

**MARSHALL ISLANDS DEVELOPMENT BANK**

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**FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT**

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**NINE MONTHS ENDED SEPTEMBER 30, 2002  
AND YEAR ENDED DECEMBER 31, 2001**

## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Marshall Islands Development Bank:

We have audited the accompanying balance sheets of the Marshall Islands Development Bank (MIDB), a component unit of the Republic of the Marshall Islands, as of September 30, 2002 and December 31, 2001, and the related statements of revenues, expenses and changes in retained earnings and of cash flows for the nine months ended September 30, 2002 and for the year ended December 31, 2001. These financial statements are the responsibility of MIDB's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, 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 of material misstatements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MIDB's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

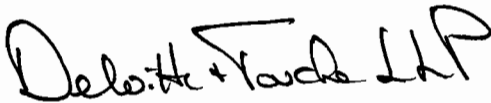
We were unable to determine the propriety of loans and accrued interest receivables as of September 30, 2002 stated at \$12,080,923 and \$465,106, respectively, and loans receivable as of December 31, 2001 stated at \$13,769,364, as MIDB does not adequately assess the allowance for loan and interest receivable losses. We were unable to satisfy ourselves as to the carrying value of loans and accrued interest receivables by means of other auditing procedures. The allowances for loan and interest receivable losses materially affect the determination of the results of operations for the nine months ended September 30, 2002 and for the year ended December 31, 2001.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves about the carrying value of loans and accrued interest receivables as of September 30, 2002 and December 31, 2001, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of MIDB as of September 30, 2002 and December 31, 2001, and the results of its operations and its cash flows for the nine months ended September 30, 2002 and for the year ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

As described in note 14 of the financial statements, MIDB changed its method of accounting for nonexchange transactions as required by the provisions of Governmental Accounting Standards Board (GASB) Statement No. 33. MIDB has restated the 2001 financial statements to reflect the changes.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of MIDB taken as a whole. The accompanying Combining Balance Sheet and Combining Statement of Revenues, Expenses and Changes in Retained Earnings as of and for the nine months ended September 30, 2002 (pages 16 and 17) and the Schedule of Operating Expenses and Capital Expenditures - Budget and Actual for the nine months ended September 30, 2002 (page 18) are presented for purposes of additional analysis and are not a required part of the basic financial statements of MIDB. This additional information is the responsibility of the management of MIDB. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for the effect of the matter discussed in the third paragraph above, is fairly stated, in all material respects, when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 13, 2006, on our consideration of MIDB's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A handwritten signature in black ink, appearing to read "Deloitte Touche LLP". The signature is written in a cursive, flowing style.

October 13, 2006

# MARSHALL ISLANDS DEVELOPMENT BANK

Balance Sheets  
September 30, 2002 and December 31, 2001

<u>ASSETS</u>	<u>2002</u>	<u>2001</u> <u>(As Restated)</u>
Cash and cash equivalents	\$ 122,056	\$ 103,567
Restricted time certificates of deposit	833,954	845,459
Investments	397,106	397,106
Receivables:		
Loans, net	12,080,923	13,769,364
Accrued interest, net	465,106	207,787
Other	175,355	229,870
Premises and equipment, net	113,778	69,605
Foreclosed assets, net	312,083	-
	<u>\$ 14,500,361</u>	<u>\$ 15,622,758</u>

## LIABILITIES AND RETAINED EARNINGS

Liabilities:		
Bank overdraft	\$ 44,097	\$ 64,391
Long-term debt	5,100,000	5,300,000
RepMar deposit	470,366	470,366
Accounts payable	4,561	2,699
Accrued interest payable	85,330	120,355
Accrued expenses	238,166	191,877
Deposits pledged	395,731	272,449
	<u>6,338,251</u>	<u>6,422,137</u>
 Total liabilities		
 Commitments and contingency		
 Retained earnings	<u>8,162,110</u>	<u>9,200,621</u>
	<u>\$ 14,500,361</u>	<u>\$ 15,622,758</u>

See accompanying notes to financial statements.

## MARSHALL ISLANDS DEVELOPMENT BANK

### Statements of Revenues, Expenses and Changes in Retained Earnings Nine Months Ended September 30, 2002 and Year Ended December 31, 2001

