palau Water Conservation Incentive Program is modeled after the EESP program, where specific requirements are incorporated into a water catchment project and a subsidy payment is applied to the borrower's loan principal. Total awarded grant is \$156,450 with the project deadline of September 31, 2015. Initial fund of \$56,450.00 received on 6/11/2014. Deadline date was extended to November 30, 2015.

Expenses

Total operating expenses for 2015 was 9% less than 2014. Savings were realized in professional fees, depreciation, travel and training, dues and subscriptions, supplies and printing and utilities. The Bank's commitment for training new and existing staff with internet-based, bank-designed and on-island and off-island training continues each year.

General and administrative Expenses

	2015	2014-Restated	Changes	
			Amount	Percent
Salaries, wages and fringe benefit	\$436,483	\$492,317	(\$55,834)	-11%
Professional fees	68,989	109,074	(40,085)	-37%
Depreciation	42,122	50,253	(8,131)	-16%
Travel and Transportation	19,705	24,381	(4,676)	-19%
Dues and subscription	22,558	25,953	(3,395)	-13%
Repairs and maintenance	20,660	16,746	3,914	23%
Supplies, printing and reproduction	15,486	20,817	(5,331)	-26%
Utilities	12,016	16,071	(4,055)	-25%
Honorariums and meeting expenses	18,371	13,386	4,985	37%
Communications	19,932	13,484	6,448	48%
Insurance	7,886	8,607	(721)	-8%
Rent	0	0	0	0%
Marketing and advertising	8,505	0	8,505	
Training	39,539	24,011	15,528	65%
Miscellaneous	21,909	14,280	7,629	53%
	<u>\$754,161</u>	<u>\$829,380</u>	<u>\$(75,219)</u>	<u>-9%</u>

	2014-Restated	2013	Changes	
			Amount	Percent
Salaries, wages and fringe benefit	\$492,317	\$426,516	\$65,801	15%
Professional fees	109,074	69,950	39,124	56%
Depreciation	50,253	51,812	(1,559)	-3%
Travel and Transportation	24,381	25,897	(1,516)	-6%
Dues and subscription	25,953	22,006	3,947	18%
Repairs and maintenance	16,746	21,459	(4,713)	-22%
Supplies, printing and reproduction	20,817	16,203	4,614	28%
Utilities	16,071	15,437	634	4%
Honorariums and meeting expenses	13,386	11,591	1,795	15%
Communications	13,484	11,549	1,935	17%
Insurance	8,607	7,895	712	9%
Rent	0	5,500	(5,500)	-100%
Training	24,011	4,798	19,213	400%
Miscellaneous	14,280	26,681	(12,401)	-46%
	<u>\$829,380</u>	<u>\$717,294</u>	<u>\$112,086</u>	<u>16%</u>

Overview of Financial Condition

The Bank recovered from a loss of \$382 thousand in 2014 to a net income of \$1.4 million largely due to the adjustments of Non-Performing loans as per FIC regulations and GASB 68 requirements. Net position now includes Deferred inflow from Pension, Pension Liability and Deferred outflow from Pension.

Condensed Statements of Net Position

	2015	2014-Restated	Changes	
			Amount	Percent
Current Assets	\$11,574,417	\$10,012,634	\$1,561,783	16%
Property and equipment, net	631,916	651,710	(\$19,794)	-3%
Economic development loans receivable	16,096,355	16,634,339	(\$537,984)	-3%
Other non-current assets	1,095,850	2,502,711	(\$1,406,861)	-56%
Total Assets	29,398,538	29,801,394	(\$402,856)	-1%
Deferred Outflows from Pension	153,041	131,673	\$21,368	16%
Total Assets & Outflows of Resources	\$29,551,579	\$29,933,067	\$(381,488)	-1%
Accounts payable and accrued expenses	568,198	181,733	\$386,465	213%
Other liabilities	168,688	339,854	(\$171,166)	-50%
Interest payable	81,809	94,628	(\$12,819)	-14%
Loans payable	9,478,214	11,496,251	(\$2,018,037)	-18%
Net Pension Liability	1,566,224	1,566,224	\$0	0%
Total liabilities	11,863,133	13,678,690	(\$1,815,557)	-13%
Loan origination fees	428,641	425,693	\$2,948	1%
Deferred Inflows from Pension	209,731	209,731	\$0	0%
Total deferred inflows of resources	638,372	635,424	\$2,948	0%
Net Position	17,050,074	15,618,953	1,431,121	9%
Total Assets & Inflows of Resources	\$29,551,579	\$29,933,067	\$(381,488)	-1%

