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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2010 AND 2009

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INDEPENDENT AUDITORS' REPORT

Board of Directors
National Development Bank of Palau:

We have audited the accompanying statements of net assets of the National Development Bank of Palau (the Bank), a component unit of the Republic of Palau, as of September 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Bank as of September 30, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Management's Discussion and Analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Bank's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 29, 2011, on our consideration of internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLC

March 29, 2011

NATIONAL DEVELOPMENT BANK OF PALAU

Financing the Future of Palau

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2010

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 2010 is intended to contribute to the reader's better understanding of the Bank's structure and activities. The report should be read in conjunction with the audited financial statements and associated reports.

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

Organization of the Bank

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

The President of ROP appoints six of its seven Board members for three-year terms subject to Senate confirmation. These six Board members appoint the seventh Board member and the President of the Bank. The Board of Directors elects their own officers to the posts of Chairman, Vice Chairman and Secretary/Treasurer, to serve the length of their terms. The Bank operated with a full board during the year. Two Directors' terms expire in 2011 and four expire in 2012.

The Bank achieves its mission and goals by relending funds obtained from lenders, donors and the government. Its financial objective is not to maximize profit but to attain sufficient financial strength to achieve its objectives. Therefore, the Bank functions as a development financial institution and not a commercial or central bank. It is exempt from banking supervision by ROP's Financial Institutions Commission (FIC) as long as it does not take in deposits; however, it is subject to prudential and reporting guidelines established by its Act and is subject to oversight hearings by either house of Congress at any time. The Senate issued a subpoena in April 2010 requesting certain information. The Bank complied with the subpoena and is part of a lawsuit filed by a private citizen resulting from the subpoena.

The Bank's Act has changed little since its last major revision. The most recent amendment was to specifically allow the Bank to lend to ROP. Several proposed amendments remain pending in Congress related to control over the Bank's interest rates and terms and restrictions on Bank lending. This year, the Bank also requested Congress to approve a resolution to allow the Bank to borrow the balance of 5,000,000 euros granted by the European Investment Bank (EIB) in 2006. Congress approved that resolution but the amendment to the EIB contract was pending approval at year end.

The Bank's policies and strategies are implemented through the Bank's President and management. Management consists of three managers organized by the functional areas of the Bank - Finance, Lending and Special Assets. These managers answer directly to the Bank's President. One position was not filled at the beginning of the year and another at the end of the year due to recruitment needs and separation. A total of fourteen management and staff positions were filled during the year. This excludes one staff member on educational leave studying abroad.

All Bank operations were conducted from its office in Ngetkib Village, Airai State. Aside from the move to the Bank's new building/location finalized in November 2009, no branches, other offices or subsidiaries were operating in 2010.

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Significant Events in 2010

The performance of the Palau economy in 2010 was lackluster. The continued effect of the weaker dollar and sluggish U.S. economy are partly the cause, although weaknesses in the Japanese economy and the need for an improved investment regime in Palau are also believed to be contributing factors. A slight rebound in tourist arrivals due to new air carrier service offset some of these other factors. This year, the government reported success in securing U.S. government support for new funding under the Compact of Free Association. Congressional approval in the U.S. is still required which may delay the receipt of funds and prolong the status quo.

The Bank focused on maintaining credit quality on several large accounts in distress during the year. Part of that initiative was contracting a lending coach to follow-up on prior year recommendations made by the same consultant. The Bank also received formal approval and pursued procurement of solar energy kits as part of its introduction of an Energy Loan Program to assist homeowners and businesses with rising energy costs. Procurement included a replacement for a staff vehicle. A new multi-year contract for audit services was also procured during the year. Announcements were provided to the public on the Bank's new website.

The Board of Directors' actions during the year also included a renewal of the President's contract for an additional three years and approval of a new Strategic Plan to begin in 2011. The plan calls for continued growth and expansion of programs to achieve the Bank's mission over the next 10 years. The plan is designed in a three-year rolling plan format.

Funding for Operations

Historically, the Bank has funded its operations from three main sources: paid-in capital, accumulated retained income and borrowed funds. The most recent paid-in capital received from ROP was in the year 2000 for $3 million to fund a first-time homeowner program. The Bank has relied upon accumulated retained income since 2002, and borrowed funds since 2003, to fund loan operations and the Bank's growth. Additional fund sources pursued during the year included additional long-term borrowings, loan sales and grants. Some effort was also expended towards a possible bond issuance. The Bank's Strategic Plan also considers deposit liabilities as a new source in the future.

Borrowed funds currently outstanding are from signed notes with Mega International Commercial Bank (MICB, previously the International Commercial Bank of China), the Republic of Palau Social Security Administration (ROPSSA), the EIB and a cash secured revolving line of credit with Bank of Hawaii (BOH). The first three notes are for long-term intermediary relending funds. The ROPSSA loan was fully drawn by the end of the year. A balance remained on the EIB loan and an amendment to the contract is in process to allow the Bank to draw the remaining estimated $2,000,000 available.

The Bank's BOH line of credit facility was opened as a short-term funding instrument. Cash security allows the Bank to reduce its cost of funds from this commercial facility. The line of credit is primarily utilized when funds are requested from the Bank's EIB loan to replace funds already disbursed to beneficiaries.

