

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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2020 AND 2019

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, 2020 and 2019, 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.

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, 2020 and 2019, 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 Matters

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.

Risk Related to COVID-19

As discussed in note 13 to the financial statements, the Bank's operations have been affected by the recent and ongoing coronavirus pandemic. As a result of the spread of COVID-19, governments worldwide have implemented actions to restrict travel and economic activities. The ultimate effect of the disruption which may be caused by the pandemic is uncertain and, therefore, the actual impact on the Bank's business, results of operations, and financial position for 2021 and beyond is currently not determinable.

Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 11 as well as the Schedule of Proportional Share of the Net Pension Liability on page 39 and the Schedule of Pension Contributions on page 40 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 September 27, 2021 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

September 27, 2021



MANAGEMENT'S DISCUSSION AND ANALYSIS YEAR ENDED SEPTEMBER 30, 2020

This Management's 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, 2020 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 annually elects its own officers to the posts of Chairman, Vice Chairman and Secretary/Treasurer.

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 nineteen 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 2020. Plans for expansion of the Bank's building are set forth in the Bank's ten-year Strategic Plan.

Economic Outlook

2020 proved to be a challenging year for the Bank as the COVID-19 pandemic had major implications for all countries. There were a number of challenges the Bank faced including the closure of borders, restriction of travel, and a public health declaration. As Palau relies heavily on tourism, many of the Bank's borrowers were severely affected. This was somewhat mitigated by the many borrowers receiving income through government employment.

The Bank's Board of Directors and management responded to the challenges presented by COVID-19 by allowing customers whose income had been badly affected the options to move to interest only, defer principal and interest payments or restructure loans.

The Bank was also provided with the Coronavirus Relief One Stop Shop (CROSS) Act funding of \$1.5 million which was available to tourism-related businesses to cover fixed costs severely affected by the drop in tourists. This certainly alleviated the financial pressure these businesses faced.

To counter the effects on the economy by the tourism slowdown, the Bank continued to provide housing loans to Palauan citizens under the Housing Development Loan Program (HDLP). Seventy-seven loans totaling \$6,304,397 were approved during the 2020 financial year.

It is expected that the COVID-19 pandemic will continue to have a negative effect on the Palauan economy during fiscal year 2021. The Palauan economy is projected to decline 25% compared to pre-pandemic levels.

Tourism will continue to be adversely affected by the collapse in tourist numbers. Tourism-related businesses will continue to require financial assistance in order to be able to cover fixed costs such as lease, rental payments, plant and equipment maintenance and wages and salaries. As Palau works through its vaccination program, there is discussion on the instigation of a travel bubble with Taiwan. Should the travel bubble materialize, and other international flights resume during 2021, businesses will also need assistance in reopening and re-tooling the business to meet COVID-19 safety requirements. It is also expected that borrowers will be reluctant to increase their debt burden due to uncertainty as to when the economy will begin to improve.

The construction sector will continue to be active as further housing loans are approved under HDLP. It is anticipated that HDLP funds will be fully committed during fiscal year 2021. In regard to capital improvement projects, it is expected that existing projects will continue, and new public infrastructure projects will come on line.

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 are recorded when liabilities are incurred.

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 the U.S. Department of Agriculture Rural Development (USDA RD) program loans.

Financial Policies, Continued

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 Memorandum of Understanding (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 the Palau Housing Authority 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.

Guaranteed Loans

Significant financial policies include a 10% reserve requirement for the Bank's commercial guaranteed loans. Currently, there are no loans under this program. A reserve of \$500,000 is also held at a commercial bank as required by USDA RD. 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 program through the Bank of Guam (BOG) is a new addition to our guaranteed loans program. To date, no completed loan packages from BOG have been received by the Bank.

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 three programs: Small Business, Microfinance, and Pre-Development Loan. The Bank's Microfinance and Pre-Development Loan programs are at a 6% interest rate targeting those borrowers who are able to secure their loans 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.

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. A new addition to the homeowners' program is HDLP which offers interest rates of 1%, 3% and 6%.

Operations, Continued

Direct Loans, Continued

Pre-development loans to projects for both business and housing are provided for up to 15% of project costs with a term not to exceed five years. The maximum amount for commercial and housing is \$15,000 and \$10,000, respectively. The purpose of the Pre-Development loan is to help borrowers pay for plan design, title search, appraisals and all related soft costs associated with packaging loans and cash equity contribution. Eligible purposes for housing loans include new construction, renovation and extensions.