	2014-Restated	2013	Changes	
			Amount	Percent
Current Assets	\$10,012,634	\$9,029,644	\$982,990	11%
Property and equipment, net	651,710	701,963	(\$50,253)	-7%
Economic development loans receivable	16,634,339	18,617,524	(\$1,983,185)	-11%
Other non-current assets	2,502,711	2,354,648	\$148,063	6%
Total Assets	29,801,394	30,703,779	(\$902,385)	-3%
Deferred Outflows from Pension	131,673	0	\$131,673	
Total Assets & Outflows of Resources	\$29,933,067	\$30,703,779	(\$770,712)	-3%
Accounts payable and accrued expenses	181,733	71,912	\$109,821	153%
Other liabilities	339,854	92,265	\$247,589	268%
Interest payable	94,628	101,805	(\$7,177)	-7%
Loans payable	11,496,251	12,423,591	(\$927,340)	-7%
Net Pension Liability	1,566,224	0	\$1,566,224	
Total liabilities	13,678,690	12,689,573	\$989,117	8%
Loan origination fees	425,693	427,889	(\$2,196)	-1%
Deferred Inflows from Pension	209,731	0	\$209,731	
Total deferred inflows of resources	635,424	427,889	\$207,535	49%
Net Position	15,618,953	17,586,317	(1,967,364)	-11%
Total Assets & Inflows of Resources	\$29,933,067	\$30,703,779	\$(770,712)	-3%

Loan Portfolio

NDBP loan portfolio includes new, amended and renewed loans and bonds. The Bank approved one hundred and forty five (145) loans in 2015 for \$6.1 million and two hundred two loans (202) in 2014 for \$11.3 million.

The Bank's goal during the year remained growth in income and assets while maintaining credit quality. Emphasis was also made towards increasing the agriculture and fishing sectors of the portfolio which were challenging given the less than favorable industry and economic conditions. Simultaneously, emphasis was placed on adjusting the portfolio distribution to reduce exposure and diversify risk. The outstanding loans by sector for 2015 and 2014 are presented in the following table:

Sector	2015			2014		
	Number	Amount	Percent	Number	Amount	Percent
Agriculture	15	\$277,046	1.38%	14	\$297,372	1.28%
Fishing	35	281,882	1.41%	33	170,649	0.73%
Commercial	141	7,869,525	39.22%	144	11,128,194	47.81%
Housing	568	11,634,294	57.99%	562	11,679,329	50.18%
Totals	759	\$20,062,747	100.00%	753	\$23,275,544	100.00%

The total number of loans on the Bank's books at year end 2015 was seven hundred fifty nine (759) accounts for \$20.1 million. For 2014, the total number of loan notes outstanding was seven hundred fifty three (753) for \$23.3 million. A decrease of \$3.2 million or 14% of total outstanding notes in 2015 compared to 2014.

Arrears

The total number of accounts with amounts in arrears at end of 2015 is eighty five (85) for \$625 thousand as compared to eighty (80) accounts amounting to \$1.5 million in 2014. The amount of Arrears as a percentage of the value of the total outstanding notes is 3% for 2015 and 6% for 2014.

New Debts

There were no new debts for 2015.

Net Assets

The Bank's change total asset for 2014 and 2015 was \$29,933,067 to \$29,551,579, a decrease of \$381,488 a 1% change.

Plant and Equipment

At September 30, 2015, capital assets total \$631 thousand as compared to \$651 thousand in 2014. This is a decrease of \$19 thousand or 3%.

Affiliations

The Bank's membership and partnership affiliations locally and abroad include the Palau Chamber of Commerce, the Risk Management Association, various foreign government agencies, the Association of Development Finance Banks and the Association of Development Finance Institutions in Asia and the Pacific. 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's provisions for loan losses with a general provision of 3% and specific provisions of 3%, 5%, 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 non-accrual status are made according to Bank policy. As of September 30, 2015, fifty three (53) loans amounting to \$2.4 million (principle balance) were on non-accrual status. An increase of thirty eight (38) loans as compared to 2014. Total non-accrual principle balance outstanding as of September 30, 2014 was \$2.0 million.

Economic Outlook

Activities of significance planned in 2015 include the Bank to start taking in deposits. The funds received for deposits can be a source of funds for new and existing loans. The expansion and sustainability of the Bank's energy loan products on renewable energy will continue in 2016. 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. The target for loan approvals in the new fiscal year is \$7.5 million with target portfolio growth of \$5.4 million with lending increases in the agriculture and fisheries sectors.

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. That Discussion and Analysis explains the major factors impacting the 2015 financial statements.

If you have questions about the 2015 or 2014 reports, or need additional information, please contact the Comptroller / Chief Financial Officer at the National Development Bank of Palau at PO Box 816, Koror, Republic of Palau 96940, or e-mail sbasilio@ndbp.com or call (680) 587-6327.

NATIONAL DEVELOPMENT BANK OF PALAU
(A Component Unit of the Republic of Palau)

Statements of Net Position
September 30, 2015 and 2014

	2015	2014 As Restated
<u>ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</u>		
Current assets:		
Cash and cash equivalents	\$ 8,561,793	\$ 6,054,109
Restricted time certificates of deposit	454,320	453,639
Receivables:		
Current portion of economic development loans receivable, net	2,153,153	2,571,600
Accrued interest	69,509	181,236
Other receivables	82,231	448,450
Inventories	222,703	282,138
Prepaid expenses	30,708	21,462
Total current assets	11,574,417	10,012,634
Restricted cash and cash equivalents	748,651	915,526
Economic development loans receivable	16,096,355	16,634,339
Capital assets, net	631,916	651,710
Foreclosed real estate	347,199	1,587,185
Total assets	29,398,538	29,801,394
Deferred outflows of resources:		
Deferred outflows from pension	153,041	131,673
Total deferred outflows of resources	153,041	131,673
Total assets and deferred outflows of resources	\$ 29,551,579	\$ 29,933,067
<u>LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION</u>		
Current liabilities:		
Current portion of loans payable	\$ 1,039,113	\$ 969,694
Due to grantor	168,688	339,854
Accounts payable and accrued expenses	568,198	181,733
Interest payable	81,809	94,628
Total current liabilities	1,857,808	1,585,909
Long-term debt, net of current maturities	8,439,101	10,526,557
Net pension liability	1,566,224	1,566,224
Total liabilities	11,863,133	13,678,690
DEFERRED INFLOWS OF RESOURCES:		
Deferred inflows from pension	209,731	209,731
Loan origination fees	428,641	425,693
Total deferred inflows of resources	638,372	635,424
NET POSITION:		
Net investment in capital assets	631,916	651,710
Restricted	16,418,158	14,967,243
Total net position	17,050,074	15,618,953
Total assets and deferred inflows of resources	\$ 29,551,579	\$ 29,933,067