	<u>2002</u>	<u>2001</u> (As Restated)
Operating revenues:		
Interest income on loans (net of bad debts of \$334,993 and \$494,854 as of September 30, 2002 and December 31, 2001, respectively)	\$ 1,534,650	\$ 1,777,812
Loan fees	28,489	45,420
Interest income on time certificates of deposit	27,853	51,918
Other	34,716	82,732
Total operating revenues	<u>1,625,708</u>	<u>1,957,882</u>
Provision for loan losses	<u>1,904,498</u>	<u>670,720</u>
Operating expenses:		
Interest expense:		
Interest on loans payable	197,939	272,129
Interest on deposits	33,023	49,039
Total interest expense	<u>230,962</u>	<u>321,168</u>
General and administrative expenses:		
Salaries and employee benefits	364,090	418,407
Bad debts	97,588	-
Office rental	64,607	58,800
Foreclosed assets, net	37,917	-
Travel and training	35,829	45,736
Depreciation	27,347	35,722
Insurance	26,371	25,787
Professional fees	21,386	25,468
Communications	17,697	11,561
Printing, stationery and advertising	14,981	14,041
Repairs and maintenance	6,336	34,959
Miscellaneous	17,213	21,268
Total general and administrative expenses	<u>731,362</u>	<u>691,749</u>
Operating (loss) income	<u>(1,241,114)</u>	<u>274,245</u>
Nonoperating revenues (expenses), net:		
Contributions from RepMar	151,489	136,416
Investment earnings	51,114	39,000
Loss on disposal of equipment	-	(11,963)
Total nonoperating revenues (expenses), net	<u>202,603</u>	<u>163,453</u>
Net (loss) income	<u>(1,038,511)</u>	<u>437,698</u>
Retained earnings at beginning of period	<u>9,200,621</u>	<u>8,762,923</u>
Retained earnings at end of period	<u>\$ 8,162,110</u>	<u>\$ 9,200,621</u>

See accompanying notes to financial statements.

**MARSHALL ISLANDS DEVELOPMENT BANK**

Statements of Cash Flows  
 Nine Months Ended September 30, 2002 and Year Ended December 31, 2001

	<u>2002</u>	<u>2001</u> (As Restated)
Cash flows from operating activities:		
Operating (loss) income	\$ (1,241,114)	\$ 274,245
Adjustments to reconcile operating (loss) income to net cash provided by operating activities:		
Provision for loan losses and bad debts	2,337,079	1,165,574
Depreciation	27,347	35,722
Provision for foreclosed asset losses	37,917	-
Increase in assets:		
Receivables:		
Accrued interest	(592,312)	(594,829)
Other	(82,073)	(62,556)
Increase (decrease) in liabilities:		
Accounts payable	1,862	2,407
Accrued interest payable	(35,025)	7,445
Accrued expenses	43,604	75,389
Deposits pledged	123,282	123,184
Net cash provided by operating activities	<u>620,567</u>	<u>1,026,581</u>
Cash flows from noncapital financing activities:		
Net borrowings (repayments) under bank overdraft	(20,294)	23,471
Net change in RepMar deposit	-	30,836
Contributions from RepMar	151,489	136,416
Net cash provided by noncapital financing activities	<u>131,195</u>	<u>190,723</u>
Cash flows from capital and related financing activities:		
Principal repayment of long-term debt	(200,000)	-
Additions to equipment	(71,520)	(24,651)
Net cash used in capital and related financing activities	<u>(271,520)</u>	<u>(24,651)</u>
Cash flows from investing activities:		
Loan originations and principal collections, net	(563,372)	(1,041,646)
Net change in restricted time certificates of deposit	11,505	(79,830)
Purchase of investments, net	-	(97,106)
Dividends received	90,114	-
Net cash used in investing activities	<u>(461,753)</u>	<u>(1,218,582)</u>
Net change in cash and cash equivalents	18,489	(25,929)
Cash and cash equivalents at beginning of period	103,567	129,496
Cash and cash equivalents at end of period	<u>\$ 122,056</u>	<u>\$ 103,567</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	<u>\$ 265,987</u>	<u>\$ 374,620</u>
Summary disclosure of noncash items:		
Foreclosed real estate transferred from loans:		
Loans receivable	\$ (768,424)	\$ -
Accrued interest receivable	(85,766)	-
Allowance for loan and interest receivable losses	504,190	-
Foreclosed real estate	350,000	-
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

# MARSHALL ISLANDS DEVELOPMENT BANK

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

## (1) Organization

The Marshall Islands Development Bank (MIDB), a component unit of the Republic of the Marshall Islands (RepMar), was incorporated under the laws of RepMar as a non-stock corporation pursuant to the Marshall Islands Development Bank Act of 1988 (Public Law 1988-1). MIDB was established to promote the development and expansion of the economy of the Marshall Islands in order to improve the standard of living of the people and is governed by a seven-member Board of Directors appointed by the Cabinet of RepMar. The primary activities of MIDB have been designed to strengthen the nation's economic base, increase employment and production, improve the standards of housing, promote exports, and reduce the country's dependence on imports and foreign aid through the approval of viable development loans. MIDB has received funds under Sections 111 and 211 of the Compact of Free Association (the Compact), direct contributions from RepMar and funds from the U.S. Department of Agriculture under the Rural Housing and Community Development Service Housing Preservation Grant. MIDB also assumed the assets and liabilities of the former Marshall Islands Economic Development Loan Office, Inc.

