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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2018 AND 2017

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INDEPENDENT AUDITORS' REPORT

Board of Directors
National Development Bank of Palau:

Report on the Financial Statements

We have audited the accompanying financial statements of the National Development Bank of Palau (the Bank), a component unit of the Republic of Palau, which comprise the statements of net position as of September 30, 2018 and 2017, and the related statements of revenues, expenses and changes in net position and of 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 opinions 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 the National Development Bank of Palau as of September 30, 2018 and 2017, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Financial Statement Presentation

As discussed in note 2 to the financial statements, the Bank elected to present an unclassified statement of net position because current assets are not matched with current liabilities. 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 3 through 10 as well as the Schedule of Proportional Share of the Net Pension Liability on page 34 and the Schedule of Pension Contributions on page 35 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 our 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 April 29, 2019 on our consideration of the Bank'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 solely 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 effectiveness of the Bank's 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 the Bank's internal control over financial reporting and compliance.

Deloitte & Touche LLC

April 29, 2019

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2018

This Management Discussion and Analysis (MD&A) of the National Development Bank of Palau's (the Bank) financial performance and condition for the fiscal year ended September 30, 2018 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 ROP appoints six of its seven Board members for 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 annually.

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 Board of Directors approves the hiring of managers for each functional area. The Bank's President has authority over all positions of the Bank. Staff levels and funding are determined against strategic, corporate and budget plans proposed by management and approved by the Board. At fully-staffed capacity, the Bank has seventeen full-time equivalent employees, including the President/Chief Executive Officer (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 2018. Plans for expansion of the Bank's building are set forth in the Bank's ten-year Strategic Plan.

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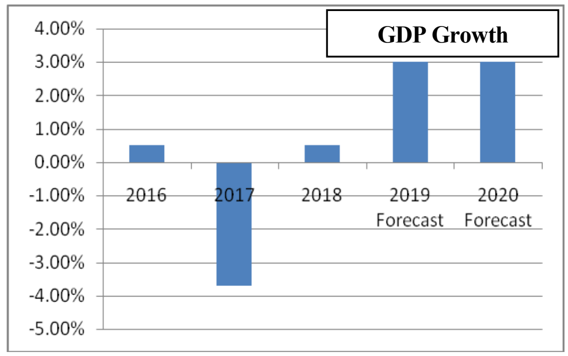
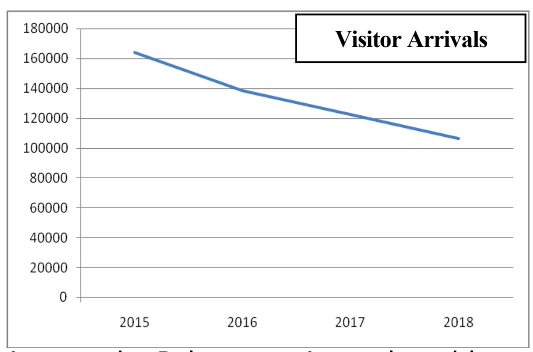
Economic Outlook

After a 3.7% contraction in the economy in 2017 due mainly to tourist arrivals dropping sharply by 17%, the Gross Domestic Product (GDP) recovered, albeit modestly in 2018 by 0.5%. This modest growth in the GDP is primarily a result of increased infrastructure spending on projects such as the Asian Development Bank (ADB)-funded sewer project, the Japanese-funded water project and other various road improvement projects. Tourist arrivals continued to decline during the same period.



In FY2019 through FY2021 the economy is projected to experience strong growth originating from several sources. The tourism economy is projected to continue to rebound as occupancy rates return to more profitable levels and a new hotel plant comes into operation. Construction of the $30 million airport renewal PPP project is anticipated to commence mid FY2019 and be completed by the end of FY2021. Also, it is anticipated that use of the CRA $40 million dedicated to capital projects will include investment in infrastructure that will boost the economy. Construction of the Koror Airai sanitation project is anticipated to be completed during this period. Finally, a recent launch of faster internet services via fiber-optic cables is expected to have a positive impact on growth in the medium run. After FY2021, the impact of additional infrastructure projects will have worked their way through the system, and the economy is projected to converge to a steady rate of growth of 3.0 percent.

The tourist industry is the driving force behind the economy of Palau. The ADB emphasized this point on its member fact sheet, stating that "growth in tourism has driven strong economic performance for the country". The overall tourist arrivals to Palau in 2018 shrunk by 13.2%, with the China tourist market leading the shrinkage.



Tourist arrivals are expected to pick-up in the coming year with expected additional flights from Taiwan, Japan and Hong Kong. In addition, the new ADB Outlook report expects Palau's economy to grow by at least 3% in 2019.

Risks to the economic outlook are tilted to the downside. The economic downturn due to lower than expected tourism arrivals would worsen the fiscal position and the external sector. A shortfall of non-Compact capital grants would lead to lower infrastructure investments and lower economic growth. Palau remains vulnerable to natural disasters and climate change as in other Pacific Island economies. Other risks include weaker than expected global growth, including in the U.S. and China and a sharp tightening of global financial conditions and further U.S, dollar appreciation. These risks could adversely affect the economy through lower tourism receipts.

Palau's economic growth rate has been volatile because of its strong reliance on tourism. With its small population and land area, there is limited scope to diversify the economy. Nevertheless, structural policies to enhance the potential in tourism could strengthen future growth opportunities while also reducing sectoral and thus macroeconomic volatility. The focus should be on greater diversification of the source markets and moving toward high-end tourism, building on the pristine environment.

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 position. The accrual basis of accounting is utilized whereby revenues are recorded when earned and expenses recorded when liabilities are incurred.

Significant financial policies include a 10% reserve requirement for the Bank's commercial guaranteed loans. The reserve is held in a time certificate of deposit with a commercial bank. A reserve of $500,000 is also held at a commercial bank as required by the U.S. Department of Agriculture Rural Development (USDA RD) for programs loans guaranteed by the Bank.

All current guarantees are granted under recourse loan purchase agreements. While the Bank offers 90% loan guarantees to local banks, the Bank may also guarantee up to 100% of select home loans from commercial banks to Palauan citizens as in the case of USDA RD.

A Memorandum of Understanding (MOU) was signed on April 1, 2014 between the Bank of Guam (BOG), the Bank and the Palau Housing Authority (PHA) pursuant to the Belau Real Estate Financing Program.

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.

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 (SBDC) to assist clients with creating business plans; collaboration with the Palau SBDC and the Ministry Natural Resources, Environment and Tourism on the Farm Loan Program; and the MOU with PHA on providing subsidy for 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 U.S. dollar denominated.