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

(A Component Unit of the Republic of Palau)

Statements of Revenues, Expenses and Changes in Net Position

September 30, 2015 and 2014

	2015	2014 As Restated
Operating revenues:		
Interest income on loans	\$ 1,661,610	\$ 1,902,707
Loans fees and late charges	90,417	90,933
Other	41,128	61,409
Total operating revenues	1,793,155	2,055,049
Recovery of (provision for) loan losses and doubtful accounts, net	411,892	(1,138,980)
Net operating revenues	2,205,047	916,069
Operating expenses:		
General and administrative expenses:		
Salaries, wages and fringe benefit	436,483	492,317
Professional fees	68,989	109,074
Depreciation	42,122	50,253
Training	39,539	24,011
Dues and subscription	22,558	25,953
Repairs and maintenance	20,660	16,746
Communications	19,932	13,484
Travel and transportation	19,705	24,381
Honorariums and meeting expenses	18,371	13,386
Supplies, printing and reproduction	15,486	20,817
Utilities	12,016	16,071
Marketing and advertising	8,505	-
Insurance	7,886	8,607
Miscellaneous	21,909	14,280
Total operating expenses	754,161	829,380
Operating income	1,450,886	86,689
Nonoperating revenues (expenses), net:		
Grant revenues	141,521	83,320
Interest income on interest bearing accounts	8,695	4,625
Other income (expenses), net	271,548	4,246
Interest expense and loan fees	(421,068)	(483,272)
Energy Efficiency Home Loan Project	(118,000)	(57,200)
Gain on sale of foreclosed real estate	105,956	3,047
Gain on sale of fixed assets	21,138	-
Renovation energy loan program	(23,521)	(22,650)
Energy Loan Program	(6,034)	(805)
Total nonoperating revenues (expenses), net	(19,765)	(468,689)
Change in net position	1,431,121	(382,000)
Net position at beginning of year	15,618,953	16,000,953
Net position at end of year	\$ 17,050,074	\$ 15,618,953

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

(A Component Unit of the Republic of Palau)

Statements of Cash Flows
September 30, 2015 and 2014

	2015	2014 As Restated
Cash flows from operating activities:		
Cash received from borrowers	\$ 2,580,661	\$ 2,171,159
Cash payments to employees for services	(457,851)	(433,399)
Cash payments to suppliers for goods and services	<u>(275,556)</u>	<u>(172,092)</u>
Net cash provided by operating activities	<u>1,847,254</u>	<u>1,565,668</u>
Cash flows from capital and related financing activities:		
Proceeds from disposal of foreclosed real estate	1,573,044	91,402
Proceeds from disposal of capital assets	-	-
Acquisition of property and equipment	<u>26,185</u>	<u>-</u>
Net cash provided by (used for) capital and related financing activities	<u>1,599,229</u>	<u>91,402</u>
Cash flows from investing activities:		
Net change in time certificate of deposits	681	(680)
Interest received on interest bearing deposits	8,695	4,625
Net change in restricted cash and cash equivalents	(166,875)	(236,418)
Loan collections (originations), net	<u>1,428,721</u>	<u>816,781</u>
Net cash provided by (used for) investing activities	<u>1,271,222</u>	<u>584,308</u>
Cash flows from noncapital financing activities:		
Repayment of long-term debt	(2,018,037)	(927,340)
Interest paid on debt and borrowings	(433,887)	(490,449)
Other income received (expenses paid)	271,548	4,236
Cash received from grantor (payment to grantor)	<u>(29,645)</u>	<u>330,909</u>
Net cash provided by (used for) noncapital financing activities	<u>(2,210,021)</u>	<u>(1,082,644)</u>
Net increase (decrease) in cash and cash equivalents	2,507,684	1,158,734
Cash and cash equivalents at beginning of year	<u>6,054,109</u>	<u>4,895,375</u>
Cash and cash equivalents at end of year	<u>\$ 8,561,793</u>	<u>\$ 6,054,109</u>

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

(A Component Unit of the Republic of Palau)

Statements of Cash Flows
September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u> <u>As Restated</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 1,450,886	\$ 145,607
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation	42,122	50,253
Pension recovery	(21,368)	-
(Recovery of) provision for loan losses and doubtful accounts	(411,892)	1,138,980
Gain on sale of foreclosed properties	(105,956)	-
Gain on sale of capital assets	(21,138)	-
(Increase) decrease in assets:		
Accrued interest	111,727	3,982
Other receivables	366,219	112,128
Inventories	59,435	483
Prepaid expenses	(9,246)	4,414
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	<u>386,465</u>	<u>109,821</u>
Net cash provided by operating activities	<u>\$ 1,847,254</u>	<u>\$ 1,565,668</u>

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2015 and 2014

(1) Reporting Entity

The National Development Bank of Palau (the Bank), a component unit of the Republic of Palau (ROP), was formed on February 24, 1982, under the provisions of the 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 ROP 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 economic development within ROP, and considers all of its net position, except net investment in capital assets, to be restricted for such purposes.