The Bank delayed its signing of a $750,000 Intermediary Relending Program (IRP) Loan from the United States Department of Agriculture (USDA) while it worked on other administrative matters. The Bank is required to match these funds in a revolving fund which was established during 2010. Loan funds are to be used to support micro, small and medium sized business projects while keeping customer affordability high with low interest rates. The Bank also worked towards securing a new finance contract from the EIB in 2010. These funds are granted for environmental projects under a concessionary interest rate. The program targeted for these funds was the Bank's Energy Loan Program. Efforts were also made to secure additional funds from MICB and other Taiwan banks. The prospects for success of these efforts appeared positive at the end of the year.

The timing and extent to which borrowed funds are utilized for lending activities is determined mainly by cost and availability. MICB loan proceeds represent the least costly funds available at 3.5% fixed interest rate charged per annum. All proceeds from MICB have been drawn.

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

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 the financial statements in conformity with GAAP and actual results may differ from amounts reported during the reporting period. The basis of accounting used is the flow of economic resources measurement focus, which means all assets and liabilities are included within the statement of net assets. The accrual basis of accounting is utilized whereby revenues are recorded when earned and expenses recorded when liabilities are incurred.

Significant financial policies of the Bank include a 10% reserve requirement for the Bank's loan guarantees. These reserves are held in time certificates of deposit (TCD) with commercial banks. The Bank maintained cash reserves of at least 10% for commercial bank guarantees throughout the year. Restricted deposits are also held as part of requirements for the USDA Rural Development (USDA RD) for loans guaranteed by the Bank. These requirements are for fixed dollar and ratio amounts. The total reserve for commercial bank and USDA RD loans for 2010 was 15%.

All current guarantees are granted under recourse. The Bank offers 90% loan guarantees to local banks but the Bank may also guarantee up to 100% of select home loans from commercial banks made to Palauan citizens. The total amount for which the Bank was contingently liable in 2010 for commercial bank and USDA RD loans guaranteed by the Bank was $4.2 million. The Bank signed an updated Memorandum of Understanding (MOU) with USDA RD towards the end of the year. The MOU amended requirements for accounts allowable for reserves and several procedural issues.

Other financial policies include ROP's full faith and credit guarantee backing Bank loans up to $15 million in the aggregate, subject to specific purpose limitations. Maximum Bank external borrowing authorized by ROP is $100 million. The maximum single exposure to a single borrowing entity was 20% of the Bank's unimpaired paid-up capital, earned surpluses and reserves. Specific targets for exposure to sector or loan type are established in the Bank's Strategic Plan which are monitored monthly. Loan maturities are monitored to match borrowings, operation costs and long outstanding loan commitments. In September 2010, maturities were concentrated in the 15-year range.

Operations

Financial assistance is provided by the Bank for projects involving housing, agriculture, marine resources, commerce and industry. Emphasis is given to new enterprises or ventures that promote import substitution. Authorized financing schemes include guarantees, direct loans and direct investment. The Bank is also required to provide technical assistance services as part of its operations. The Bank's MOU and financial and logistical support with the Palau Small Business Development Center is an effort towards this responsibility. Information on other financial and technical service providers including government agencies is also provided for client or applicant consideration. Currently, the Bank's financial activities are limited to projects within ROP. All financial transactions are US dollar denominated.

Direct loans. Short to medium term financing is extended to new business startup or existing businesses to fund short-term working capital and equipment acquisitions. Longer term financing is extended to individuals for housing and business facilities. Rates are fixed depending on the type of financing provided. Posted interest rates reported publicly by the Bank range from 6% to 10%. Certain accounts remain at 12% due to their non-performing status. Rates are considered to include cost of funds and a lending spread to cover cost of operations, a risk component, and a small return for growth purposes. Fees are usually 2% of financing extended. Costs of originating and closing the loan are also charged to borrowers. Specific programs offered under direct financing are agriculture loans, fishing loans, small business loans, housing loans and business loans. In 2010, the Bank approved 156 loan applications. This includes renewals, extensions, performance bonds, cancelled loans and guarantees. Loans approved amounted to $10.8 million with $5.7 million undisbursed at year end. Ninety-one accounts were in various stages of implementation with fifteen approved but not booked. Undisbursed loans also included sixteen line of credit and bonding accounts.

In the category of small business loans, the Bank offers customers four programs: Small Business, WEDAP, Microfinance and its newest program, Pre-Development Loan. All of these loans can be approved by the Bank's President. The Bank's general policy is all loans are fully secured. The Bank's Microfinance program and Pre-Development Loan are for small loans for housing or business purposes at a 6% interest rate targeting those borrowers able to secure their loan with an assignment of income. No collateral is required and turnover is intended to be quick. These programs appear to be successful and are popular. Specifically, interest in Microfinance Loans, which are also available for home projects such as extensions and renovations, has been popular. This may be due to the postponement of larger investments by borrowers due to current sentiment regarding a weak economy.

Direct housing loans are provided in two categories, the first-time homeowner program which offers an 8% interest rate and all other housing loans at a 10% interest rate. Owner contribution to projects is required at 15% of project cost with a maximum amount of $10,000 under Pre-Development Loan and a loan term not to exceed 5 years. The purpose of Pre-Development Loan is to help borrowers pay for plan design, appraisal, title search and all related fees associated with packaging loans and cash equity contribution. Eligible purposes for housing loans include new construction, renovation and extension. Most loans granted are for new construction. The Bank has observed more loans being approved under the first time homeowner program than the standard housing program.