<u>Guaranteed Loans</u>

The Bank offers guarantees backed by the Bank or ROP to commercial banks and other institutions. There are only guarantees outstanding from the Bank for the USDA RD loans. Popularity is low with these programs as they often take months to receive approval and are stricter in terms and loan covenants. The Belau Real Estate Financing Program through BOG is a new addition to our guaranteed loans program. As of September 30, 2018, no completed loan packages from BOG were received by the Bank.

Operations, Continued

Energy Programs

Energy is one of the national policy directions for industry under Palau's leadership. The Bank continuously works to secure grants to expand its Energy Program.

Direct Loans

In the category of small business loans, the Bank offers customers four programs: Small Business, WEDAP, Microfinance, and Pre-Development Loan. The Bank's general policy is for all loans to be fully secured; except for Microfinance loans, which are up to $15,000. Microfinance loans are administered like signature loans; however, the Bank may take collateral if it deems it necessary for caution. The Bank's Microfinance and Pre-Development Loan programs 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.

Short to medium-term financing is extended to new or existing businesses to fund short-term working capital and equipment acquisitions. Long-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 3% to 10%. Rates are considered to include the cost of funds, the lending spread to cover the cost of operations, risk components 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.

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 costs with a maximum amount of $10,000 under the Pre-Development Loan program and a loan term not to exceed five years. The purpose of Pre-Development Loan program 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.

Overview of Financial Performance

A condensed year-to-year comparison of operating activity reflecting the foregoing statements follows:

Statements of Revenues, Expenses and Changes in Net Position

	2018	2017	$ Change	% Change	2016
Revenues:					
Interest income on loans	1,704,965	1,611,157	93,808	6%	$ 1,491,715
Loan fees and late charges	157,932	97,570	60,362	62%	95,428
Other	66,508	28,449	38,059	134%	53,510
Total operating revenues	1,929,405	1,737,176	192,229	11%	1,640,653
Recovery of (provision for) loan losses and doubtful accounts	126,826	(190,930)	317,756	-166%	492,375
Net operating revenues	2,056,231	1,546,246	509,985	33%	2,133,028
Operating expenses:					
Salaries, wages and fringe benefits	667,750	598,852	68,898	12%	544,977
Training and travel and transportation	101,506	91,497	10,009	11%	116,306
Depreciation	45,420	40,667	4,753	12%	36,953
Other expenses	232,290	207,603	24,687	12%	244,025
Total operating expenses	1,046,966	938,619	108,347	12%	942,261

Overview of Financial Performance, Continued

Statements of Revenues, Expenses and Changes in Net Position, Continued

	2018	2017	$ Change	% Change	2016
Operating income	1,009,265	607,627	401,638	66%	1,190,767
Nonoperating revenues (expenses)	(458,815)	(639,762)	180,947	-28%	(179,988)
Change in net position	550,450	(32,135)	582,585	-1813%	1,010,779
Net position in beginning of year	18,457,359	18,489,494	(32,135)	-0%	17,478,715
Net position at end of year	$ 19,007,809	$ 18,457,359	$ 550,450	3%	$ 18,489,494

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

Statements of Cash Flows

	2018	2017	$ Change	% Change	2016
Cash flows from operating activities	$ 957,138	$ 550,265	$ 406,873	74%	$ 660,318
Cash flows from capital and related financing activities	(1,571,878)	(1,609,957)	38,079	-2%	3,517,938
Cash flows from investing activities	(2,845,670)	(1,204,063)	(1,641,607)	136%	639,932
Cash flows from noncapital financing activities	21,283	32,682	(11,399)	-35%	(28,919)
Net (decrease) increase in cash and cash equivalents	(3,439,127)	(2,231,073)	(1,208,054)	54%	4,789,269
Cash and cash equivalents at beginning of year	11,818,431	14,049,504	(2,231,073)	-16%	9,260,235
Cash and cash equivalents at end of year	$ 8,379,304	$ 11,818,431	$ (3,439,127)	-29%	$ 14,049,504

Revenue

Operating revenues include all direct revenues such as interest income and fees on loans and other miscellaneous fees, such as late and performance bond fees. Operating revenues in 2018 increased by 11% over 2017 and increased in 2017 by 6% over 2016 largely due to the increase in the Bank's loan portfolio.

Loan Interest Rates

The Bank’s interest rates remained fixed according to the type of loan funded. Rates ranged from 3% for our newest agriculture program, 6% for existing 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 interest rate of 9% as required by a court-ordered judgment. At the end of fiscal year 2018, the average yield decreased from 8.24% in 2017 to 8.13% in 2018 and from 8.25% in 2016 to 8.24% in 2017.

Expenses

Total operating expenses for 2018 was $108,347 more than 2017. The increase is largely due to additional staffing, training as well as professional assistance in preparation for the Bank to take on deposits. Total operating expenses for 2017 was $3,642 less than 2016.

Overview of Financial Condition

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

Overview of Financial Condition, Continued

Statements of Net Position

	2018	2017	$ Change	% Change	2016
Economic development loans receivable, net	$ 22,062,755	$ 19,136,177	$ 2,926,578	15%	$ 18,112,014
Capital assets	661,791	675,502	(13,711)	-2%	623,208
Other assets	9,625,408	13,037,438	(3,412,030)	-26%	15,525,773
Total assets	32,349,954	32,849,117	(499,163)	-2%	34,260,995
Deferred outflows of resources from pension	428,070	337,651	90,419	27%	198,993
Total assets and deferred outflows of resources	$ 32,778,024	$ 33,186,768	$ (408,744)	-1%	$ 34,459,988
Loans payable	$ 11,189,624	$ 12,340,586	$ (1,150,962)	-9%	$ 13,433,219
Net pension liability	1,831,279	1,837,001	(5,722)	0%	1,630,006
Other liabilities	382,977	335,778	47,199	14%	670,695
Total liabilities	13,403,880	14,513,365	(1,109,485)	-8%	15,733,920
Deferred inflows of resources from pension	366,335	216,044	150,291	70%	236,574
Total liabilities and deferred inflows of resources	13,770,215	14,729,409	(959,194)	-7%	15,970,494
Net position:					
Net investment in capital assets	661,791	675,502	(13,711)	-2%	623,208
Restricted	18,346,018	17,781,857	564,161	3%	17,866,286
Total net position	19,007,809	18,457,359	550,450	3%	18,489,494
Total liabilities, deferred inflows of resources and net position	$ 32,778,024	$ 33,186,768	$ (408,744)	-1%	$ 34,459,988

Loan Portfolio

The Bank's loan portfolio includes new, amended and renewed loans, lines of credit and bonds. The Bank approved two hundred and thirty-one loans in 2018 for $14.6 million inclusive of $8.9 million in loans and $5.7 million in performance bonds. For 2017, the Bank approved two hundred eleven loans for $9.3 million inclusive of $4.9 million in loans and $4.4 million in performance bonds.