(2) Summary of Significant Accounting Policies

For the year ended September 30, 2015, the College implemented the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. GASB Statement Nos. 68 and 71 establish standards for measuring and recognizing net pension liabilities, deferred outflows of resources, deferred inflows of resources, and expenses related to pension benefits provided through defined pension plans. In addition, Statement No. 68 requires disclosure of information related to pension benefits.

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 Statement of Net position. Proprietary fund operating statements present increases and decreases in total net position. 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.

NATIONAL DEVELOPMENT BANK OF PALAU
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

B. Cash and Cash Equivalents and Time Certificates of Deposit

For the purpose of the Statements of Net Position 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 \$9,764,164 and \$7,423,274 at September 30, 2015 and 2014, respectively. Bank deposits of \$9,974,070 and \$1,254,945 were FDIC insured at September 30, 2015 and 2014, respectively.

Time certificates of deposit maintained in an uninsured bank amounted to \$202,285 as of September 30, 2014. The bank does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. The bank recorded a 100% valuation allowance of this deposit as of September 30, 2014. The time certificate of deposit was recovered during March 2015.

The RPPL 4-48, Section 126, as amended by RPPL 5-37, stipulates that the Bank shall maintain a reserve amount to be applied to all defaults on commercial loans guaranteed by the Bank. The reserve account shall equal ten percent of (10%) of the total amount of all loan guarantees on commercial bank loans, whether or not protected by the full faith and credit of ROP. The bank has restricted \$50,209 and \$50,188 of cash and cash equivalents as of September 30, 2015 and 2014, respectively, to comprise this reserve. The Bank has also restricted cash and cash equivalents held solely for the guarantee of U.S. Department of Agriculture Rural Development (USDA RD) loans in the amount of \$538,559 and \$532,554 as of September 30, 2015 and 2014, respectively. Additionally, \$159,882 and \$332,783 of cash received from grantor agencies was restricted at September 30 2015 and 2014.

NATIONAL DEVELOPMENT BANK OF PALAU
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

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

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 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 Bank’s name; or
- Category 3 – Deposits that are collateralized with securities held by 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 an exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Bank’s deposit 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.

C. Loans and Allowance for Loan Losses

The Bank grants loans to eligible borrowers, including affiliates, officers and employees, all of which are located in ROP. 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.

NATIONAL DEVELOPMENT BANK OF PALAU
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

C. Loans and Allowance for Loan Losses, Continued

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 borrower's ability to pay.

All of the Bank's loans are subject to review for impairment as a part of management's internal asset review process. A loan is considered impaired when, based on current information and events, the borrower is deemed unable to repay the outstanding amount of the obligation under the loan. When a loan is determined to be impaired, a valuation allowance is established based upon the difference between the outstanding amount due under the loan and the amount considered recoverable given the existing financial condition of the borrower and the underlying collateral. Subsequent collections of cash may be applied as a reduction to the principal balance or recorded as income, depending upon management's assessment of the ultimate collectability of the loan.

D. Inventory

Inventory of on-grid and off-grid solar photovoltaic systems and commemorative coins are stated at the lower of cost (first-in, first out) or market.

In 2011, the Bank implemented the Energy Loan Program to provide loans to business and housing customers to acquire renewable energy technologies. The Bank received on-grid and off-grid solar photovoltaic systems amounting to \$402,819 from the United Nations Development Program through the ROP Energy Office under the Sustainable Economic Development through Renewable Energy Applications (SEDREA) Program. Inventory of on-grid and off-grid solar photovoltaic systems amounted to \$216,585 and \$275,771 as of September 30, 2015 and 2014, respectively.

E. Capital Assets

Capital assets are stated at cost. The Bank capitalizes the property and equipment with cost exceeding \$1,000. Depreciation is provided using the straight-line method over the estimated useful lives of the respective assets.

NATIONAL DEVELOPMENT BANK OF PALAU
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September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

F. 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.

G. Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. The Bank determined the differences between expected and actual experience with regard to economic or demographic factors in the measurement of the total pension liability, pension contributions made subsequent to the measurement date and changes in proportion and difference between the Bank pension contributions and proportionate share of contributions qualify for reporting in this category.

H. Deferred Inflows of Resources

In additions to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources represent acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. The Bank has determined the difference between projected and actual earnings on pension plan investments qualify for reporting in this category.

I. Pensions

Pensions are required to be recognized and disclosed using the accrual basis of accounting. The Bank recognizes a net pension liability for the defined benefit pension plan in which it participates, which represents the Bank's proportional share of excess total pension liability over the pension plan assets – actuarially calculated – of a defined benefit, cost sharing multi-employer plan. Changes in the net pension liability during the period are recorded as pension expense, or as deferred inflows of resources or deferred outflows of resources, depending on the nature of the change, in the period incurred.