Guarantees. The Bank offers guarantees either backed by the Bank or ROP to commercial banks and other institutions. Commercial banks, government authorities and the regional development financial institution, Pacific Island Development Bank (PIDB), either currently accept or hold guarantees from the Bank. The majority of guarantees outstanding from the Bank are to USDA RD loans. In addition to the USDA RD Section 502 and 504 loans guaranteed by the Bank, there are leveraged loans which are co-financed by both the Bank and the USDA RD. The signing of an updated MOU with USDA RD was the latest development of the Bank's guaranty programs. Popularity is low with these programs as they often take many months to receive approval and are often stricter in terms and standards enforced.

Investments. There were no further investments made by the Bank since its initial investment in Palau Micronesia Air (PMA) which has been repurchased by other stockholders. The Bank still maintains representation on the Board of PMA.

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

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

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

Overview of Financial Performance

Revenue. 2010 revenue, including loan fees and interest income on interest bearing accounts, increased 1% from 2009 due to write-offs and placement of loans on non-accrual status. Over $245,000 was reversed from interest income in May 2010 for loans placed on non-accrual status. Revenue yield decreased due to a proportionately larger amount of lower interest rate loans approved and booked. The largest of these loans was $3,000,000 to a public corporation for equipment purchasing. At the end of the year, loans were also written-off resulting in 17% lower revenues than the Bank's budget estimates. Revenues and yields going forward are expected to be stronger in 2011 as the Bank disburses approved loans of over $5,000,000 and collection efforts reflect expected results.

Interest income on interest bearing accounts and revenues from loan fees and charges also supported revenue levels. Cash was drawn from savings accounts to fund loan operations reducing balances which, combined with lower interest rates due to weakness in the global economy, resulted in a reduction in income from interest bearing accounts from 2009. The Bank amortizes loan fees and the annual portion of loan fees is reported as income in the current period.

Loan Interest Rates. The Bank's interest rates remained fixed according to the type of loan activity funded. Rates ranged from a low of 6% for agriculture, microfinance and pre-development loans to 8% for fishing and other loans such as first-time homeowner loans and 10% for commercial and housing loans. Several problem loan accounts in the process of collection remain priced at 12%. Other accounts in collection continue to be assessed a 9% interest rate as required by court ordered judgment. At the end of this reporting period, the average yield on the Bank's portfolio declined from 8.85% in 2009 to 8.58% as loan growth continued in lower interest rate loan programs.

Grant Requests. The Bank continued to draw on the cash received from a $500,000 grant implemented in 2009 for the Energy Efficient Subsidy Program (EESP). Energy subsidy assistance is for clients building new homes with energy efficient measures. The $81,767 in grant revenues recognized in 2010 were from this program.

Expenses. The Bank's net provision for loan losses in 2010 was $761,397 as additional provisions were made and specific provisions were made for large delinquent accounts at the end of fiscal year. An adjustment to reverse the specific provisions is expected in 2011 to reflect success in collection efforts beginning in 2010 and the strength of loan collateral. Provisions are net of recoveries for the year. Interest expense savings for the Bank versus budget reflected the Bank's reduction in cash balances to fund lending and low interest rates due to a weakened global economy. Rates are expected to increase slightly in 2011 based on recent media reports – although there is a degree of uncertainty involved in this forecast. Interest expense in 2011 will also depend on draws from current and additional long-term borrowing.

Total operating expenses for 2010 was 3% higher than 2009 expenses and 6.6% under budget. Savings were realized in salary, training, travel and depreciation. The Bank's commitment for training new and existing staff with internet based, bank designed, and off-island training continued with a new contract for mentoring consultancy. Depreciation costs increased as further improvements to the Bank's leasehold were recorded. A new vehicle was also procured to replace an existing vehicle which was fully depreciated. The Bank also worked towards implementation of its Energy Loan Program which included the procurement of specially designed solar photovoltaic equipment and the installation of the same on Bank premises as part of its energy savings policy, demonstration of technology, and training of installers.

Change in Net Assets. The change in net assets was negative for the year resulting from loan write-offs, non-accrual interest income reversals and large provisioning expenses. The budgeted change in net assets was $939,600. A condensed year-to-year comparison of operating activity reflecting the foregoing statements follows:

Statements of Revenues, Expenses and Changes in Net Assets

	2010	2009	$ Change	% Change	2008
Revenues:					
Interest income on loans	$ 1,953,169	$ 1,938,063	$ 15,106	1%	$ 1,719,225
Loan fees and late charges	66,428	59,191	7,237	12%	30,872
Other	6,412	6,420	(8)	-0%	6,724
Total operating revenues	2,026,009	2,003,674	22,335	1%	1,756,821
Provision for loan losses	(761,397)	(247,078)	(514,319)	208%	(118,474)
Operating expenses:					
Salaries, wages and fringe benefits	432,754	416,497	16,257	4%	358,498
Rent	10,415	42,568	(32,153)	-76%	41,624
Depreciation	42,366	35,297	7,069	20%	42,115
Training	32,094	2,065	30,029	1454%	26,280
Other expenses	335,580	331,255	4,325	1%	215,242
Total operating expenses	853,209	827,682	25,527	3%	683,759
Operating income	411,403	928,914	(517,511)	-56%	954,588
Total non-operating revenues (expenses), net	(500,217)	(330,740)	(169,477)	51%	(202,386)
Change in net assets	(88,814)	598,174	(686,988)	-115%	752,202
Net assets at beginning of year	15,697,047	15,098,873	598,174	4%	14,346,671
Net assets at end of year	$ 15,608,233	$ 15,697,047	$ (88,814)	-1%	$ 15,098,873