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 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 2018 and 2017 are presented in the following table:

	2018		2017		Change	
Sector	Amount	Percent	Amount	Percent	Amount	Percent
Agriculture	$ 1,602,271	6.92%	$ 847,471	4.23%	$ 754,800	89.06%
Fishing	415,144	1.79%	374,316	1.87%	40,828	10.91%
Commercial	8,923,332	38.52%	7,618,347	38.04%	1,304,985	17.13%
Housing	12,226,308	52.77%	11,187,398	55.86%	1,038,910	9.29%
Totals	$ 23,167,055	100.00%	$ 20,027,532	100.00%	$ 3,139,523	15.68%

The total number of loans at end of 2018 was eight hundred sixty-nine accounts for $23,167,055 and seven hundred eighty-two for $20,027,532 at the end of 2017, which is an increase of $3,139,523 or 15.68% of total outstanding notes in 2018 compared to 2017.

Total Assets

The Bank's total assets for 2018 was $32,349,954 compared to $32,849,117 for 2017 and $34,260,995 for 2016. Total assets decreased by $499,163 or 2% in 2018 and by $1,411,878 or 4% in 2017.

Overview of Financial Condition, Continued

Capital Assets and Long-Term Debt

At September 30, 2018, 2017 and 2016, the Bank had net investment in capital assets of $661,791, $675,502 and $623,208, respectively, net of accumulated depreciation where applicable, including leasehold rights, leasehold improvements, furniture, fixtures and equipment and vehicles. The decrease in 2018 is due to increases in accumulated depreciation and the increase in 2017 is due to a new server and replacement of old equipment. See note 5 to the financial statements for more detailed information on the Bank's capital assets. No additions to long-term debt occurred in fiscal years 2018 and 2017. For additional information on long-term debt, please see notes 3 and 7 to the financial statements.

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.

The loan provision as of September 30, 2018 totaled $1,104,300 versus $891,355 as of September 30, 2017 and $995,979 as of September 30, 2016. The increase in 2018 of $212,945 is expected with a 15% growth in the loan portfolio. The decrease in 2017 is due to the Bank's continued efforts to seek remedies or foreclose on non-performing loans.

The Management's Discussion and Analysis for the year ended September 30, 2017 is set forth in the Bank's report on the audit of financial statements, which is dated May 4, 2018. That discussion and Analysis explains the major factors impacting the 2017 financial statements and can be viewed at the Office of the Public Auditor's website at www.palauopa.org.

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

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Net Position
September 30, 2018 and 2017

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	2018	2017
Assets:		
Cash and cash equivalents	$ 8,379,304	$ 11,818,431
Time certificates of deposit	457,494	456,143
Economic development loans receivable, net	22,062,755	19,136,177
Accrued interest receivable	130,786	116,096
Other receivables	83,565	74,433
Inventory	93,845	154,826
Prepaid expenses	22,944	20,061
Restricted cash and cash equivalents	50,271	50,249
Capital assets, net	661,791	675,502
Foreclosed real estate	407,199	347,199
Total assets	32,349,954	32,849,117
Deferred outflows of resources from pension	428,070	337,651
Total assets and deferred outflows of resources	$ 32,778,024	$ 33,186,768
LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION		
Liabilities:		
Loans payable	$ 11,189,624	$ 12,340,586
Accounts payable and accrued expenses	141,707	139,873
Payable to grantor agencies	141,826	123,844
Interest payable	99,444	72,061
Net pension liability	1,831,279	1,837,001
Total liabilities	13,403,880	14,513,365
Deferred inflows of resources from pension	366,335	216,044
Total liabilities and deferred inflows of resources	13,770,215	14,729,409
Commitments and contingencies		
Net position:		
Net investment in capital assets	661,791	675,502
Restricted	18,346,018	17,781,857
Total net position	19,007,809	18,457,359
Total liabilities, deferred inflows of resources and net position	$ 32,778,024	$ 33,186,768

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2018 and 2017

	2018	2017
Operating revenues:		
Interest income on loans	$ 1,704,965	$ 1,611,157
Loan fees and late charges	157,932	97,570
Other	66,508	28,449
Total operating revenues	1,929,405	1,737,176
Recovery of (provision for) loan losses and doubtful accounts	126,826	(190,930)
Net operating revenues	2,056,231	1,546,246
Operating expenses:		
General and administrative expenses:		
Salaries, wages and fringe benefits	667,750	598,852
Training	68,536	69,270
Depreciation	45,420	40,667
Professional fees	44,087	32,719
Dues and subscriptions	43,272	31,623
Repairs and maintenance	33,084	21,591
Travel and transportation	32,970	22,227
Communications	26,265	28,622
Supplies, printing, and reproduction	22,743	21,119
Rental	13,200	13,200
Honorariums and meeting expense	13,080	10,107
Insurance	10,803	9,322
Utilities	4,440	12,004
Marketing and advertising	3,255	12,338
Miscellaneous	18,061	14,958
Total general and administrative expenses	1,046,966	938,619
Operating income	1,009,265	607,627
Nonoperating revenues (expenses), net:		
Interest income on interest bearing accounts	15,455	12,191
Grant revenues	6,100	23,700
Other income	2,320	38,949
Interest expense and loan fees	(416,590)	(428,467)
Energy Loan Program	(60,000)	(262,435)
Energy Efficiency Home Loan Project	(6,100)	(23,700)
Total nonoperating revenues (expenses), net	(458,815)	(639,762)
Change in net position	550,450	(32,135)
Net position at beginning of year	18,457,359	18,489,494
Net position at end of year	$ 19,007,809	$ 18,457,359