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

	<u>2020</u>	<u>2019</u>	<u>\$ Change</u>	<u>% Change</u>	<u>2018</u>
Revenues:					
Interest income on loans	\$ 2,142,335	\$ 1,890,784	\$ 251,551	13%	\$ 1,704,965
Loan fees and late charges	202,588	183,395	19,193	10%	157,932
Other	<u>92,629</u>	<u>90,674</u>	<u>1,955</u>	2%	<u>66,508</u>
Total operating revenues	2,437,552	2,164,853	272,699	13%	1,929,405
(Provision for) recovery of loan losses and doubtful accounts	<u>(2,507,873)</u>	<u>532,566</u>	<u>(3,040,439)</u>	571%	<u>126,826</u>
Net operating revenues	<u>(70,321)</u>	<u>2,697,419</u>	<u>(2,767,740)</u>	-103%	<u>2,056,231</u>
Operating expenses:					
Salaries, wages and fringe benefits	787,315	706,557	80,758	11%	667,750
Training and travel and transportation	46,574	88,755	(42,181)	-48%	101,506
Depreciation	42,525	44,194	(1,669)	-4%	45,420
Other expenses	<u>243,720</u>	<u>251,610</u>	<u>(7,890)</u>	-3%	<u>232,290</u>
Total operating expenses	<u>1,120,134</u>	<u>1,091,116</u>	<u>29,018</u>	3%	<u>1,046,966</u>
Operating (loss) income	<u>(1,190,455)</u>	<u>1,606,303</u>	<u>(2,796,758)</u>	-174%	<u>1,009,265</u>
Nonoperating revenues (expenses):					
Grant revenues	1,500,000	-	1,500,000	100%	6,100
Housing Development Loan Project subsidy expense	(175,000)	-	(175,000)	100%	-
Interest expense and loan fees	(314,303)	(407,163)	92,860	-23%	(416,590)
Other nonoperating revenues (expenses)	<u>(50,464)</u>	<u>66,165</u>	<u>(116,629)</u>	-176%	<u>(48,325)</u>
Total nonoperating revenues (expenses)	<u>960,233</u>	<u>(340,998)</u>	<u>1,301,231</u>	382%	<u>(458,815)</u>
Capital contribution from the Republic of Palau	<u>5,739,306</u>	<u>-</u>	<u>5,739,306</u>	100%	<u>-</u>
Change in net position	5,509,084	1,265,305	4,243,779	335%	550,450
Net position in beginning of year	<u>20,273,114</u>	<u>19,007,809</u>	<u>1,265,305</u>	7%	<u>18,457,359</u>
Net position at end of year	\$ <u>25,782,198</u>	\$ <u>20,273,114</u>	\$ <u>5,509,084</u>	27%	\$ <u>19,007,809</u>

Overview of Financial Performance, Continued

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 2020 increased by \$272,699 or 13% over 2019 and by \$234,448 or 12% in 2019 over 2018 largely due to the increase in the Bank's loan portfolio.

Expenses

Operating expenses in 2020 increased by \$29,018 or 3% as compared to 2019. Salaries, wages and fringe benefits increased by 11% while training and travel and transportation decreased by 48%. Operating expenses in 2019 increased by \$44,150 or 4% compared to 2018.

Nonoperating Revenues (Expenses)

Nonoperating revenues (expenses) increased by 382% due to a \$1.5 million grant from ROP for the CROSS Act loan program. Interest expense and loan fees decreased by \$92,860 or 23% in 2020. Nonoperating revenues (expenses) in 2019 include interest expense and loan fees on the Bank's borrowings of \$407,163, \$46,239 of interest earned from bank accounts and \$19,926 of other income.

Cash Flows

In 2020, the Bank received \$5.7 million for the HDLP program and \$1.5 million for the CROSS Act program. In 2019, the Bank used 28% or \$2,362,816 of its cash to fund operations and new loans. A condensed year-to-year comparison of the Statements of Cash Flows follows:

	Statements of Cash Flows				
	<u>2020</u>	<u>2019</u>	<u>\$ Change</u>	<u>% Change</u>	<u>2018</u>
Cash flows from operating activities	\$ 1,391,115	\$ 1,365,218	\$ 25,897	2%	\$ 957,138
Cash flows from capital and related financing activities	(1,609,550)	(1,836,721)	227,171	-12%	(1,571,878)
Cash flows from investing activities	(4,073,607)	(1,895,136)	(2,178,471)	115%	(2,845,648)
Cash flows from noncapital financing Activities	<u>7,075,651</u>	<u>3,823</u>	<u>7,071,828</u>	184981%	<u>21,283</u>
Net increase (decrease) in cash and cash equivalents	2,783,609	(2,362,816)	5,146,425	-218%	(3,439,105)
Cash and cash equivalents at beginning of year	<u>6,066,759</u>	<u>8,429,575</u>	<u>(2,362,816)</u>	-28%	<u>11,868,680</u>
Cash and cash equivalents at end of year	\$ <u>8,850,368</u>	\$ <u>6,066,759</u>	\$ <u>2,783,609</u>	46%	\$ <u>8,429,575</u>