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

Statements of Cash Flows

	2010	2009	$ Change	% Change	2008
Cash flows from operating activities	$ 1,194,094	$ 1,028,137	$ 165,957	16%	$ 948,565
Cash flows from capital and related financing activities	172,692	4,624,098	(4,451,406)	-96%	(292,481)
Cash flows from investing activities	(2,130,354)	(4,745,518)	2,615,164	-55%	(2,283,751)
Cash flows from noncapital financing activities	333,643	(53,828)	387,471	-720%	317,500
Net decrease in cash and cash equivalents	(429,925)	852,889	(1,282,814)	-150%	(1,310,167)
Cash and cash equivalents at beginning of year	1,701,090	848,201	852,889	101%	2,158,368
Cash and cash equivalents at end of year	$ 1,271,165	$ 1,701,090	$ (429,925)	-25%	$ 848,201

The table above reflects the $1,500,000 draw from ROPSSA funds and the over $1,100,000 paid for long-term debt financing activities. It also illustrates cash drawn from investments to fund lending activities and the net use of cash on hand of $429,925. The Bank anticipates loan proceeds to be the major funding source in 2011.

Overview of Financial Condition

Loan Portfolio. The Bank approved one hundred and fifty-six loans including line renewals and amendments, amounting to $12.4 million in 2010 compared to its $6.4 million budget. The larger number of loans extended reflected full staffing in the loan section as well as the success of the Microfinance and Pre-Development Loan programs in 2010. The number of applications noticeably increased during the year following community visits that were made by the lending section.

The Bank's goal during the year remained growth in income and assets while maintaining credit quality. Emphasis was also made towards growing the commercial sector portfolio which was challenging given less than favorable industry and economic conditions. As the economy weakened, growth in the housing portfolio slowed in comparison to business loan growth which tends to be for larger amounts. Commercial loans, as a share of the portfolio, increased to 59% of the Bank's loan portfolio compared to 54% the year before. The proportion of loans by major sector follows. Note that Microfinance loans are also included in the housing loan category. Many of these loans were for renovations and improvements to existing dwellings. Outstanding loans by type of loan for 2010 and 2009 are as follows:

Sector	Number	Amount	%Value
Agriculture	13	$ 99,813	0.34%
Fishing	8	$ 65,423	0.23%
Commercial	125	$ 17,070,674	58.83%
Housing	412	$ 11,780,414	40.60%

The total number of loans on the Bank's books at year end was 457 . The Bank did not sell any of its loans in 2010 and no participated loans were made. Discussions were being entertained with a commercial bank for a purchase of NDBP loans in 2010 on a full recourse basis. The purchase may occur in 2011.

Arrears. Total number of accounts with amounts in arrears and notes past maturity (over 90 days) at the end of 2010 was 51 accounts amounting to $829,000. The amount of arrears as a percentage of the value of outstanding notes at the end of 2010 was close to 2.8%.

New Debt. The Bank used and renewed a $300,000 line of credit with a commercial bank to support its liquidity needs. This facility is for a one year term and is renewable. The Bank maintained a deposit of $400,000 with the same commercial bank securing this line of credit. See notes 6 and 7 to the financial statements for more information on the Bank's loans payable.

Net Assets. The Bank's overall change in net assets for 2010 and 2009 was $(88,814) and $598,174 respectively. Net increase in capital assets for 2010 was $148,140 reflective of additional improvements of the Bank's building in Airai.

Plant and Equipment. At September 30, 2010, 2009 and 2008, the Bank had $727,862, $579,722 and $528,830, respectively, invested in capital assets, net of accumulated depreciation where applicable, including leasehold rights, furniture, fixtures and equipment, vehicles and leasehold improvements and construction in progress, which represents a net increase in 2010 of $148,140 or 26% over 2009 and a net increase in 2009 of $50,892 or 10% over 2008. See note 4 to the financial statements for more information on the Bank's plant and equipment.

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

Statements of Net Assets

	2010	2009	$ Change	% Change	2008
Current and other assets	$ 29,587,138	$ 28,698,390	$ 888,748	3%	$ 23,134,270
Capital assets	727,862	579,722	148,140	26%	528,830
Total assets	$ 30,315,000	$ 29,278,112	$ 1,036,888	4%	$ 23,663,100
Loans payable	$ 14,538,223	$ 13,301,696	$ 1,236,527	9%	$ 8,461,687
Other liabilities	168,544	279,369	(110,825)	-40%	102,540
Total liabilities	$ 14,706,767	$ 13,581,065	$ 1,125,702	8%	$ 8,564,227
Net assets:					
Invested in capital assets	$ 727,862	$ 579,722	$ 148,140	26%	$ 528,830
Restricted	14,880,371	15,117,325	(236,954)	-2%	14,570,043
Total net assets	$ 15,608,233	$ 15,697,047	$ (88,814)	-1%	$ 15,098,873

Affiliations

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

Risk Management

Primary risks the Bank faces include Strategic/Operational, Credit, Technology, Economic, Reputation/Political, and Climatic/Environmental risks (in no particular order). The Board of Directors manages these risks with the assistance of the 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 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. Some consideration will be given to increased general provisions in 2011.

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

Decisions to place loans on non-accrual of income status are made according to Bank policy which also provides that loans may be held on accrual if justified by the Bank Officer. As of September 30, 2010, forty-eight loans amounting to $735,000 (payoff balance) were on non-accrual status.