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Cash Flows
Years Ended September 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from customers	$ 1,905,583	$ 1,725,238
Cash payments to employees for services	(691,536)	(613,917)
Cash payments to suppliers for goods and services	(256,909)	(561,056)
Net cash provided by operating activities	957,138	550,265
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(31,709)	(92,961)
Repayments of long-term debt	(1,150,962)	(1,092,633)
Interest paid on long-term debt	(389,207)	(424,363)
Net cash used for capital and related financing activities	(1,571,878)	(1,609,957)
Cash flows from investing activities:		
Net change in time certificates of deposit	(1,351)	(1,139)
Interest received on interest bearing deposits	15,455	12,191
Net change in restricted cash and cash equivalents	(22)	(22)
Loan originations, net	(2,859,752)	(1,215,093)
Net cash used for investing activities	(2,845,670)	(1,204,063)
Cash flows from noncapital financing activities:		
Other income received	2,320	38,949
Subsidy paid for energy program	(33,018)	(55,331)
Cash received from sale of solar system	51,981	49,064
Net cash provided by noncapital financing activities	21,283	32,682
Net decrease in cash and cash equivalents	(3,439,127)	(2,231,073)
Cash and cash equivalents at beginning of year	11,818,431	14,049,504
Cash and cash equivalents at end of year	$ 8,379,304	$ 11,818,431
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 1,009,265	$ 607,627
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	45,420	40,667
(Recovery of) provision for loan losses and doubtful accounts	(126,826)	190,930
Noncash pension cost	54,150	47,807
(Increase) decrease in assets:		
Accrued interest receivable	(14,690)	(17,516)
Other receivables	(9,132)	5,578
Prepaid expenses	(2,883)	9,862
Increase (decrease) in liabilities:		
Accounts payable and other liabilities	1,834	(334,690)
Net cash provided by operating activities	$ 957,138	$ 550,265
Supplemental schedule of noncash investing activities:		
Increase in foreclosed property	$ 60,000	$ -
Decrease in loans receivable	(60,000)	-
	$ -	$ -
Subsidy for Energy Loan Program:		
Increase in Energy Loan Program expense	$ -	$ 260,499
Decrease in inventory	-	(260,499)
	$ -	$ -

See accompanying notes to financial statements.

(1) Organization

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 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 and promoting economic development within ROP, and the Bank considers all of its net position, except net investment in capital assets, to be restricted for such purposes.

(2) Summary of Significant Accounting Policies

The accounting policies of the Bank conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. The Bank utilizes the flow of economic resources measurement focus. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of this fund are included within the statements of net position. Proprietary fund operating statements present increases (e.g. revenues) and decreases (e.g. expenses) in net position. 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.

GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments,* requires assets and liabilities of proprietary funds be presented in a classified format to distinguish between current and long-term assets and liabilities. The Bank is a government-owned bank. Banks do not present a classified statement of net position because current assets are not matched with current liabilities. The statements of net position of the Bank present assets and liabilities in order of their relative liquidity, rather than in a classified format.

Concentrations of Credit Risk

Financial instruments which potentially subject the Bank to concentrations of credit risk consist principally of cash demand deposits, investments, receivables and loans receivable from related party.

(2) Summary of Significant Accounting Policies, Continued

Concentrations of Credit Risk, Continued

At September 30, 2018 and 2017, the Bank has cash deposits in bank accounts that exceed federal depository insurance limits. The Bank has not experienced any losses on such accounts.

As of September 30, 2018 and 2017, concentrations of credit risk result from receivables from significant customers and receivable from a related party which represent 18% and 17% of total receivables, respectively. Management assesses the risk of loss and provides an allowance for doubtful accounts to compensate for known credit risk.

Cash and Cash Equivalents and Time Certificates of Deposit

For purposes of the statements of net position and of 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. Restricted and unrestricted cash and cash equivalents and time certificates of deposit maintained in Federal Deposit Insurance Corporation (FDIC) insured banks amounted to $9,009,471 and $12,416,458 at September 30, 2018 and 2017, respectively. Of this amount, bank deposits of $750,000 were FDIC insured at September 30, 2018 and 2017. Accordingly, the deposits are exposed to custodial credit risk. The Bank does not require collateralization of its deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized.

RPPL 4-48, Section 126, as amended by RPPL 5-37, stipulates that the Bank shall maintain a reserve account to be applied to all defaults on commercial loans guaranteed by the Bank. The reserve account shall equal ten percent (10%) of the total amount of all loan guarantees on commercial bank loans, whether or not protected by the full faith and credit of ROP. The Bank has restricted $50,271 and $50,249 of cash and cash equivalents as of September 30, 2018 and 2017, respectively, to comprise this reserve. The Bank has internally restricted (not reflected as restricted in the Statements of Net Position) cash and cash equivalents held solely for the guarantee of U.S. Department of Agriculture Rural Development (USDA RD) loans in the amount of $543,520 and $541,271 as of September 30, 2018 and 2017, respectively. Additionally, $106,887 and $82,673 of cash received from grantor agencies was internally restricted at September 30, 2018 and 2017, respectively.

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.

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

(2) Summary of Significant Accounting Policies, Continued

Loans and Allowance for Loan Losses, Continued

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.

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 Programme through the ROP Energy Office under the Sustainable Economic Development through Renewable Energy Applications (SEDREA) Program. On March 29, 2016, the Bank received one hundred (100) 1.7 kilowatt (kW) solar systems amounting to $1,000,000 from ROP, through the Palau Public Utilities Corporation, under the Abu Dhabi Fund for Development (ADFD) allocated grant. On August 30, 2016, the Bank transferred remaining off-grid solar photovoltaic systems of $113,302 to the ROP Energy Office. Inventory of on-grid solar photovoltaic systems and 1.7 kW solar systems and commemorative coins amounted to $93,845 and $154,826 as of September 30, 2018 and 2017, respectively.

Capital Assets

Capital assets are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the respective assets. Current policy is to capitalize items in excess of $1,000.

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.

(2) Summary of Significant Accounting Policies, Continued

Deferred Outflows of Resources

In addition to assets, the statement 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 has determined the changes in assumptions, changes in proportion and difference between the Bank's contributions, difference between projected and actual earnings on pension plan investments, and proportionate share of contributions and pension contributions made subsequent to the measurement date qualify for reporting in this category.

Deferred Inflows of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an 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 changes in assumption, differences between projected and actual earnings on pension plan investments and changes in proportion and difference between the Bank's contributions and proportionate share of contributions qualify for reporting in this category.

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, which represents the Bank's proportional share of excess total pension liability over the pension plan assets - actuarially calculated - of a single employer defined benefit plan, measured one year prior to fiscal year-end and rolled forward. 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. Those changes in net pension liability that are recorded as deferred inflows of resources or 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. 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.