NATIONAL DEVELOPMENT BANK OF PALAU
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(2) Summary of Significant Accounting Policies, Continued

I. Pensions, continued

Those changes in net pension liability that are recorded as deferred inflows of resources or as deferred outflows of resources, that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience, are amortized over the weighted-average remaining service life of all participants in the qualified pension plan and recorded as a component of pension expense beginning with the period in which they are incurred. Projected earnings on qualified pension plan investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense on a closed basis over a five year period beginning with the period in which the difference occurred.

J. Revenue

Operating revenues include all direct revenues such as interest and fees on loans and interest on investments.

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 of approximated \$2,430,892 and \$2,024,882 at September 30, 2015 and 2014.

K. Net Position

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, required the Bank to establish net position categories as follows:

Net investment in capital assets - consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be included in this component of net position.

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September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

K. Net Position, continued

Restricted:

Nonexpendable – Net assets subject to externally imposed stipulations that the Bank maintains them permanently. At September 30, 2015 and 2014, 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 investment in capital assets, to be restricted for economic development.

Unrestricted – Net position 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 position as of September 30, 2015 and 2014.

L. New Accounting Standards

During the year ended December 31, 2015, the Bank implemented the following GASB Statements:

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revised and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions of this Statement are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of this Statement on the financial statements of the Bank.

NATIONAL DEVELOPMENT BANK OF PALAU
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

L. New Accounting Standards, Continued

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application* which addresses accounting and financial reporting issues related to fair value measurements and guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. This Statement requires additional analysis of fair value if the volume or level of activity for an asset or liability has significantly decreased. It also requires identification of transactions that are not orderly. This Statement requires measurement at acquisition value (an entry price) for donated capital assets, donated works of art, historical treasures, and similar assets and capital assets received in a service concession arrangement. This Statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. It also requires additional disclosures regarding investments in certain entities that calculate net asset value per share (or its equivalent). The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. Earlier application is encouraged. Management has not yet determined the effect of implementation of this Statement will have on Bank's financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 69, which are effective for fiscal years beginning after June 15, 2016. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

L. New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management has not evaluated the impact that the implementation of this statement will have on the financial statements.

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The provisions in Statement No.76 are effective for fiscal years beginning after June 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

M. Off-Balance Sheet Financial Risk

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, 2015 and 2014, the Bank had not recognized any liability from such off-balance sheet financial instruments.

NATIONAL DEVELOPMENT BANK OF PALAU
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Notes to Financial Statements
September 30, 2015 and 2014

(3) Economic Development Loans and Allowance for Loan Losses

The components of loans receivable as of September 30, 2015 and 2014 are as follows:

	2015	2014
Loans receivable	\$ 20,030,772	\$ 23,275,544
Allowance for loan losses	(1,781,264)	(4,069,605)
	18,249,508	19,205,939
Current portion of economic development loans receivable	(2,153,153)	(2,571,600)
	\$ 16,096,355	\$ 16,634,339

Maturities of the above principal balances subsequent to September 30, 2015, will be as follows:

Fully matured and others	\$ 236,210
1 to 6 months	509,303
7 to 18 months	175,827
19 months to 3 years	906,175
After 3 years	18,203,257
	\$ 20,030,772

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Notes to Financial Statements
September 30, 2015 and 2014

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

An analysis of the change in the allowance for loan losses as of September 30, 2015 and 2014 is as follows:

9/30/2015

	<u>Agriculture</u>	<u>Fishing</u>	<u>Commercial</u>	<u>Housing</u>	<u>Total</u>
Beginning of the year	\$ 19,738	\$ 8,572	\$ 2,569,213	\$ 1,472,082	\$ 4,069,605
Recoveries of loans previously charged off	2,860	-	196,712	13,522	213,094
Provision (recoveries) for loan losses	5,697	2,039	142,549	(562,177)	(411,892)
Loans charged off	(1,123)	(1,404)	(1,852,235)	(234,781)	(2,089,543)
Balance, end of year	<u>\$ 27,172</u>	<u>\$ 9,207</u>	<u>\$ 1,056,239</u>	<u>\$ 688,646</u>	<u>\$ 1,781,264</u>

9/30/2014

	<u>Agriculture</u>	<u>Fishing</u>	<u>Commercial</u>	<u>Housing</u>	<u>Total</u>
Beginning of the year	\$ 13,360	\$ 6,685	\$ 1,641,923	\$ 1,194,388	\$ 2,856,356
Recoveries of loans previously charged off	(3,750)	-	(56,437)	(14,082)	(74,269)
Provision for loan losses	6,378	1,887	927,290	277,694	1,213,249
Loans charged off	3,750	-	56,437	14,082	74,269
Balance, end of year	<u>\$ 19,738</u>	<u>\$ 8,572</u>	<u>\$ 2,569,213</u>	<u>\$ 1,472,082</u>	<u>\$ 4,069,605</u>

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Notes to Financial Statements
September 30, 2015 and 2014

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

As of September 30, 2015 and 2014, the composition of the Bank's loan portfolio is comprised of unsecured and secured loans as follows:

9/30/2015

	<u>Unsecured</u>	<u>Secured</u>	<u>Total</u>
Housing	\$ 840,218	\$ 10,794,076	\$ 11,634,294
Commercial	214,125	7,623,426	7,837,551
Fishing	113,577	168,304	281,881
Agriculture	49,703	227,343	277,046
Total	<u>\$ 1,217,623</u>	<u>\$ 18,813,149</u>	<u>\$ 20,030,772</u>

9/30/2014

	<u>Unsecured</u>	<u>Secured</u>	<u>Total</u>
Housing	946,887	10,732,443	11,679,330
Commercial	\$ 236,712	\$ 10,891,481	\$ 11,128,193
Agriculture	53,318	244,054	297,372
Fishing	134,205	36,444	170,649
Total	<u>\$ 1,371,122</u>	<u>\$ 21,904,422</u>	<u>\$ 23,275,544</u>

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September 30, 2015 and 2014

(4) Capital Assets

A summary of capital assets as of September 30, 2015 and 2014 is as follows:

	Estimated Useful Lives	Balance at October 1, 2014	Additions	Deletions	Balance at September 30, 2015
Depreciable asset:					
Leasehold rights	39 - 50 years	\$ 493,206	\$ -	\$ -	\$ 493,206
Leasehold improvements	5 years	252,422	-	-	252,422
Furniture, fixtures and equipment	2 - 20 years	221,705	1,190	-	222,895
Vehicles	5 years	91,783	24,995	(33,059)	83,719
		1,059,116	26,185	(33,059)	1,052,242
Accumulated depreciation		(407,406)	(42,122)	29,202	(420,326)
		<u>\$ 651,710</u>	<u>\$ (15,937)</u>	<u>\$ (3,857)</u>	<u>\$ 631,916</u>

	Estimated Useful Lives	Balance at October 1, 2013	Additions	Deletions	Balance at September 30, 2014
Depreciable asset:					
Leasehold rights	39 - 50 years	\$ 493,206	\$ -	\$ -	\$ 493,206
Leasehold improvements	5 years	252,422	-	-	252,422
Furniture, fixtures and equipment	2 - 20 years	221,705	-	-	221,705
Vehicles	5 years	91,783	-	-	91,783
		1,059,116	-	-	1,059,116
Accumulated depreciation		(357,153)	(50,253)	-	(407,406)
		<u>\$ 701,963</u>	<u>\$ (50,253)</u>	<u>\$ -</u>	<u>\$ 651,710</u>

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Notes to Financial Statements
September 30, 2015 and 2014

(5) Foreclosed Real Estate

A summary of the changes in foreclosed real estate as of September 30, 2015 and 2014 is as follows:

	2015	2014
Beginning of the year	\$ 1,587,185	\$ 1,675,540
Additions	349,000	146
Deletions	(1,490,229)	(88,501)
Balance, end of year	\$ 445,956	\$ 1,587,185

Proceeds from sale of foreclosed properties amounted to \$1,573,044 and \$91,402 for the years ended September 30, 2015 and 2014. The Bank recognized a gain of \$105,956 and \$31,591 for the years ended September 30, 2015 and 2014 for the sale of foreclosed real estate.

(6) 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 ROP. The loan was for \$3,000,000 with a subsequent \$2,000,000 line of credit to be made available with terms and conditions 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 Funds 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 is 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.

The loan was \$3,587,577 and \$4,934,525 with interest of 4.5% as of September 30, 2015 and 2014, respectively. The loan is collateralized by the full faith and credit of the ROP 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-monthly installments of \$142,858, and guaranteed by ROP. Interest is payable semi-annually and commences six months after the advance of proceeds. Annual expected principal payments are \$285,716. The amount outstanding is \$2,571,414 and \$2,857,130 at September 30, 2015 and 2014, respectively.

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Notes to Financial Statements
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(6) Loans Payable, Continued

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 ROP. As of September 30, 2015 and 2014, the Bank has drawn down two tranches of \$3,016,465 and \$1,391,285 with interest rates of 5.175% and 3.679%, respectively. Interest and principal are payable semi-annually until September 10, 2021. On December 12, 2011 EIB cancelled the remaining balance of the Bank's credit line of \$1,739,427 Euros. The balance outstanding at September 30, 2015 and 2014 is \$2,363,736 and \$2,704,596, respectively.

On May 17, 2012, the Bank entered into a \$4,000,000 loan agreement with ROP to finance a loan to the Palau National Communications Corporation (PNCC) for the acquisition of underwater fiber-optic cable for \$3,000,000 and for additional Bank lending activities. The note is uncollateralized and is due and payable 120 months after the loan date, with interest fixed at 2.0% per annum and payable in monthly installments. Interest and principal is payable monthly and commences thirty-six months after the advance of proceeds over the remaining period of the loan. The PNCC fiber-optic project did not proceed and \$3,000,000 was returned to ROP on April 5, 2013. The balance outstanding at September 30, 2015 and 2014 is \$955,486 and \$1,000,000, respectively.