Economic Outlook

Activities planned in 2011 of significance include implementation of the Bank's energy loan product, receipt of an additional $500,000 in grants to support that program, recording of the $750,000 USDA IRP Program Loan and further borrowings from the EIB, ROPSSA, and MICB. Additional credit training and technical assistance for capacity building and client support are also planned. The development of these activities relies upon an improved global economy and reduced uncertainty in the local market. The target for loan approvals in the new year will be $7 million with lending increases in the agriculture and fisheries sectors.

Contacting the Bank's Financial Management

This financial report is designed to provide a general overview of the Bank's finances and to demonstrate the Bank's accountability for the money it receives. The MD&A for the year ended September 30, 2009 is set forth in the report on the audit of the Bank's financial statements which is dated March 11, 2010. That Discussion and Analysis explains the major factors impacting the 2009 financial statements. If you have questions about the 2009 or 2008 reports, or need additional information, please contact the Finance Manager at the National Development Bank of Palau, P.O. Box 816, Koror, Republic of Palau 96940, or e-mail frirou@ndbp.com or call 488-2578/3955.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Net Assets
September 30, 2010 and 2009

ASSETS	2010	2009
Current assets:		
Cash and cash equivalents	$ 1,271,165	$ 1,701,090
Restricted time certificates of deposit	449,520	3,061,188
Receivables:		
Current portion of economic development loans receivable, net	5,960,782	2,707,480
Accrued interest	416,457	421,965
Other receivables	224,742	214,130
Inventory	9,371	8,716
Prepaid expenses	33,221	43,216
Total current assets	8,365,258	8,157,785
Restricted cash and cash equivalents	600,066	598,301
Time certificates of deposit	205,112	205,112
Economic development loans receivable, net	20,049,484	19,466,114
Property and equipment, net	727,862	579,722
Foreclosed real estate	367,218	271,078
	$ 30,315,000	$ 29,278,112
LIABILITIES AND NET ASSETS		
Current liabilities:		
Short-term loan payable	$ 300,000	$ -
Current portion of loans payable	788,084	575,989
Due to grantor	100,689	182,456
Accounts payable and accrued expenses	67,855	96,913
Interest payable	121,193	108,677
Total current liabilities	1,377,821	964,035
Loans payable, net of current portion	13,328,946	12,617,030
Total liabilities	14,706,767	13,581,065
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	727,862	579,722
Restricted	14,880,371	15,117,325
Total net assets	15,608,233	15,697,047
	$ 30,315,000	$ 29,278,112

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2010 and 2009

	2010	2009
Operating revenues:		
Interest income on loans	$ 1,953,169	$ 1,938,063
Loan fees and late charges	66,428	59,191
Other	6,412	6,420
Total operating revenues	2,026,009	2,003,674
Provision for loan losses	(761,397)	(247,078)
Net operating revenues	1,264,612	1,756,596
Operating expenses:		
General and administrative expenses:		
Salaries, wages and fringe benefits	432,754	416,497
Professional fees	123,455	109,599
Travel and transportation	87,795	102,741
Depreciation	42,366	35,297
Training	32,094	2,065
Utilities	20,894	28,998
Supplies, printing, and reproduction	15,820	13,917
Honorariums and meeting expense	12,325	7,935
Communications	10,930	13,102
Rent	10,415	42,568
Repairs and maintenance	9,936	8,151
Dues and subscriptions	8,452	10,347
Insurance	7,104	6,559
Miscellaneous	38,869	29,906
Total general and administrative expenses	853,209	827,682
Operating income	411,403	928,914
Nonoperating revenues (expenses), net:		
Interest income on interest bearing accounts	34,969	78,547
Rental income	30,000	30,000
Grant revenues	81,767	37,743
Energy Efficiency Home Loan Project	(81,767)	(29,795)
Interest expense and loan fees	(575,581)	(447,402)
Gain on sale of property and equipment	4,500	-
Other	5,895	167
Total nonoperating revenues (expenses), net	(500,217)	(330,740)
Change in net assets	(88,814)	598,174
Net assets at beginning of year	15,697,047	15,098,873
Net assets at end of year	$ 15,608,233	$ 15,697,047

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Cash Flows
Years Ended September 30, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Cash received from customers	$ 2,035,267	$ 1,872,478
Cash payments to employees for services	(433,670)	(438,628)
Cash payments to suppliers for goods and services	(407,503)	(405,713)
Net cash provided by operating activities	1,194,094	1,028,137
Cash flows from capital and related financing activities:		
Proceeds from issuance of long-term debt	1,500,000	5,407,750
Acquisition of property and equipment	(190,506)	(86,189)
Repayments of long-term debt	(575,989)	(286,187)
Interest paid on long-term debt	(560,813)	(411,276)
Net cash provided by capital and related financing activities	172,692	4,624,098
Cash flows from investing activities:		
Net change in time certificates of deposit	2,611,668	(2,509,415)
Interest received on interest bearing deposits	31,219	157,423
Gain on sale of property and equipment	4,500	-
Net change in restricted cash and cash equivalents	(1,765)	180,791
Loan originations and collections, net	(4,775,976)	(2,574,317)
Net cash used for investing activities	(2,130,354)	(4,745,518)
Cash flows from noncapital financing activities:		
Proceeds from short-term borrowings	600,000	600,000
Rental income received	30,000	30,000
Other income received	5,895	-
Cash received from grantor	-	220,199
Interest paid on short-term borrowings	(2,252)	(4,027)
Repayments of short-term borrowings	(300,000)	(900,000)
Net cash provided by (used for) noncapital financing activities	333,643	(53,828)
Net (decrease) increase in cash and cash equivalents	(429,925)	852,889
Cash and cash equivalents at beginning of year	1,701,090	848,201
Cash and cash equivalents at end of year	$ 1,271,165	$ 1,701,090
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 411,403	$ 928,914
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation	42,366	35,297
Provision for loan losses	761,397	247,078
(Increase) decrease in assets:		
Interest receivable	9,258	(160,991)
Other receivables	(10,612)	(25,069)
Inventory	(655)	(1,692)
Prepaid expenses	9,995	10,227
Increase (decrease) in liabilities:		
Accounts payable and other liabilities	(29,058)	(5,627)
Net cash provided by operating activities	$ 1,194,094	$ 1,028,137

See accompanying notes to financial statements.