Revenue Recognition

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

(2) Summary of Significant Accounting Policies, Continued

Revenue Recognition, Continued

Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. Interest on loans is accrued and credited to income based on the principal amount outstanding. The accrual of interest on loans is discontinued when principal or interest payments are delinquent ninety days or more, or when, in the opinion of the Bank, there is an indication that the borrower may be unable to meet payments as they become due. Interest income thereafter is recognized only to the extent of cash payments received. Nonaccrual loans approximated $159,197 and $582,907 at September 30, 2018 and 2017, respectively.

Compensated Absences

Vested or accumulated vacation leave is recorded as benefits accrue to employees. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits. Accumulated sick pay benefits as of September 30, 2018 and 2017 were $64,824 and $58,304, respectively.

Net Position

The Bank’s net position is classified as follows:

- Net investment in capital assets; capital assets, net of accumulated depreciation.

- Restricted:

  Nonexpendable - Net position subject to externally imposed stipulations that the Bank maintains them permanently. At September 30, 2018 and 2017, the Bank does not have nonexpendable net position.

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

- Unrestricted; net position that is 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 of September 30, 2018 and 2017.

New Accounting Standards

During the year ended September 30, 2018, the Bank implemented the following pronouncements:

- GASB 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.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 81, *Irrevocable Split-Interest Agreements,* which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

- GASB Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits).

- GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

The implementation of these statements did not have a material effect on the Bank's financial statements.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests - an Amendment of GASB Statements No. 14 and No. 61,* which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and loan guarantees. Such financial instruments are recorded in the financial statements when they become payable.

(3) Employees' Retirement Plan

Defined Benefit Plan

A. General Information About the Pension Plan:

Plan Description: The Bank contributes to the Republic of Palau Civil Service Pension Trust Fund (the Plan), a defined benefit, cost sharing multi-employer plan, which is a component unit of the Republic of Palau (ROP) National Government, providing retirement, security and other benefits to employees, their spouses and dependents, of the ROP, ROP State Governments and ROP agencies, funds and public corporations. The Plan was established pursuant to RPPL No. 2-26 passed into law on April 3, 1987, and began operations on October 1, 1987. Portions of RPPL No. 2-26 were revised by RPPL 3-21, RPPL 4-40, RPPL 4-49, RPPL 5-30, RPPL 6-37, RPPL 7-56, RPPL 8-10 and RPPL 9-2.

A single actuarial valuation report is performed annually covering all plan members and the same contribution rate applies to each employer. The Plan issues a publicly available financial report that includes financial statements and required supplementary information for the defined benefit plan. That report may be obtained by writing to the Plan's Administrator at the Republic of Palau Civil Service Pension Trust Fund, P.O. Box 1767, Koror, Republic of Palau 96940, or e-mail cspp@palaunet.com or call (680) 488-2523.

Plan Membership. As of September 30, 2017, the date of the most recent valuation, plan membership consisted of the following:

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Inactive members currently receiving benefits	1,576
Inactive members entitled to but not yet receiving benefits	1,162
Active members	3,422
Total members	6,160

Pension Benefits. Retirement benefits are paid to members who are required, with certain exceptions, to retire no later than their sixtieth birthday or after thirty years of service. A member may retire after his or her fifty-fifth birthday at a reduced pension amount if the member has completed at least twenty years of government employment. A married member of a former member receiving a distribution of benefits under the Pension Fund receives reduced benefit amounts to provide survivors' benefits to his or her spouse. An unmarried member or former member may elect to receive a reduced benefit amount during his or her lifetime with an annuity payable to his or her designated beneficiary. Disability benefits are paid to qualified members for the duration of the disability. Effective May 17, 1996, through RPPL 4-49, members, who have twenty-five years or more of total service, are eligible for retirement regardless of their age and, upon such retirement, are eligible to receive pension benefits at a level established by the Board.

Effective July 1, 1999, pursuant to RPPL 4-49 and RPPL 5-30, retirement is mandatory for all members who have thirty years or more of total service and all employees who are sixty years of age or older with certain exceptions. Beginning October 1, 2003, pursuant to RPPL 6-37, mandatory retirement may be delayed for up to five years, by specific exemption by the Board. In December 2008, RPPL 7-56 eliminated early retirement and thirty-year mandatory service provisions. These provisions were restored through RPPL 8-10 in October, 2009. On April 30, 2013, RPPL 9-2 eliminated the mandatory service retirement after thirty years of service. After December 31, 2013, no employee shall be entitled to pension benefits until reaching the age of sixty.

In accordance with the directives of RPPL 5-7, the Board adopted a resolution which provides that "no person who retires after October 1, 1997, may receive benefits under the Plan unless he or she has contributed to the Plan for at least five years or has made an actuarially equivalent lump sum contribution". In accordance with RPPL 9-2, members who retire after April 30, 2013 must not receive benefits greater than thirty thousand dollars per year. Further, the amount of benefits that a member receives should not be recalculated if the member is re-employed after the member begins receiving benefits under the Plan. Additionally, a member should not receive benefits during the time the member is re-employed subsequent to retirement.

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Currently, normal benefits are paid monthly and are two percent of each member's average monthly salary for each year of credited total service up to a maximum of thirty years total service. The average annual salary is the average of the highest three consecutive fiscal years of compensation received by a member during his or her most recent ten full fiscal years of service. For members who have not completed three consecutive fiscal years of employment during his or her most recent ten full fiscal years of service, the average annual salary is the average monthly salary during the term of the member's service multiplied by twelve.

The benefit amount that married members or unmarried members receive, who have elected to designate a beneficiary, is based on the normal benefit amount reduced by the following factors:

Factor	If the Spouse or Beneficiary is:
1.00	21 or more years older than the member
0.95	16 to 20 years older than the member
0.90	11 to 15 years older than the member
0.85	6 to 10 years older than the member
0.80	0 to 5 years younger than the member or 0 to 5 years older than the member
0.75	6 to 10 years younger than the member
0.70	11 to 15 years younger than the member
0.65	16 or more years younger than the member

Surviving beneficiaries of an employee may only receive benefits up to the total present value of the employee's accrued benefit pursuant to RPPL 9-2.

A member that meets the requirements for early retirement and elects to retire on an early retirement date is entitled to receive payment of an early retirement benefit equal to the member's normal retirement benefit reduced according to the following schedule based on the age at which early retirement benefit payments begin:

- 1/12th per year for the first 3 years before age 60;
- plus an additional 1/18th per year for the next 3 years;
- plus an additional 1/24th per year for the next 5 years; and
- plus an additional 1/50th per year for each year in excess of 11 years.