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

<u>Year ending</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 1,039,113	\$ 402,149	\$ 1,441,262
2017	1,055,253	360,012	1,415,265
2018	1,099,180	316,086	1,415,266
2019	1,144,975	270,291	1,415,266
2020	2,213,314	268,475	2,481,789
2021 - 2025	2,226,163	270,034	2,496,197
2026 - 2029	700,216	30,445	730,661
	<u>\$ 9,478,214</u>	<u>\$ 1,917,492</u>	<u>\$ 11,395,706</u>

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(6) Loans Payable, Continued

Changes in loans payable for the years ended 2015 and 2014, are as follows:

	Balance at October 1, 2014			Balance at September 30, 2015	
	Additions	Deletions	Due Within One Year	Due Within One Year	
Republic of Palau Social Security					
Retirement Fund	\$ 4,934,525	\$ -	\$ (1,346,947)	\$ 3,587,578	\$ 267,764
ROP Government	1,000,000	-	(44,514)	955,486	135,336
Mega Internations Commercial Bank	2,857,130	-	(285,716)	2,571,414	285,716
European Investment Bank	2,704,596	-	(340,860)	2,363,736	350,297
	<u>\$ 11,496,251</u>	<u>\$ -</u>	<u>\$ (2,018,037)</u>	<u>\$ 9,478,214</u>	<u>\$ 1,039,113</u>

	Balance at October 1, 2013			Balance at September 30, 2014	
	Additions	Deletions	Due Within One Year	Due Within One Year	
Republic of Palau Social Security					
Retirement Fund	\$ 5,255,926	\$ -	\$ (321,401)	\$ 4,934,525	\$ 333,935
ROP Government	1,000,000	-	-	1,000,000	-
Mega Internations Commercial Bank	3,142,405	-	(285,275)	2,857,130	262,504
European Investment Bank	3,025,260	-	(320,664)	2,704,596	373,255
	<u>\$ 12,423,591</u>	<u>\$ -</u>	<u>\$ (927,340)</u>	<u>\$ 11,496,251</u>	<u>\$ 969,694</u>

(7) Related Party Transactions

The Bank grants loans to affiliates, 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 \$183,019 and \$71,074 at September 30, 2015 and 2014, respectively. Loans receivable from an affiliate are \$2,391,329 and \$2,539,902 at September 30, 2015 and 2014, respectively. Loans receivable from officers and employees and loans receivable from an affiliate are included with economic development loans receivable in the accompanying Statement of Net position.

On November 29, 2010, the Bank and ROP entered into an agreement to assign \$820,000 owed to ROP from the PSB Receiver to the Bank and the Bank paid ROP \$302,000. On January 5, 2012, the Bank and PSB Receiver agreed to extend the maturity date of the Bank's loans receivable from November 7, 2011 to November 12, 2012. The PSB Receiver will continue to pay installments of \$10,000 at the end of each month until the maturity date. The Bank paid ROP the remaining balance of \$500,000 in August 2012. The loan receivable of \$350,000 due from the PSB Receiver was paid-off during April 2015.

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September 30, 2015 and 2014

(8) Commitments

Loans Approved

The Bank approved and disbursed loans aggregating \$3,561,931 and \$11,285,262 in fiscal years 2015 and 2014, respectively. At September 30, 2015, \$9,477,587 was undisbursed. Of the undisbursed loans as of September 30, 2014, \$4,399,000 relates to performance bonds on various construction contracts where the Bank acts as insurer and \$64,687 relates letters of credit. At September 30, 2015 no performance bonds have been called.

Loan Guarantees

The Bank offers 90% loan guarantees to local banks; however, the Bank may also guarantee up to 100% of select home loans from commercial banks made to Palauan citizens. The USDA RD contingent liability is 100%. The total amount of commercial bank loans and USDA RD loans guaranteed by the Bank as of September 30, 2015 and 2014 amounted to approximately \$3.7 million and \$4,000,000, respectively.

On March 20, 2008, the Bank entered into an agreement with Airai State Public Lands Authority for the lease of land to be used for bank operations and other retail businesses. The term of the lease is fifty years commencing March 20, 2008. NDBP exchanged certain real property and allowed the use the property rent free.

(9) Retirement Plan

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 Fund issues a stand-alone financial report which is available at its office site.

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents, of the Republic of Palau State Governments and Republic of Palau agencies, funds and public corporations, which are paid monthly and are two percent of each member's average monthly salary. Normal benefits are the 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 30 years of vesting service, are entitled to retirement benefits. Republic of Palau Public Law 2-26 is the authority under which benefit provisions and contributions rates are established. Member contribution rates are established by Republic of Palau Public Law 2-26 at six percent (6%) of total payroll and are deducted from the member's dollar for dollar by the employer.

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September 30, 2015 and 2014

(9) Retirement Plan, Continued

Under the provisions of the Republic of Palau Public Law 2-26, the Fund's Board of Trustees adopted a Trust Fund Operation 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 Fund utilizes the actuarial cost method termed "level aggregate cost method" with actuarial assumptions used to compute the pension benefit obligation. The following is the statement of actuarial assumptions as of October 1, 2013 applicable to the plan year ending September 30, 2014 of the ROP Civil Service Pension Plan:

Actuarial Cost Method	: Normal costs are calculated under the entry age normal method
Investment Income	: 7.5% per year
Expenses	: \$300,000 each year
Salary Increase	: 3% per year
Mortality	: RP 2000 Combined Healthy Mortality Table, set forward four years
Disabled Mortality	: PBGC Mortality Table for Disabled Persons Receiving Social Security
Retirement Age	: Age 60 and contributed for at least 5 years

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.