Statements of Cash Flows, Continued
Years Ended September 30, 2010 and 2009

	2010	2009
Supplemental schedule of noncash investing activities:		
Foreclosed real estate transferred from loans:		
Increase in foreclosed real estate	$ 102,140	$ -
Decrease in economic development loans receivables	(102,140)	-
	$ -	$ -
Investment transferred to loans:		
Increase in economic development loans receivable	$ -	$ 1,000,000
Decrease in investment	-	(1,000,000)
	$ -	$ -

See accompanying notes to financial statements.

(1) Organization

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

(2) Summary of Significant Accounting Policies

The accounting policies of the Bank conform to accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Bank has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

A. Basis of Accounting

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

B. Cash and Cash Equivalents and Time Certificates of Deposit

For the purpose of the statements of net assets and cash flows, the Bank considers all highly liquid investments, with maturities of three months or less when purchased, to be cash and cash equivalents. Time certificates of deposit with initial maturities of greater than three months are separately classified. The Bank does not require collateralization of its bank accounts. Cash and cash equivalents and time certificates of deposit maintained in Federal Deposit Insurance Corporation (FDIC) insured banks amounted to $2,378,883 and $5,297,902 at September 30, 2010 and 2009, respectively, with $750,000 being subject to FDIC insurance coverage.

(2) Summary of Significant Accounting Policies, Continued

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

Time certificates of deposit maintained in an uninsured bank amounted to $205,112 at September 30, 2010 and 2009. The Bank does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

RPPL 4-48, Section 126, as amended by RPPL 5-37, stipulates that the Bank shall maintain a reserve account to be applied to all defaults on commercial loans guaranteed by the Bank. The reserve account shall equal ten percent (10%) of the total amount of all loan guarantees on commercial bank loans, whether or not protected by the full faith and credit of the Republic of Palau. The Bank has restricted $50,047 and $50,016 of cash and cash equivalents as of September 30, 2010 and 2009, respectively, to comprise this reserve. The Bank has also restricted cash and cash equivalents held solely for the guarantee of Rural Housing and Community Development Service (RHCDS) loans in the amount of $550,019 and $548,285 as of September 30, 2010 and 2009, respectively.

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1 Deposits that are federally insured or collateralized with securities held by the Bank or its agent in the Bank's name;

Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Bank's name; or

Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Bank's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Bank's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Bank does not have a deposit policy for custodial credit risk. As of September 30, 2010 and 2009, cash holdings of $-0- and $53,435 are held and administered by an investment manager subject to Securities Investor Protection Corporation insurance, respectively.

C. Loans and Allowance for Loan Losses

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

(2) Summary of Significant Accounting Policies, Continued

C. Loans and Allowance for Loan Losses, Continued

Loan origination fees are deferred and amortized to income as an adjustment of yield using the straight-line method over the contractual life of the loans. Direct loan origination costs are expensed as incurred. Differences between this method and the method prescribed by FASB ASC Subtopic 310-20, *Receivables: Nonrefundable Fees and Other Costs* (formerly FASB No. 91, *Accounting For Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*) are not significant and do not otherwise materially affect the accompanying financial statements.

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.

D. Inventory

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

E. Property and Equipment

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

F. Foreclosed Real Estate

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

(2) Summary of Significant Accounting Policies, Continued

G. Revenue Recognition

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

Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. Interest on loans is accrued and credited to income based on the principal amount outstanding. The accrual of interest on loans is discontinued when principal or interest payments are delinquent ninety days or more, or when, in the opinion of the Bank, there is an indication that the borrower may be unable to meet payments as they become due. Interest income thereafter is recognized only to the extent of cash payments received. Nonaccrual loans approximated $4,262,932 and $1,305,525 at September 30, 2010 and 2009, respectively.

H. Net Assets

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

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

- Restricted:

  Nonexpendable - Net assets subject to externally imposed stipulations that the Bank maintains them permanently. At September 30, 2010 and 2009, the Bank does not have nonexpendable net assets.

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

- Unrestricted; net assets that are not subject to externally imposed stipulations. As the Bank considers all assets, except investments in capital assets, to be restricted for economic development, the Bank does not have unrestricted net assets of September 30, 2010 and 2009.

I. New Accounting Standards

During fiscal year 2010, the Bank implemented the following pronouncements:

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes.

(2) Summary of Significant Accounting Policies, Continued

I. New Accounting Standards, Continued

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

- GASB Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* for calculating the annual required contribution (ARC) adjustment.

- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

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

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

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Bank.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of the Bank.

(2) Summary of Significant Accounting Policies, Continued

J. Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and loan guarantees. Such financial instruments are recorded in the financial statements when they become payable. At September 30, 2010 and 2009, the Bank had no such off-balance sheet financial instruments.

K. Reclassifications

Certain 2009 balances in the accompanying financial statements have been reclassified to conform to the 2010 presentation.