## (2) Summary of Significant Accounting Policies

The accounting policies of MIDB conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statements No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. MIDB has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989. The preparation of MIDB's financial statements conform to general practices within the banking industry, which includes the presentation of an unclassified balance sheet.

### 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 the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

### Estimates

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. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan and interest receivable losses.

# MARSHALL ISLANDS DEVELOPMENT BANK

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

## (2) Summary of Significant Accounting Policies, Continued

### Cash and Cash Equivalents and Time Certificates of Deposit

For purposes of the balance sheets and the statements of cash flows, cash and cash equivalents is defined as amounts in demand deposits as well as short-term investments maturing within three months of the date acquired. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified. As of September 30, 2002 and December 31, 2001, the carrying amounts of cash and cash equivalents and time certificates of deposit are \$956,010 and \$949,026, respectively, and the corresponding bank balances are \$1,038,228 and \$1,100,550, respectively. Of the bank balance amounts, \$344,214 and \$495,950, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2002 and December 31, 2001, bank deposits in the amount of \$125,140 and \$220,462, respectively, are FDIC insured. MIDB does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

### Investments

Investments in companies that exceed 20% and which MIDB exercises significant influence over are accounted for using the equity method.

### Loans Receivable, Interest Receivable and Allowances for Losses

Loans and interest receivables are due from customers, both individuals and businesses, located within the Republic of the Marshall Islands and are stated at the unpaid balances less the allowances for losses. Interest on loans is calculated using the simple interest method on daily balances of the principal amount outstanding. The allowances for loan losses and interest receivable losses are established through a provision for losses charged to expense. Loans and interest receivables are charged against the allowance for losses when management believes that collection is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans and interest receivables that may be uncollectible, based on evaluations of the collectibility and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrowers' ability to pay.

### Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method based on the estimated useful lives of the respective assets.

### Foreclosed Assets

Assets acquired through, or in lien of, loan foreclosures are held for sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

# MARSHALL ISLANDS DEVELOPMENT BANK

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

## (2) Summary of Significant Accounting Policies, Continued

### Taxes

Corporate profits are not subject to income tax in the Republic of the Marshall Islands. The Government of the Republic of the Marshall Islands imposes a gross revenue tax of 3% on revenues. MIDB is specifically exempt from gross revenue tax pursuant to Section 817 of Public Law 1988-1.

### Adoption of New Accounting Standards

For fiscal year 2003, MIDB will be implementing the following:

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*.

GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - Omnibus*.

GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.

These statements establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements. Management does not believe that the implementation of these statements will have a material effect on the financial statements of MIDB.

In May 2002, GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. GASB Statement No. 39 amends GASB Statement 14 to provide additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. The provisions of this Statement are effective for periods beginning after June 15, 2003. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MIDB.

### Reclassifications

Certain reclassifications have been made to the 2001 financial statements in order to conform with the 2002 presentation.

## (3) Restricted Time Certificates of Deposit

As of September 30, 2002 and December 31, 2001, MIDB has a time certificate of deposit in the amount of \$300,000 and \$311,285, respectively, with a correspondent bank, which guarantees a \$300,000 available credit line. In addition, MIDB has time certificates of deposit as of September 30, 2002 and December 31, 2001 in the amount of \$533,954 and \$534,174, respectively, with an affiliate bank that are restricted to secure loans funded by Rural Housing Service (RHS). The Memorandum of Understanding signed with the RHS requires MIDB to create and maintain an escrow account with an initial deposit of \$500,000. If the account falls below \$500,000, MIDB shall deposit in the escrow account 5% of all RHS loans issued until such time that the account has reached \$500,000.

## MARSHALL ISLANDS DEVELOPMENT BANK

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

### (4) Investments

A summary of MIDB's investments as of September 30, 2002 and December 31, 2001 is as follows:

	<u>2002</u>	<u>2001</u>
Bank of Marshall Islands	\$ 397,106	\$ 397,106
Air Marshall Islands, Inc.	<u>-</u>	<u>-</u>
	<u>\$ 397,106</u>	<u>\$ 397,106</u>

The investment in Bank of Marshall Islands (BOMI) is recorded at cost as MIDB does not exercise significant influence over the operating and financial policies of the investee. The investment comprises approximately 16% and 17% of outstanding BOMI shares as of September 30, 2002 and December 31, 2001, respectively. During the year ended December 31, 2001, MIDB purchased \$153,571 and sold \$56,465 in shares of BOMI. There were no purchases or sales of BOMI shares during the nine months ended September 30, 2002. During the nine months ended September 30, 2002 and for the year ended December 31, 2001, dividend income earned from BOMI amounted to \$51,114 and \$39,000, respectively.