Based on the actuarial valuation of the Fund as of October 1, 2013 issued in October 2012, the actuarial valuation determined the unfunded pension benefit obligation as follows:

Accrued liability as of October 1, 2013 for:

Active participants	\$ 82,099,216
Inactive participants with vested deferred benefits	3,323,468
Participants in pay status	<u>61,865,857</u>
Total accrued liability	147,288,541
Market value of assets	<u>(34,261,206)</u>
Unfunded accrued liability	\$ <u>113,027,335</u>
Funded ratio (ratio of assets to liabilities)	23.3%

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(9) Retirement Plan, Continued

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

Deferred Outflows and Inflows of Resources: As of September 30, 2015, the Bank reported total deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 131,673	\$ -
Net difference between projected and actual earnings on pension plan investments	-	209,731
NDBP contributions subsequent to the measurement date	<u>21,638</u>	<u>-</u>
Total	<u>\$ 153,311</u>	<u>\$ 209,731</u>

Medical and Life Insurance Benefit

In April 2010, the Republic of Palau (ROP) enacted RPPL No. 8-14 “*The National Healthcare Financing Act*”. The law requires each resident in the Republic of Palau to have coverage for healthcare costs. The law establishes a national Medical Savings Fund and a Health Insurance System in the ROP.

In October 2010, in compliance with the requirements of RPPL 8-14, the Bank began withholding from its employees 2.5% of gross earnings each pay period, with a matching employer share (a 5% combined contribution) for remittance to the ROP Social Security Administration that administers the Medical Savings Fund and Palau Health Insurance. For the years ended December 31, 2015, 2014 and 2013, the Bank’s employer’s share paid to the Social Security Administration was for these costs was \$10,253, \$8,924 and \$9,154, respectively.

(10) 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.

NATIONAL DEVELOPMENT BANK OF PALAU
(A Component Unit of the Republic of Palau)

Notes to Financial Statements
September 30, 2015 and 2014

(11) Impairment of Fixed Assets

The Bank reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends, and prospects, as well as the effects of obsolescence, demand, competition, and other economic factors.

(12) Fair Value of Financial Instruments

The Bank's financial instruments are cash, loans receivable and other receivables, accounts payables and loans payable. The recorded values of these financial instruments approximate their fair values based on their short-term nature.

(13) Restatement

Net position as of September 30, 2014, has been restated for the implementation of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*.

The following is a summary of the restatement for the year ending September 30, 2015:

Net assets, beginning , as previously reported	\$ 17,263,235
Restatement	<u>(1,644,282)</u>
Net assets, beginning, as restated	<u>\$ 15,618,953</u>

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Notes to Financial Statements
September 30, 2015 and 2014

(13) Restatement, Continued

The effect of the Bank's previously issued 2014 financial statements are summarized as follows:

Statement of Financial Position:

	Previously Reported	Increase (Decrease)	As Restated
Current assets	\$ 10,012,634	\$ -	\$ 10,012,634
Noncurrent assets	19,788,760	-	19,788,760
Total assets	29,801,394	-	29,801,394
Deferred outflows of resources	-	131,673	131,673
	29,801,394	131,673	29,933,067
Current liabilities	1,585,909	-	1,585,909
Noncurrent liabilities	10,526,557	-	10,526,557
Net pension liability	-	1,566,224	1,566,224
Loan origination fees	425,693	-	425,693
Deferred inflows of resources	-	209,731	209,731
Net position	<u>\$ 17,263,235</u>	<u>\$ (1,644,282)</u>	<u>\$ 15,618,953</u>

Statement of Revenues, Expenses, and Changes in Net Position:

	Previously Reported	Increase (Decrease)	As Restated
Net operating revenues	\$ 916,069	\$ -	\$ 916,069
Operating expenses	(770,462)	(58,918)	(829,380)
Non-operating revenues (expenses), net	(468,689)	-	(468,689)
Changes in net position	(323,082)	(58,918)	(382,000)
Net position at beginning of year	<u>17,586,317</u>	<u>(1,585,364)</u>	<u>16,000,953</u>
Net position, at the end of year	<u>\$ 17,263,235</u>	<u>\$ (1,644,282)</u>	<u>\$ 15,618,953</u>

NATIONAL DEVELOPMENT BANK OF PALAU
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Notes to Financial Statements
September 30, 2015 and 2014

(14) Subsequent Events

The Bank evaluated subsequent events from September 30, 2015 through June 24, 2016, the date the financial statements were available to be issued. The Bank did not note any subsequent events requiring disclosure or adjustment to the financial statements.

NATIONAL DEVELOPEMNT BANK OF PALAU
(A Component Unit of the Republic of Palau)

REPORT ON COMPLIANCE AND INTERNAL CONTORL

For The Year Ended September 30, 2015



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

Board of Directors
National Development Bank of Palau

We have audited, in accordance with the 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, the financial statements of National Development Bank of Palau (the Bank), which comprise the statement of financial position as of September 30, 2015, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 24, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the National Development Bank of Palau's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the National Development Bank of Palau's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the organization's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Koror, Republic of Palau
June 24, 2016