(3) Economic Development Loans and Allowance for Loan Losses

The components of loans receivable as of September 30, 2010 and 2009 are as follows:

	2010	2009
Loans receivable	$ 28,612,086	$ 24,178,921
Less:		
Allowance for loan losses	(2,431,451)	(1,889,054)
Deferred loan origination fees	(170,369)	(116,273)
	26,010,266	22,173,594
Current portion of economic development loans receivable	(5,960,782)	(2,707,480)
	$ 20,049,484	$ 19,466,114

Maturities of the above principal balances subsequent to September 30, 2010, will be as follows:

Fully matured and others	$ 361,061
1 - 6 months	59,932
7 - 18 months	4,057,684
19 months - 3 years	813,442
After 3 years	23,319,967
	$ 28,612,086

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

	2010	2009
Balance - beginning of year	$ 1,889,054	$ 1,546,992
Recoveries of loan previously charged-off	206,350	94,984
Provision for loan losses	761,397	247,078
Loans charged-off	(425,350)	-
Balance - end of year	$ 2,431,451	$ 1,889,054

(4) Plant and Equipment

A summary of plant and equipment as of September 30, 2010 and 2009, is as follows:

	Estimated Useful Lives	Balance at October 1, 2009	Additions	Transfer	Deletions	Balance at September 30, 2010
Depreciable assets:						
Leasehold rights	39 - 50 years	$ 493,206	$ -	$ -	$ -	$ 493,206
Furniture, fixtures and equipment	2 - 20 years	184,748	18,463	-	(10,720)	192,491
Vehicles	5 years	63,495	19,400	-	(18,500)	64,395
Leasehold improvement	5 years	2,164	-	225,880	(2,164)	225,880
		743,613	37,863	225,880	(31,384)	975,972
Less accumulated depreciation		(237,128)	(42,366)	-	31,384	(248,110)
		506,485	(4,503)	225,880	-	727,862
Non-depreciable assets:						
Construction in progress		73,237	152,643	(225,880)	-	-
		$ 579,722	$ 148,140	$ -	$ -	$ 727,862

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

(5) Foreclosed Real Estate

A summary of the changes in foreclosed real estate as of September 30, 2010 and 2009 is as follows:

	2010	2009
Balance at beginning of year	$ 271,078	$ 326,578
Additions	102,140	-
Disposals	(6,000)	(55,500)
Balance at end of year	$ 367,218	$ 271,078

Title to foreclosed real estate of $340,218 and $160,000 is in the Bank's name as of September 30, 2010 and 2009, respectively.

(6) Short-Term Loans Payable

The Bank entered into a $300,000 revolving credit line (credit line) with a local bank on October 27, 2007 for the purpose of supplementing disbursements of approved loans and temporary cash requirements to fund operations. On October 21, 2008, the Bank renewed the credit line under essentially the same terms and conditions. Repayment of the credit line is due one year from the initial drawdown with interest at the time certificate of deposit (TCD) rate, plus 1.50% (2.0% and 2.5% at September 30, 2010 and 2009, respectively). The credit line is collateralized by an assignment of $449,520 and $446,172 in TCDs as of September 30, 2010 and 2009, respectively.

Changes in short-term loans payable for the years ended September 30, 2010 and 2009, are as follows:

	Balance October 1, 2009	Additions	Reductions	Balance September 30, 2010	Due Within One Year
Short-term loans payable	$ -	$ 600,000	$ (300,000)	$ 300,000	$ 300,000

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

(7) Loans Payable

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

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

The loan was $6,000,000 and $4,500,000 with interest at 4.5% as of September 30, 2010 and 2009, respectively. The loan is collateralized by the full faith and credit of the Republic of Palau Government.

(7) Loans Payable, 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 for the Bank. The note is uncollateralized and is due on July 1, 2024, with interest fixed at 3.5% per annum, payable in semi-annual installments of $142,858, and guaranteed by the Republic of Palau. Interest is payable semi-annually and commences six months after the advance of proceeds. Annual expected principal repayments are $285,716.

On December 5, 2006, the Bank entered into an agreement with the European Investment Bank (EIB) to borrow up to 5,000,000 euros, which will be converted to U.S. dollars at the effective exchange rate upon disbursement. The available credit shall be drawn in tranches upon written request by the Bank. Loan proceeds may be used for purposes of financing 50% of the total cost of projects and portfolio projects of the Bank. The agreement is backed by the full faith and credit of the government of the Republic of Palau. As of September 30, 2010 and 2009, the Bank has drawn down two tranches of $3,016,465 and $1,391,285 with interest rates of 3.679% and 5.175%, respectively. Interest and principal are payable semi-annually until September 10, 2021.

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

Year ending September 30,	Principal	Interest	Total
2011	$ 788,084	$ 569,956	$ 1,358,040
2012	1,000,698	532,272	1,532,970
2013	1,013,852	490,396	1,504,248
2014	1,027,572	448,644	1,476,216
2015	1,041,881	406,301	1,448,182
2016 - 2020	5,446,590	1,374,546	6,821,136
2021 - 2025	3,798,353	362,034	4,160,387
	$ 14,117,030	$ 4,184,149	$ 18,301,179

Changes in loans payable for the years ended September 30, 2010 and 2009, are as follows:

	Balance October 1, 2009	Additions	Reductions	Balance September 30, 2010	Due Within One Year
Republic of Palau Social Security Retirement Fund	$ 4,500,000	$ 1,500,000	$ -	$ 6,000,000	$ 200,000
Mega International Commercial Bank	4,285,269	-	(285,716)	3,999,553	285,716
European Investment Bank	4,407,750	-	(290,273)	4,117,477	302,368
	$ 13,193,019	$ 1,500,000	$ (575,989)	$ 14,117,030	$ 788,084