Overview of Financial Condition

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

Overview of Financial Condition, Continued

Statements of Net Position

	<u>2020</u>	<u>2019</u>	<u>\$ Change</u>	<u>% Change</u>	<u>2018</u>
Assets and Deferred Outflows of Resources					
Economic development loans receivable, net	\$ 26,375,326	\$ 24,335,130	\$ 2,040,196	8%	\$ 22,062,755
Capital assets, net	662,587	682,664	(20,077)	-3%	661,791
Other assets	<u>9,665,354</u>	<u>7,407,890</u>	<u>2,257,464</u>	30%	<u>9,625,408</u>
Total assets	36,703,267	32,425,684	4,277,583	13%	32,349,954
Deferred outflows of resources from pension	<u>802,858</u>	<u>509,559</u>	<u>293,299</u>	58%	<u>428,070</u>
Total assets and deferred outflows of resources	<u>\$ 37,506,125</u>	<u>\$ 32,935,243</u>	<u>\$ 4,570,882</u>	14%	<u>\$ 32,778,024</u>
Liabilities, Deferred Inflows of Resources and Net Position					
Loans payable	\$ 8,332,825	\$ 9,796,076	\$ (1,463,251)	-15%	\$ 11,189,624
Net pension liability	2,428,960	1,954,037	474,923	24%	1,831,279
Other liabilities	<u>574,812</u>	<u>497,834</u>	<u>76,978</u>	15%	<u>382,977</u>
Total liabilities	11,336,597	12,247,947	(911,350)	-7%	13,403,880
Deferred inflows of resources from pension	<u>387,330</u>	<u>414,182</u>	<u>(26,852)</u>	-6%	<u>366,335</u>
Total liabilities and deferred inflows of resources	<u>11,723,927</u>	<u>12,662,129</u>	<u>(938,202)</u>	-7%	<u>13,770,215</u>
Net position:					
Net investment in capital assets	662,587	682,664	(20,077)	-3%	661,791
Restricted	<u>25,119,611</u>	<u>19,590,450</u>	<u>5,529,161</u>	28%	<u>18,346,018</u>
Total net position	<u>25,782,198</u>	<u>20,273,114</u>	<u>5,509,084</u>	27%	<u>19,007,809</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 37,506,125</u>	<u>\$ 32,935,243</u>	<u>\$ 4,570,882</u>	14%	<u>\$ 32,778,024</u>

Total Assets

The Bank's total assets and deferred outflows of resources for 2020 and 2019 was \$37,506,125 and \$32,935,243, respectively, an increase of 14% or \$4,570,882. The Bank's total assets and deferred outflows of resources for 2019 and 2018 was \$32,935,243 and \$32,778,024, respectively, an increase of less than 1% or \$157,219.

Loan Portfolio

The Bank's loan portfolio includes new, amended and renewed loans and lines of credit. 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.

Total loans outstanding in 2020 was for \$29,719,682 and \$25,744,132 in 2019. This is an increase of \$3,975,550 or 15.44%. Outstanding loans by sector for 2020 and 2019 are presented in the following table:

Overview of Financial Condition, Continued

Loan Portfolio, Continued

SECTOR	2020		2019		Change	
	Amount	Percent	Amount	Percent	Amount	Percent
Agriculture	\$ 1,645,246	5.54%	\$ 1,717,111	6.67%	\$ (71,865)	-4.19%
Fishing	827,766	2.79%	457,470	1.78%	370,296	80.94%
Commercial	10,629,046	35.76%	9,529,582	37.01%	1,099,464	11.54%
Housing	16,617,624	55.91%	14,039,969	54.54%	2,577,655	18.36%
Totals	\$ 29,719,682	100.00%	\$ 25,744,132	100.00%	\$ 3,975,550	15.44%

Loss Provisioning

The Bank's provisions for loan losses with a general provision of 3% and specific provisions of 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 for 2020 totaled \$3,344,356 versus \$1,409,002 in 2019, an increase of \$1,935,354 or 137%. With the pandemic and tourism nearing 0%, businesses were closing and the unemployment rate was high. The loan provision for 2019 totaled \$1,409,002 versus \$1,104,300 in 2018, an increase of \$304,702 or 28%.

Capital Assets and Long-Term Debt

At September 30, 2020, 2019 and 2018, the Bank had net investment in capital assets of \$662,587, \$682,664 and \$661,791, respectively, net of accumulated depreciation where applicable, including leasehold rights, leasehold improvements, furniture, fixtures and equipment and vehicles. The decrease in 2020 is due to decreases in accumulated depreciation. The increase in 2019 is due to increases in leasehold rights, furniture, fixtures and equipment and vehicles. 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 2020 and 2019. 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 (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.