On December 23, 1994, MIDB accepted an offer from Air Marshall Islands, Inc. (AMI) to convert loans and interest receivables to an equity interest. The equity interest comprises approximately 30% of the outstanding shares of AMI and is considered fully impaired as of September 30, 2002 and December 31, 2001.

MIDB's investments are categorized as either (1) insured or registered or for which the securities are held by MIDB or its agent in MIDB's name, (2) uninsured and unregistered for which the securities are held by the broker's or dealer's trust department or agent in MIDB's name or (3) uninsured and unregistered for which the securities are held by the broker or dealer or by its trust department or agent but not in MIDB's name. All of MIDB's investments are classified in category (1).

### (5) Loans Receivable

Loans receivable as of September 30, 2002 and December 31, 2001 are summarized as follows:

	2002		
	<u>Loans Receivable</u>	<u>Allowance</u>	<u>Net Loans</u>
Compact Section 111	\$ 8,183,347	\$ (7,867,450)	\$ 315,897
Compact Section 211	1,544,510	(1,047,853)	496,657
Republic of the Marshall Islands	15,559,953	(4,310,896)	11,249,057
Housing Preservation Grant	<u>23,193</u>	<u>(3,881)</u>	<u>19,312</u>
	<u>\$ 25,311,003</u>	<u>\$ (13,230,080)</u>	<u>\$ 12,080,923</u>

**MARSHALL ISLANDS DEVELOPMENT BANK**

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

(5) Loans Receivable, Continued

	2001		
	<u>Loans Receivable</u>	<u>Allowance</u>	<u>Net Loans</u>
Compact Section 111	\$ 8,881,309	\$ (8,619,095)	\$ 262,214
Compact Section 211	1,619,496	(1,011,690)	607,806
Republic of the Marshall Islands	14,987,125	(2,113,219)	12,873,906
Housing Preservation Grant	<u>25,438</u>	<u>-</u>	<u>25,438</u>
	<u>\$ 25,513,368</u>	<u>\$ (11,744,004)</u>	<u>\$ 13,769,364</u>

An analysis of the change in the allowance for loan losses during the nine months ended September 30, 2002 and the year ended December 31, 2001 is as follows:

	2002	2001
Beginning balance	\$ 11,744,004	\$ 11,073,284
Provision for loan losses	1,904,498	670,720
Loans charged off	<u>(418,422)</u>	<u>-</u>
Ending balance	<u>\$ 13,230,080</u>	<u>\$ 11,744,004</u>

(6) Accrued Interest Receivable

Accrued interest receivable as of September 30, 2002 and December 31, 2001 is summarized as follows:

	2002		
	<u>Interest Receivable</u>	<u>Allowance</u>	<u>Net Interest Receivable</u>
Compact Section 111	\$ 4,071,756	\$ (3,991,382)	\$ 80,374
Compact Section 211	439,091	(419,650)	19,441
Republic of the Marshall Islands	925,017	(563,306)	361,711
Housing Preservation Grant	<u>3,961</u>	<u>(381)</u>	<u>3,580</u>
	<u>\$ 5,439,825</u>	<u>\$ (4,974,719)</u>	<u>\$ 465,106</u>
	2001		
	<u>Interest Receivable</u>	<u>Allowance</u>	<u>Net Interest Receivable</u>
Compact Section 111	\$ 3,869,301	\$ (3,828,696)	\$ 40,605
Compact Section 211	408,965	(374,919)	34,046
Republic of the Marshall Islands	651,644	(521,315)	130,329
Housing Preservation Grant	<u>3,369</u>	<u>(562)</u>	<u>2,807</u>
	<u>\$ 4,933,279</u>	<u>\$ (4,725,492)</u>	<u>\$ 207,787</u>

**MARSHALL ISLANDS DEVELOPMENT BANK**

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

**(6) Accrued Interest Receivable, Continued**

An analysis of the change in the allowance for interest receivable losses during the nine months ended September 30, 2002 and the year ended December 31, 2001 is as follows:

	<u>2002</u>	<u>2001</u>
Beginning balance	\$ 4,725,492	\$ 4,230,638
Provision for interest receivable losses	334,993	494,854
Interest receivable on loans charged off	<u>(85,766)</u>	<u>-</u>
Ending balance	\$ <u>4,974,719</u>	\$ <u>4,725,492</u>

**(7) Premises and Equipment**

Premises and equipment as of September 30, 2002 and December 31, 2001 consists of the following:

	<u>Estimated Useful Lives</u>	<u>2002</u>	<u>2001</u>
Computer systems	5 years	\$ 115,191	\$ 89,268
Motor vehicles	3 years	72,328	72,328
Office furniture	5 years	43,901	41,782
Office equipment	2 - 10 years	<u>30,582</u>	<u>26,515</u>
		262,002	229,893
Less accumulated depreciation		<u>(187,635)</u>	<u>(160,288)</u>
		74,367	69,605
Construction work-in-progress		<u>39,411</u>	<u>-</u>
		\$ <u>113,778</u>	\$ <u>69,605</u>

**(8) Foreclosed Assets**

Foreclosed assets are presented net of an allowance for losses. An analysis of the allowance for losses on foreclosed assets for the nine months ended September 30, 2002 and the year ended December 31, 2001 is as follows:

	<u>2002</u>	<u>2001</u>
Balance at beginning of period	\$ -	\$ -
Provision for losses	<u>37,917</u>	<u>-</u>
Balance at end of period	\$ <u>37,917</u>	\$ <u>-</u>

**MARSHALL ISLANDS DEVELOPMENT BANK**

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

(9) Long-term Debt

	<u>2002</u>	<u>2001</u>
On August 6, 1999, MIDB entered into a loan agreement with the International Commercial Bank of China in the amount of \$5,000,000, due August 6, 2014, for the purpose of funding private enterprise purchase of transportation ships. The loan is uncollateralized, bears interest at 5% per annum, with interest due semi-annually commencing March 6, 2000. Repayment of principal commenced August 6, 2002 in semi-annual installments of \$200,000.	\$ 4,800,000	\$ 5,000,000
Bank credit line of \$300,000, due December 31, 2002, interest at 3.75% per annum as of September 30, 2002 (7% per annum as of December 31, 2001), payable monthly, collateralized by a \$300,000 time certificate of deposit.	<u>300,000</u>	<u>300,000</u>
	<u>\$ 5,100,000</u>	<u>\$ 5,300,000</u>

Future repayment commitments for these loans are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 700,000	\$ 241,142	\$ 941,142
2004	400,000	218,611	618,611
2005	400,000	197,750	597,750
2006	400,000	177,472	577,472
2007	400,000	157,194	557,194
Thereafter	<u>2,800,000</u>	<u>525,558</u>	<u>3,325,558</u>
	<u>\$ 5,100,000</u>	<u>\$ 1,517,727</u>	<u>\$ 6,617,727</u>

(10) Related Party Transactions

MIDB has deposits with a bank of \$620,120 and \$604,600 as of September 30, 2002 and December 31, 2001, respectively, in which MIDB has an equity investment. The deposits accrue interest at rates of 1.5% to 5.5% per annum. Interest earned for the nine months ended September 30, 2002 and for the year ended December 31, 2001 amounted to \$20,527 and \$36,089, respectively.

MIDB is a component unit of RepMar and is therefore affiliated with all RepMar-owned and affiliated entities, including Air Marshall Islands, Inc (AMI). As of September 30, 2002 and December 31, 2001, MIDB has loans outstanding with affiliated entities of \$185,000. These loans are fully provided for in the allowance for loan losses. In addition, interest receivable as of September 30, 2002 and December 31, 2001 from affiliated entities amounted to \$66,233 and \$60,698, respectively, and are fully provided for in the allowance for interest receivable losses. All loans were made at normal commercial terms and conditions. These receivables are included under loans receivable and interest receivable, respectively.

# MARSHALL ISLANDS DEVELOPMENT BANK

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

## (10) Related Party Transactions, Continued

Several employees of MIDB have loans outstanding as of September 30, 2002 and December 31, 2001, of \$581,521 and \$678,106, respectively. In addition, the directors of MIDB have loans outstanding as of September 30, 2002 and December 31, 2001, of \$171,892 and \$87,533, respectively. All loans were made at normal commercial terms and conditions. These loans are included under loans receivable.

MIDB has issued certificates of deposit to RepMar in the amount of \$470,366 as of September 30, 2002 and December 31, 2001. The deposits are for one-year terms and accrue interest at 7% per annum. As of September 30, 2002 and December 31, 2001, interest payable relating to these deposits amounted to \$25,709 and \$1,173, respectively, and are included within the balance sheets as accrued interest payable.

On August 7, 2000, MIDB entered into a loan agreement with RepMar whereby MIDB loaned RepMar \$1,800,000 for the purpose of paying off debts owed by the Marshall Islands Social Security Administration for medical bills. Amounts outstanding as of September 30, 2002 and December 31, 2001 are \$69,157. As of September 30, 2002 and December 31, 2001, total interest accrued is \$4,446 and \$48, respectively. These receivables are included under loans receivable and interest receivable, respectively.