	Balance October 1, 2008	Additions	Reductions	Balance September 30, 2009	Due Within One Year
Republic of Palau Social Security Retirement Fund	$ 3,500,000	$ 1,000,000	$ -	$ 4,500,000	$ -
Mega International Commercial Bank	4,571,456	-	(286,187)	4,285,269	285,716
European Investment Bank	-	4,407,750	-	4,407,750	290,273
	$ 8,071,456	$ 5,407,750	$ (286,187)	$ 13,193,019	$ 575,989

(8) Related Party Transactions

The Bank grants loans to officers and employees. Loans made to related parties were extended in the normal course of business and at prevailing interest rates. Loans receivable from officers and employees are $250,055 and $162,090 as of September 30, 2010 and 2009, respectively, and are included within economic development loans receivable in the accompanying statements of net assets.

(9) Commitments

Loans Approved

The Bank approved loans aggregating $10,756,689 and $8,903,973 of which $5,668,011 and $3,650,673 were undisbursed at September 30, 2010 and 2009, respectively. Of the undisbursed loans as of September 30, 2010, $941,000 relates to performance bonds on various construction contracts where the Bank acts as insurer.

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,	
2011	$ 4,917
2012	4,917
2013	4,917
2014	4,917
2015	4,917
2016 - 2020	24,587
2021 - 2025	24,587
2026 - 2030	24,587
2031 - 2035	24,587
2036 - 2040	24,587
2041 - 2045	24,587
2046 - 2050	24,587
2051 - 2055	24,587
2056 - 2058	12,294
Total future minimum payments	$ 233,575

On May 16, 2008, the Bank entered into an agreement with the Pacific Savings Bank Receiver (PSB Receiver) for the lease of office space. The lease is for three years commencing May 16, 2008. The PSB Receiver prepaid $90,000 representing the entire lease obligation for three years. Total rental income recognized for the years ended September 30, 2010 and 2009 amounted to $30,000. The remainder of the prepaid lease rental is included in accounts payable and accrued expenses in the accompanying statements of net assets.

(9) Commitments, Continued

Others

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

On May 5, 2008, the Bank entered into an agreement with the International Union for Conservation of Nature and Natural Resources (IUCNNR) for the implementation of the Energy Efficiency Home Loan Project. To enable the completion of the project activities, IUCNNR will provide $500,000 in grant funds to the Bank. The project term is for a period of three years commencing October 5, 2008. As of September 30, 2010 and 2009, due to grantor amounted to $100,689 and $182,456, respectively.

(10) Contingencies

The Bank is authorized to guarantee up to 90% of the principal of loans made by financial institutions to qualified borrowers, in addition to approving direct loans. Eligible principal amounted to $361,839 as of September 30, 2010 of which the Bank was contingently liable for $325,655. Of the total loans made by financial institutions, $326,190 is backed by the Republic of Palau's full faith and credit.

The Bank also guarantees loans made by RHCDS. The Bank has approved guarantees for eighty loans aggregating $3,235,714 at September 30, 2010. Unpaid interest and subsidies related to the loan guarantees as of September 30, 2010 and 2009 amounted to $23,162 and $629,664, respectively, for which the Bank becomes liable once the borrower defaults and a demand notice is issued.

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

The Bank maintains depository accounts in a non-FDIC insured financial institution. The financial institution went into receivership in November 7, 2006. The Bank President was appointed by the Palau Financial Institutions Commission (FIC) as the receiver for the financial institution. Deposits in this financial institution amounted to $205,112 as of September 30, 2010 and 2009 which are collateralized by a third party personal guarantee and an asset of the financial institution. Management is of the opinion that transactions with this financial institution are of similar terms and conditions as with unrelated parties. It is uncertain when the Bank will realize the abovementioned deposits and no provision for potential losses has been made in the accompanying financial statements.

(11) Republic of Palau Civil Service Pension Trust Fund

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

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents of the Republic, Republic State Governments and Republic agencies, funds and public corporations, which are paid monthly and are two percent of each member's average monthly salary. Normal benefits are of credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members who retire at or after age 60, or with 25 years of vesting service, are entitled to retirement benefits. RPPL 2-26 is the authority under which benefit provisions are established. Member contribution rates are established by RPPL 2-26 at six percent (6%) of total payroll and matched dollar for dollar by the employer. The Bank contributed $22,507, $27,560 and $18,695 to the Fund during the fiscal years 2010, 2009 and 2008, respectively.

Under the provisions of RPPL No. 2-26, the Pension Fund's Board of Trustees adopted a Trust Fund Operation Plan which has the force and effect of law, and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code. The Bank's total payroll for fiscal years 2010 and 2009 was covered in total by the Fund's plan.

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

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

The Fund's October 1, 2009 actuarial valuation determined the unfunded pension benefit obligation as follows:

Active participants	$ 56,060,970
Participants in pay status	47,666,805
Participants with vested deferred benefits	1,779,610
Total pension benefit obligation	105,507,385
Net assets available for benefits, at market value	41,254,319
Unfunded benefit obligation	$ 64,253,066

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

(12) Risk Management

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

(13) Subsequent Event

On November 29, 2010, the Bank and the Republic of Palau (ROP) entered into an agreement to assign amounts owed to ROP from the PSB Receiver to the Bank in the amount of $820,000.