

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

INDEPENDENT AUDITORS' REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2008

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 the financial statements of the National Development Bank of Palau (the Bank) as of and for the year ended September 30, 2008, and have issued our report thereon dated April 14, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Bank's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Bank's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Bank's financial statements that is more than inconsequential will not be prevented or detected by the Bank's internal control. We consider the deficiency described in the accompanying Schedule of Findings and Responses (page 3) as item 2008-1 to be a significant deficiency in internal control over financial reporting.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency described above to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Bank's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants 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*.

We noted certain matters that we reported to management of the Bank in a separate letter dated April 14, 2009.

The Bank's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Responses. We did not audit the Bank's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management, the Board of Directors, and others within the Bank, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLC

April 14, 2009

NATIONAL DEVELOPMENT BANK OF PALAU

Schedule of Findings and Responses
Year Ended September 30, 2008

Investments

Finding No. 2008-1

Criteria: Investments should be recorded at fair market value.

Condition: In fiscal year 2004, the Bank paid \$1,000,000 for 10,000 shares in Palau Rock Island Air, Inc. The investment is collateralized by real property owned by other stockholders in the airline. The airline has ceased operations and it is uncertain when operations will resume. The Bank has not recorded an impairment of the investment.

Cause: The cause of the condition is that the Bank believes airline operations will resume and that collateral is sufficient.

Effect: The effect of the condition is a potential misstatement of investments.

Recommendation: The Bank should strengthen controls to ensure that investments are recorded at fair market value. Additionally, we recommend that the Bank obtain appraisals of the collateralizing property to document its position.

Prior Year Status: Lack of internal controls to ensure that investments are recorded at fair market value was reported as a finding in the audits of the Bank for fiscal years 2004 through 2007.

Auditee Response and Corrective Action Plan:

Name of Contact Persons: Kaleb Udui Jr., President and Florencia Rirou, Finance Manager

Corrective Action: PMAir's principals repurchase shares from the Bank in cash or financing from the Bank. Future investments held by the Bank will be recorded at market value based on formal policy to be developed.

Proposed Completion Date: Proposed completion date for refinancing of repurchase agreements and formal policy on investment valuations by December 2009.

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Unresolved Prior Year Comments
Year Ended September 30, 2008

The status of the unresolved prior year finding is disclosed within the Schedule of Findings and Responses section of this report (page 3).