## (11) Risk Management

MIDB 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. MIDB has elected to purchase commercial automobile insurance and fire, lightning and typhoon insurance covering office contents from independent third parties for the risks of losses to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. MIDB does not maintain general liability insurance and fire, lightning and typhoon insurance for its office building and properties. In the event of an insurable loss, MIDB may be self-insured to a material extent.

## (12) Commitments and Contingency

### Commitments

On August 1, 1996, MIDB entered into a building management agreement with a delinquent loan customer. Under the terms of the agreement, MIDB was required to collect office lease rental income and apply the proceeds against the loan customer's outstanding balance. In return, MIDB was to receive a management fee of \$25,000 per year. MIDB also leased space in the building and was required to pay for the space it uses. Annual lease rental payments for MIDB for the nine months ended September 30, 2002 and for the year ended December 31, 2001 were \$64,607 and \$58,800, respectively. The term of the agreement was for as long as was required to pay off the customer's loan with MIDB. As of September 30, 2002, the customer's principal loan balance and accrued interest were \$3,764,205 and \$2,837,553, respectively. These balances are recorded as loans receivable and accrued interest receivable, respectively, on the accompanying balance sheets.

# MARSHALL ISLANDS DEVELOPMENT BANK

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

## (12) Commitments and Contingency Continued

### Commitments, Continued

On April 12, 1999, MIDB entered into an agreement to manage an entertainment complex of a delinquent loan customer. Under the terms of the agreement, MIDB is required to manage the operations and to apply the proceeds less operating expenses to the loan customer's outstanding loan balance. In return, MIDB receives a management fee of \$12,000 per year. The term of the agreement is for as long as is required to make the loan current. As of September 30, 2002, the customer's principal loan balance and accrued interest were \$1,214,276 and \$222,522, respectively. These balances are recorded as loans receivable and accrued interest receivable, respectively, on the accompanying balance sheets.

During the year ended December 31, 2001, MIDB assumed the payment obligations under a fifteen-year ground lease, expiring on January 14, 2003, with an option to renew for an additional five years. On January 17, 2005, MIDB entered into an amended lease agreement with the landowners for the property. The term of the amended lease is twenty years, expiring on January 13, 2023.

Future minimum lease payments under this lease are as follows:

<u>Year ending</u> <u>September 30,</u>	
2003	\$ 2,833
2004	4,000
2005	4,000
2006	4,000
2007	4,000
Thereafter	<u>61,167</u>
	<u>\$ 80,000</u>

### Contingency

MIDB participates in a number of federally assisted programs from the U.S. Department of the Interior and the U.S. Department of Agriculture. These programs are subject to financial and compliance audits to ascertain if federal laws and guidelines have been followed. The United States Department of the Interior, Office of the Inspector General, in their audit report "Marshall Islands Development Bank, Republic of the Marshall Islands", dated August 1999, have identified loans funded under Sections 111 and 211 of the Compact (CFDA # 15.875) totaling \$12,410,148, and loans converted to an equity interest in Air Marshall Islands, Inc. totaling \$2,933,321, as questionable. The ultimate disposition of these questionable loans can be determined only by final action of the grantor agency. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements. If these loans are ultimately denied, MIDB could be charged for the necessary reimbursement to the grantor agency.

## (13) Subsequent Events

On December 31, 2002, MIDB paid in full its \$300,000 credit line with the collateral time certificate of deposit.

## MARSHALL ISLANDS DEVELOPMENT BANK

Notes to Financial Statements  
September 30, 2002 and December 31, 2001

### (13) Subsequent Events, Continued

On April 10, 2003, MIDB issued a loan in the amount of \$3,000,000; payable at the rate of 7.5% over fifteen years with monthly installments of \$27,825. On April 18, 2003, MIDB approved a loan in the amount of \$4,000,000 for a fifteen-year term with interest payable at 7.5%, with monthly installments of \$38,600.

On May 14, 2003, MIDB assumed ownership of a building it had been managing under an agreement with a delinquent loan customer.

On January 16, 2004, MIDB entered into a \$250,000 loan agreement with an affiliate bank.

MIDB has guaranteed three loans totaling \$1,000,000 obtained by AMI from an affiliate bank on June 10, 2005, September 21, 2005 and December 9, 2005.

On September 1, 2005, MIDB turned over to a third party the management of an entertainment complex MIDB had been managing for a delinquent loan customer.

On February 28, 2006, MIDB entered into an agreement with an affiliate bank whereby MIDB will guarantee loans issued by the bank to MIDB's borrowers. As of October 13, 2006, MIDB has guaranteed such bank loans totaling \$1,546,108.