Upon the death of a member or former member with eligible survivors before commencement of the members' normal, early, or late retirement benefits or disability retirement benefits the following shall be payable:

- If the former member is not an employee at his date of death and a spouse or beneficiary survives, the total death benefits payable shall be the actuarial equivalent of the member's present value of accrued benefit.

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

- If the member is an employee at his date of death and a spouse or beneficiary survives, the total death benefit payable shall be the actuarial equivalent of the greater of 3 times the member's average annual salary or the member's present value of accrued benefits.

Upon the death of a member or former member before commencement of his normal, early, or late retirement benefit or disability retirement benefit leaving no persons eligible for survivor benefits, the following shall be payable:

- If the former member is not an employee at the date of death, a refund of the total amount of contributions made by the member.

- If the member was an employee at the date of death and had completed one year of total service, the estate of the member shall be entitled to a death benefit equal to the greater of three times the member's annual salary or the present value of the member's accrued benefit payable in the form of a single lump sum payment.

Any member who is not otherwise eligible to receive normal, early or late retirement benefits, who shall become totally and permanently disabled for service regardless of how or where the disability occurred, shall be entitled to a disability retirement annuity, provided that he or she is not receiving disability payments from the United States Government or its agencies for substantially the same ailment, and further provided that to be eligible for a disability retirement annuity from a cause unrelated to service, the member shall have had at least ten (10) years of total service credited. The amount of disability retirement annuity shall be an amount equal to the actuarial equivalent at the attained age of the member's present value of accrued benefit and shall be paid in the same form as a normal retirement benefit. Any special compensation allowance received or payable to any member because of disability resulting from accidental causes while in the performance of a specific act or acts of duty shall be deducted from the disability annuity payable by the Plan on account of the same disability.

Contributions. Member contribution rates are established by RPPL No. 2-26 at six percent of total payroll and are deducted from the member's salary and remitted by participating employers. Upon complete separation from service, a member with less than fifteen years membership service may elect to receive a refund of all of his or her contributions. Subsequent changes in the percentage contributed by members may be made through an amendment of the Trust Fund Operation Plan subject to the requirements of Title 6 of the Palau National Code. RPPL 9-2 requires each employee of the National Government and all State Governments, without regard to whether the employee is employed part-time or on a temporary basis, seasonal or an impermanent basis, to contribute to the Plan through payroll deduction.

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Employers are required to contribute an amount equal to that contributed by employees. Pursuant to RPPL No. 2-26 and RPPL No. 3-21, the Government of the Republic of Palau must from time to time contribute additional sums to the Plan in order to keep the Plan on a sound actuarial basis. RPPL 9-2 requires the Government of ROP to make regular contributions to the Plan equal to the amount contributed by each and every employee of ROP. Additionally, an excise tax of four percent (4%) is levied against each non-citizen person transferring money out of ROP. The money transfer tax must be remitted to the Plan.

The Bank's contributions to the Plan for the years ended September 30, 2018 and 2017 were $27,331 and $24,518, respectively, which were equal to the required contributions for the years then ended.

Actuarial Assumptions. The total pension liability was determined by an actuarial valuation as of September 30, 2017, for the same measurement date, using the following actuarial assumptions:

Actuarial Cost Method:	Normal costs are calculated under the entry age normal method
Amortization Method:	Level dollar, open with remaining amortization period of 30 years
Asset Valuation Method:	Market Value of Assets
Investment Income:	7.5% per year, net of investment expenses
Inflation:	3.0%
Interest on Member Contributions:	5.0% per year
Salary Increase:	3.0% per year
Expenses:	$300,000 each year
Mortality:	RP 2000 Combined Mortality Table, set forward four years for all members except disability recipients, where the table is set forward ten years
Termination of Employment:	5% per year prior to age 35; none after age 35

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Actuarial Assumptions, Continued

Disability:	Age	Disability
	25	0.21%
	30	0.18%
	35	0.25%
	40	0.35%
	45	0.50%
	50	0.76%
	55	1.43%
	60	2.12%
Retirement Age:	100% at age 60	
Form of Payment:	Single: Straight life annuity; Married: 100% joint and survivor	
Marriage Assumption:	80% of the workers are assumed to be married and males are assumed to be 3 years older than their spouses. Beneficiaries are assumed to be the opposite gender of the member.	
Duty vs Non-duty related disability:	100% Duty related	
Refund of Contributions:	80% of terminated vested members elect a refund of contributions	
Post Retirement Survivor's Benefit:	100% of the benefit the retiree was receiving prior to death.	
Final Average Earnings:	Deferred vested members missing data for their final average earnings are assumed to have earned the average amount of current deferred vested members.	
Benefits:	Retirees and beneficiaries missing data for their monthly benefit amount are assumed to receive the average benefit of current retirees or beneficiaries, respectively.	

Long-Term Expected Rate of Return

The long-term expected rate of return on the Bank's investments of 7.5% was determined using log-normal distribution analysis, creating a best-estimate range for each asset class.

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

As of September 30, 2017, the arithmetic real rates of return for each major investment class are as follows:

Asset Class	Target Allocation	Expected Rate of Return
Cash	3%	4.55%
Equity	61%	6.35%
Governmental fixed income	31%	7.75%
Corporate fixed income	5%	4.00%
	100%	

Discount Rate

The discount rate used to measure the total pension liability was 3.62% at the current measurement date and 2.98% at the prior measurement date. The discount rate was determined using the current assumed rate of return until the point where the plan fiduciary net position is negative. Using the current contribution rates, a negative position happens in 2022 for the 2017 measurement date. For years on or after 2022, a discount rate of 3.57% is used. This rate is based on the Bond Buyer General Obligation 20-year Municipal Bond Index Rate.

Sensitivity of Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the Fund as of September 30, 2017, calculated using the discount rate of 3.62%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1.00% lower (2.62%) or 1.00% higher (4.62%) from the current rate.

1% Decrease 2.62%	Current Single Discount Rate Assumption 3.62%	1% Increase 4.62%
$ 2,120,525	$ 1,831,279	$ 1,591,278

B. Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension Liability. At September 30, 2018 and 2017, the Bank reported a liability of $1,831,279 and $1,837,001, respectively, for its proportionate share of the net pension liability. The Bank's proportion of the net pension liability was based on the projection of the Bank's long-term share of contributions to the Plan relative to the projected contributions of Republic of Palau, Republic of Palau's component units and other Government agencies, actuarially determined. At September 30, 2018 and 2017, the Bank's proportion was 0.7060% and 0.7364%, respectively.