### (14) Prior Period Restatement

Effective January 1, 2001, MIDB implemented GASB Statement No 33, *Accounting and Financial Reporting for Nonexchange Transaction*. The provisions of this statement require capital grants and contributions to be recognized as non-operating revenue on the Statements of Revenues, Expenses and Changes in Retained Earnings. In prior periods, capital grants and contributions had been recorded as a direct increase to contributions in aid in the equity section of the Balance Sheets. As a result, contributed capital and deficit have been restated from the amounts previously reported.

During the nine months ended September 30, 2002, MIDB determined that accrued interest payable was understated by \$102,083 as of December 31, 2001. As a result, accrued interest payable and fund balance have been restated from the amounts previously reported.

	<u>As Previously Reported</u>	<u>GASB 33 Implementation</u>	<u>(Over)Under Statement</u>	<u>As Restated</u>
At January 1, 2001:				
Contributed capital	\$ <u>17,471,167</u>	\$ <u>(17,471,167)</u>	\$ <u>-</u>	\$ <u>-</u>
Fund (deficit) balance	\$ <u>(8,606,161)</u>	\$ <u>17,471,167</u>	\$ <u>(102,083)</u>	\$ <u>8,762,923</u>
At December 31, 2001:				
Accrued interest payable	\$ <u>18,272</u>	\$ <u>-</u>	\$ <u>102,083</u>	\$ <u>120,355</u>
Contributed capital	\$ <u>17,471,167</u>	\$ <u>(17,471,167)</u>	<u>-</u>	\$ <u>-</u>
Fund (deficit) balance	\$ <u>(8,168,463)</u>	\$ <u>17,471,167</u>	\$ <u>(102,083)</u>	\$ <u>9,200,621</u>

**MARSHALL ISLANDS DEVELOPMENT BANK**

Combining Balance Sheet  
September 30, 2002

<u>ASSETS</u>	<u>Section 111 Compact of Free Association</u>	<u>Section 211 Compact of Free Association</u>	<u>Republic of the Marshall Islands</u>	<u>Housing Preservation Grant</u>	<u>Elimination of Interfund Balances</u>	<u>Total</u>
Cash and cash equivalents	\$ 1,013,913	\$ 1,892,270	\$ (3,046,672)	\$ 262,545	\$ -	\$ 122,056
Restricted time certificates of deposit	493,470	-	340,484	-	-	833,954
Investments	-	-	397,106	-	-	397,106
Receivables:						
Loans, net	315,897	496,657	11,249,057	19,312	-	12,080,923
Accrued interest, net	80,374	19,441	361,711	3,580	-	465,106
Other	69,762	-	105,593	-	-	175,355
Due from other funds	911,521	30,000	-	-	(941,521)	-
Premises and equipment, net	-	-	113,778	-	-	113,778
Foreclosed assets, net	312,083	-	-	-	-	312,083
	<u>\$ 3,197,020</u>	<u>\$ 2,438,368</u>	<u>\$ 9,521,057</u>	<u>\$ 285,437</u>	<u>\$ (941,521)</u>	<u>\$14,500,361</u>
 <u>LIABILITIES AND RETAINED EARNINGS</u>						
Liabilities:						
Bank overdraft	\$ -	\$ -	\$ 44,097	\$ -	\$ -	\$ 44,097
Long-term debt	-	-	5,100,000	-	-	5,100,000
RepMar deposit	-	-	470,366	-	-	470,366
Accounts payable	1,430	-	3,131	-	-	4,561
Accrued interest payable	-	-	85,330	-	-	85,330
Accrued expenses	49,505	-	188,661	-	-	238,166
Deposits pledged	-	-	395,731	-	-	395,731
Due to other funds	-	-	940,788	733	(941,521)	-
Total liabilities	<u>50,935</u>	<u>-</u>	<u>7,228,104</u>	<u>733</u>	<u>(941,521)</u>	<u>6,338,251</u>
Retained earnings	<u>3,146,085</u>	<u>2,438,368</u>	<u>2,292,953</u>	<u>284,704</u>	<u>-</u>	<u>8,162,110</u>
	<u>\$ 3,197,020</u>	<u>\$ 2,438,368</u>	<u>\$ 9,521,057</u>	<u>\$ 285,437</u>	<u>\$ (941,521)</u>	<u>\$14,500,361</u>

See accompanying independent auditors' report.