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

B. Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions, Continued

Pension Expense. For the years ended September 30, 2018 and 2017, the Bank recognized pension expense of $81,500 and $72,325, respectively.

	2018			
	Salary and Other Benefits	Pension Expense: Total Contributions	Pension Expense: Others	Total
Personnel and fringe benefits	$ 586,250	$ 27,331	$ 54,169	$ 667,750

	2017			
	Salary and Other Benefits	Pension Expense: Total Contributions	Pension Expense: Others	Total
Personnel and fringe benefits	$ 526,527	$ 24,518	$ 47,807	$ 598,852

Deferred Outflows and Inflows of Resources. At September 30, 2018 and 2017, the Bank reported total deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2018		2017	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	$ 214,130	$ 173,481	$ -	$ 47,083
Change of assumptions	10,082	8,949	281,540	43,443
Net difference between projected and actual earnings on pension plan investments	168,583	35,792	15,775	3,571
The Bank's contributions subsequent to measurement date	27,331	-	24,518	-
Changes in proportion and difference between the Bank's contributions and proportionate share of contributions	7,944	148,113	15,818	121,947
	$ 428,070	$ 366,335	$ 337,651	$ 216,044

Deferred outflows resulting from contributions subsequent to measurement date will be recognized as a reduction of the net pension liability in the following year. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions at September 30, 2018 will be recognized in pension expense as follows:

Year ending September 30,	
2019	$ (2,999)
2020	$ 10,655
2021	$ 9,292
2022	$ 11,211
2023	$ 12,170
Thereafter	$ (5,925)

(4) Economic Development Loans and Allowance for Loan Losses

Major classifications of loans receivable as of September 30, 2018 and 2017 are as follows:

	2018	2017
Housing	$ 12,226,308	$ 11,187,398
Commercial	8,923,332	7,618,347
Agriculture	1,602,271	847,471
Fishing	415,144	374,316
Loans receivable	23,167,055	20,027,532
Less allowance for loan losses	(1,104,300)	(891,355)
	$ 22,062,755	$ 19,136,177

Maturities of the above principal balances subsequent to September 30, 2018, will be as follows:

	2018	2017
Fully matured and others	$ 7,466	$ 10,576
1 - 6 months	1,229,022	1,830,918
7 - 18 months	2,752,370	3,491,555
19 months - 3 years	3,408,530	4,347,803
After 3 years	15,769,667	10,346,680
	$ 23,167,055	$ 20,027,532

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

	2018	2017
Balance - beginning of year	$ 891,355	$ 995,979
Recoveries of loan previously charged-off	530,712	285,544
Provision for (recovery of) loan losses	(126,826)	190,930
Loans charged-off	(190,941)	(581,098)
Balance - end of year	$ 1,104,300	$ 891,355

(5) Capital Assets

A summary of capital assets as of September 30, 2018 and 2017, is as follows:

	Estimated Useful Lives	Balance at October 1, 2017	Additions	Deletions	Balance at September 30, 2018
Depreciable assets:					
Leasehold rights	39 - 50 years	$ 493,206	$ 31,709	$ -	$ 524,915
Leasehold improvements	5 years	319,227	-	-	319,227
Furniture, fixtures and equipment	2 - 20 years	247,905	-	-	247,905
Vehicles	5 years	113,110	-	-	113,110
		1,173,448	31,709	-	1,205,157
Less accumulated depreciation		(497,946)	(45,420)	-	(543,366)
		$ 675,502	$ (13,711)	$ -	$ 661,791

(5) Capital Assets, Continued

	Estimated Useful Lives	Balance at October 1, 2016	Additions	Deletions	Balance at September 30, 2017
Depreciable assets:					
Leasehold rights	39 - 50 years	$ 493,206	$ -	$ -	$ 493,206
Leasehold improvements	5 years	279,427	39,800	-	319,227
Furniture, fixtures and equipment	2 - 20 years	224,135	23,770	-	247,905
Vehicles	5 years	83,719	29,391	-	113,110
		1,080,487	92,961	-	1,173,448
Less accumulated depreciation		(457,279)	(40,667)	-	(497,946)
		$ 623,208	$ 52,294	$ -	$ 675,502

(6) Foreclosed Real Estate

A summary of the changes in foreclosed real estate as of September 30, 2018 and 2017 is as follows:

	2018	2017
Balance at beginning of year	$ 347,199	$ 347,199
Additions	60,000	-
Balance at end of year	$ 407,199	$ 347,199

Title to foreclosed real estate is in the Bank's name as of September 30, 2018 and 2017.

(7) Loans Payable and Other Liabilities

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 to be agreed to by the parties at that time.

On August 7, 2008, the Bank entered into a new agreement to restructure the existing loan with the Fund. The loan ceiling increased to $6,000,000, which will be disbursed in increments of $500,000, bearing interest at a variable annual rate equal to the Fund's Fixed Income Fund Return Rate as reported monthly by Fund's investment consultant, plus 0.5%; provided, however that the interest rate to be charged and paid shall not be less than 4.5% nor more than 7.5% after addition of the 0.5% to the prime rate. Outstanding principal plus all unpaid interest 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 balance of the loan was $2,680,142 and $3,019,475 with interest at 4.5% as of September 30, 2018 and 2017, respectively. The loan is collateralized by the full faith and credit of the ROP Government.

(7) Loans Payable and Other Liabilities, Continued

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. The note is uncollateralized and is due on July 1, 2024, with interest fixed at 3.5% per annum, payable in semi-annual installments of $142,858, and guaranteed by ROP. Interest is payable semi-annually and commences six months after the advance of proceeds. Annual expected principal repayments are $285,716. The balance outstanding is $1,714,266 and $1,999,982 at September 30, 2018 and 2017, respectively.

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, 2018 and 2017, the Bank has drawn down two tranches of $1,391,285 and $3,016,465 with interest rates of 3.679% and 5.175%, 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, 2018 and 2017 is $1,253,987 and $1,639,046, respectively.

On May 17, 2012, the Bank entered into a $4,000,000 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, 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 term. 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, 2018 and 2017 is $541,229 and $682,083, respectively.

On March 31, 2016, the Bank entered into a $5,000,000 agreement with ROP to finance the development of agriculture and aquaculture projects in Palau. ROP is to provide the Bank with up to $500,000 of loan loss coverage for losses incurred by the program applicable to payments five years after the agreement. The note is uncollateralized and is due on March 31, 2036, and with interest based on 6-month LIBOR plus one percent (1%) per annum (effective interest rates were 3.44403% and 2.41989% as of September 30, 2018 and 2017, respectively), payable semi-annually until September 30, 2018 with the first semi-annual installment of $142,857 payable on March 31, 2019. Annual expected principal payments are $285,714. The outstanding balance is $5,000,000 at September 30, 2018 and 2017.