**MARSHALL ISLANDS DEVELOPMENT BANK**

Combining Statement of Revenues, Expenses and Changes in Retained Earnings  
Nine Months Ended September 30, 2002

	<u>Section 111 Compact of Free Association</u>	<u>Section 211 Compact of Free Association</u>	<u>Republic of the Marshall Islands</u>	<u>Housing Preservation Grant</u>	<u>Elimination of Interfund Balances</u>	<u>Total</u>
Operating revenues:						
Interest income on loans (net of bad debts of \$334,993)	\$ 244,586	\$ 16,577	\$ 1,272,661	\$ 826	\$ -	1,534,650
Loan fees	-	-	28,489	-	-	28,489
Interest income on time certificates of deposit	23,420	-	4,433	-	-	27,853
Other	3,000	-	31,716	-	-	34,716
Total operating revenues	<u>271,006</u>	<u>16,577</u>	<u>1,337,299</u>	<u>826</u>	<u>-</u>	<u>1,625,708</u>
Provision for loan losses	<u>(333,220)</u>	<u>36,163</u>	<u>2,197,674</u>	<u>3,881</u>	<u>-</u>	<u>1,904,498</u>
Operating expenses:						
Interest expense:						
Interest on loans payable	-	-	197,939	-	-	197,939
Interest on deposits	-	-	33,023	-	-	33,023
Total interest expense	<u>-</u>	<u>-</u>	<u>230,962</u>	<u>-</u>	<u>-</u>	<u>230,962</u>
General and administrative expenses:						
Salaries and employee benefits	125,700	-	238,390	-	-	364,090
Bad debts	5,000	-	92,588	-	-	97,588
Office rental	29,059	-	35,548	-	-	64,607
Foreclosed assets, net	37,917	-	-	-	-	37,917
Travel and training	10,441	-	25,388	-	-	35,829
Depreciation	-	-	27,347	-	-	27,347
Insurance	13,281	-	13,090	-	-	26,371
Professional fees	10,693	-	10,693	-	-	21,386
Communications	8,718	-	8,979	-	-	17,697
Printing, stationery and advertising	6,612	-	8,369	-	-	14,981
Repairs and maintenance	2,763	-	3,573	-	-	6,336
Miscellaneous	6,985	-	10,228	-	-	17,213
Total general and administrative expenses	<u>257,169</u>	<u>-</u>	<u>474,193</u>	<u>-</u>	<u>-</u>	<u>731,362</u>
Operating income (loss)	<u>347,057</u>	<u>(19,586)</u>	<u>(1,565,530)</u>	<u>(3,055)</u>	<u>-</u>	<u>(1,241,114)</u>
Nonoperating revenues (expenses), net:						
Contributions from RepMar	-	-	151,489	-	-	151,489
Investment earnings	-	-	51,114	-	-	51,114
Total nonoperating revenues (expenses), net	<u>-</u>	<u>-</u>	<u>202,603</u>	<u>-</u>	<u>-</u>	<u>202,603</u>
Net income (loss)	347,057	(19,586)	(1,362,927)	(3,055)	-	(1,038,511)
Retained earnings at beginning of period	<u>2,799,028</u>	<u>2,457,954</u>	<u>3,655,880</u>	<u>287,759</u>	<u>-</u>	<u>9,200,621</u>
Retained earnings at end of period	<u>\$ 3,146,085</u>	<u>\$ 2,438,368</u>	<u>\$ 2,292,953</u>	<u>\$ 284,704</u>	<u>\$ -</u>	<u>\$ 8,162,110</u>

See accompanying independent auditors' report.

**MARSHALL ISLANDS DEVELOPMENT BANK**

Schedule of Operating Expenses and Capital  
Expenditures - Budget and Actual  
Nine Months Ended September 30, 2002

	<u>Budget</u>	<u>Actual</u>	Variance Favorable (Unfavorable)
Provision for loan losses	\$ -	\$ 1,904,498	\$ (1,904,498)
Operating expenses:			
Interest expense:			
Interest on loans payable	-	197,939	(197,939)
Interest on deposits	-	33,023	(33,023)
Total interest expense	-	230,962	(230,962)
General and administrative expenses:			
Salaries and employee benefits	424,660	364,090	60,570
Bad debts	-	97,588	(97,588)
Office rental	80,000	64,607	15,393
Foreclosed assets, net	-	37,917	(37,917)
Travel and training	41,800	35,829	5,971
Depreciation	-	27,347	(27,347)
Insurance	15,000	26,371	(11,371)
Professional fees	24,600	21,386	3,214
Communications	10,000	17,697	(7,697)
Printing, stationery and advertising	14,000	14,981	(981)
Repairs and maintenance	10,000	6,336	3,664
Miscellaneous	21,550	17,213	4,337
Total general and administrative expenses	641,610	731,362	(89,752)
	<u>\$ 641,610</u>	<u>\$ 962,324</u>	<u>\$ (320,714)</u>
Capital expenditures:			
Computers/software	\$ 60,000	\$ 25,923	\$ 34,077
Office equipment	10,000	4,067	5,933
Office furniture	5,000	2,119	2,881
	<u>\$ 75,000</u>	<u>\$ 32,109</u>	<u>\$ 42,891</u>

See accompanying independent auditors' report.