(7) Loans Payable and Other Liabilities, Continued

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

Year ending September 30,	Principal	Interest	Total
2019	$ 1,464,351	$ 303,992	$ 1,768,343
2020	1,495,469	254,268	1,749,737
2021	1,528,311	202,252	1,730,563
2022	1,057,684	155,094	1,212,778
2023	969,261	121,878	1,091,139
2024 - 2028	2,507,750	280,942	2,788,692
2029 - 2033	1,428,570	123,534	1,552,104
2034 - 2036	738,228	31,732	769,960
	$ 11,189,624	$ 1,473,692	$ 12,663,316

Changes in loans payable and other liabilities for the years ended September 30, 2018 and 2017, are as follows:

	Balance October 1, 2017	Additions	Reductions	Balance September 30, 2018	Due Within One Year
Republic of Palau Social Security Retirement Fund	$ 3,019,475	$ -	$ (339,333)	$ 2,680,142	$ 348,159
ROP Government	5,682,083	-	(140,854)	5,541,229	429,410
Mega International Commercial Bank	1,999,982	-	(285,716)	1,714,266	285,716
European Investment Bank	1,639,046	-	(385,059)	1,253,987	401,066
	$ 12,340,586	$ -	$ (1,150,962)	$ 11,189,624	$ 1,464,351
Other liabilities:					
Net pension liability	$ 1,837,001	$ -	$ (5,722)	$ 1,831,279	$ -

	Balance October 1, 2016	Additions	Reductions	Balance September 30, 2017	Due Within One Year
Republic of Palau Social Security Retirement Fund	$ 3,318,617	$ -	$ (299,142)	$ 3,019,475	$ 363,117
ROP Government	5,820,151	-	(138,068)	5,682,083	140,853
Mega International Commercial Bank	2,285,698	-	(285,716)	1,999,982	285,716
European Investment Bank	2,008,753	-	(369,707)	1,639,046	385,059
	$ 13,433,219	$ -	$ (1,092,633)	$ 12,340,586	$ 1,174,745
Other liabilities:					
Net pension liability	$ 1,630,006	$ 206,995	$ -	$ 1,837,001	$ -

(8) 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 $771,808 and $283,655 as of September 30, 2018 and 2017, respectively. Loans receivables from an affiliate amount to $1,745,423 and $2,062,041 as of September 30, 2018 and 2017, respectively. Loans receivable from officers and employees and loans receivable from an affiliate are included within economic development loans receivable in the accompanying statements of net position.

(9) Commitments

Loans Approved

At September 30, 2018 and 2017, $8,658,932 and $8,209,569, respectively, of approved loans was undisbursed. Of the undisbursed loans as of September 30, 2018 and 2017, $5,989,958 and $4,822,798, respectively, relate to performance bonds on various construction contracts where the Bank acts as the insurer and $491,250 and $137,398, respectively, relate to letters of credit. At September 30, 2018 and 2017, no performance bonds have been called.

Leases

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

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

Years ending September 30,	
2019	$ 3,441
2020	3,441
2021	3,441
2022	3,441
2023	3,441
2024 - 2028	17,205
2029 - 2033	18,926
2034 - 2038	34,410
2039 - 2043	34,410
2044 - 2048	34,410
2049 - 2053	34,410
2054 - 2058	30,969
Total future minimum payments	$ 221,945

(10) Contingencies

On February 1, 2011, the Bank amended the MOU originally entered into on February 16, 1995 with the USDA RD to provide housing for low and very low income residents of ROP. Under the agreement, the USDA RD will make loans to the owners and lessees of ROP lands and the Bank will guarantee the repayment of the loan for which the Bank has issued a written guarantee. The Bank has approved guarantees for seventy-three loans aggregating $4,050,901 at September 30, 2018. Unpaid interest and subsidies related to the loan guarantees as of September 30, 2018 amounted to $29,086 and $22,265, respectively, for which the Bank becomes liable once the borrower defaults and a demand notice is issued. As of September 30, 2018, no demand notice has been received by the Bank.

(10) Contingencies, Continued

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

(11) 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

Required Supplemental Information (Unaudited)
Schedule of Proportional Share of the Net Pension Liability
Last 10 Fiscal Years*

	September 30,				
	2017 Valuation	2016 Valuation	2015 Valuation	2014 Valuation	2013 Valuation
Civil Service Pension Trust Fund (Plan) total net pension liability	$ 259,395,005	$ 249,453,960	$ 215,546,176	$ 204,281,232	$ 182,080,333
The Bank's proportionate share of the net pension liability	$ 1,831,279	$ 1,837,001	$ 1,630,006	$ 1,566,428	$ 1,523,284
The Bank's proportion of the net pension liability	0.706%	0.736%	0.756%	0.767%	0.837%
The Bank's covered employee payroll**	$ 409,000	$ 390,026	$ 366,745	$ 360,465	$ 349,499
The Bank's proportionate share of the net pension liability as a percentage of its covered employee payroll	447.75%	470.99%	444.45%	434.56%	435.85%
Plan fiduciary net position as a percentage of the total pension liability	10.18%	10.55%	11.54%	14.01%	15.84%

* This data is presented for those years for which information is available.

** Covered-employee payroll data from the actuarial valuation date with one-year lag.

See accompanying Independent Auditors' Report.

NATIONAL DEVELOPMENT BANK OF PALAU

Required Supplemental Information (Unaudited)
Schedule of Pension Contributions
Last 10 Fiscal Years*

	September 30,				
	2017 Valuation	2016 Valuation	2015 Valuation	2014 Valuation	2013 Valuation
Actuarially determined contribution	$ 121,283	$ 106,170	$ 82,427	$ 81,456	$ 84,209
Contribution in relation to the actuarially determined contribution	24,540	23,081	21,858	21,226	21,048
Contribution (excess) deficiency	$ 96,743	$ 83,089	$ 60,569	$ 60,230	$ 63,161
The Bank's covered-employee payroll**	$ 409,000	$ 390,026	$ 366,745	$ 360,465	$ 349,499
Contribution as a percentage of covered-employee payroll	6.00%	5.92%	5.96%	5.89%	6.02%

* This data is presented for those years for which information is available.

** Covered-employee payroll data from the actuarial valuation date with one-year lag.

See accompanying Independent Auditors' Report.