The Management's Discussion and Analysis for the year ended September 30, 2019 is set forth in the Bank's report on the audit of financial statements, which is dated May 12, 2020. That discussion and analysis explains the major factors impacting the 2019 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, 2020 and 2019

<u>ASSETS AND DEFERRED OUTFLOWS OF RESOURCES</u>	<u>2020</u>	<u>2019</u>
Assets:		
Cash and cash equivalents	\$ 5,986,567	\$ 6,066,759
Time certificates of deposit	-	459,060
Restricted cash and cash equivalents	2,863,801	-
Economic development loans receivable, net	26,375,326	24,335,130
Accrued interest receivable	365,496	139,543
Other receivables	65,606	85,155
Inventory	26,337	93,776
Prepaid expenses	10,359	16,398
Capital assets, net	662,587	682,664
Foreclosed real estate	347,188	547,199
Total assets	<u>36,703,267</u>	<u>32,425,684</u>
Deferred outflows of resources from pension	<u>802,858</u>	<u>509,559</u>
Total assets and deferred outflows of resources	<u>\$ 37,506,125</u>	<u>\$ 32,935,243</u>
<u>LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION</u>		
Liabilities:		
Loans payable	\$ 8,332,825	\$ 9,796,076
Accounts payable and accrued expenses	380,444	303,679
Payable to grantor agencies	150,752	140,980
Interest payable	43,616	53,175
Net pension liability	<u>2,428,960</u>	<u>1,954,037</u>
Total liabilities	<u>11,336,597</u>	<u>12,247,947</u>
Deferred inflows of resources from pension	<u>387,330</u>	<u>414,182</u>
Total liabilities and deferred inflows of resources	<u>11,723,927</u>	<u>12,662,129</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	662,587	682,664
Restricted	<u>25,119,611</u>	<u>19,590,450</u>
Total net position	<u>25,782,198</u>	<u>20,273,114</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 37,506,125</u>	<u>\$ 32,935,243</u>

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Operating revenues:		
Interest income on loans	\$ 2,142,335	\$ 1,890,784
Loan fees and late charges	202,588	183,395
Other	92,629	90,674
Total operating revenues	<u>2,437,552</u>	<u>2,164,853</u>
(Provision for) recovery of loan losses and doubtful accounts	<u>(2,507,873)</u>	<u>532,566</u>
Net operating revenues	<u>(70,321)</u>	<u>2,697,419</u>
Operating expenses:		
General and administrative expenses:		
Salaries, wages and fringe benefits	787,315	706,557
Depreciation	42,525	44,194
Training	33,974	64,170
Professional fees	32,621	41,135
Dues and subscriptions	32,399	22,638
Supplies, printing, and reproduction	24,985	21,497
Repairs and maintenance	23,672	39,959
Honorariums and meeting expense	20,900	17,515
Utilities	16,176	2,377
Communications	15,154	20,817
Rental	13,200	13,200
Insurance	12,628	10,953
Travel and transportation	12,600	24,585
Marketing and advertising	1,980	4,147
Miscellaneous	50,005	57,372
Total general and administrative expenses	<u>1,120,134</u>	<u>1,091,116</u>
Operating (loss) income	<u>(1,190,455)</u>	<u>1,606,303</u>
Nonoperating revenues (expenses), net:		
Grant revenues	1,500,000	-
Interest income on interest bearing accounts	15,402	46,239
Other income	1,515	19,926
Interest expense and loan fees	(314,303)	(407,163)
Housing Development Loan Project subsidy expense	(175,000)	-
Energy Efficiency Home Loan Project	(67,381)	-
Total nonoperating revenues (expenses), net	<u>960,233</u>	<u>(340,998)</u>
Capital contribution from the Republic of Palau	<u>5,739,306</u>	<u>-</u>
Change in net position	5,509,084	1,265,305
Net position at beginning of year	<u>20,273,114</u>	<u>19,007,809</u>
Net position at end of year	<u>\$ 25,782,198</u>	<u>\$ 20,273,114</u>

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Statements of Cash Flows
Years Ended September 30, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Cash flows from operating activities:		
Cash received from customers	\$ 2,231,148	\$ 2,154,506
Cash payments to employees for services	(688,405)	(662,476)
Cash payments to suppliers for goods and services	<u>(151,628)</u>	<u>(126,812)</u>
Net cash provided by operating activities	<u>1,391,115</u>	<u>1,365,218</u>
Cash flows from capital and related financing activities:		
Proceeds from disposal of foreclosed properties	200,011	75,326
Acquisition of capital assets	(22,448)	(65,067)
Repayments of long-term debt	(1,463,251)	(1,393,548)
Interest paid on long-term debt	<u>(323,862)</u>	<u>(453,432)</u>
Net cash used for capital and related financing activities	<u>(1,609,550)</u>	<u>(1,836,721)</u>
Cash flows from investing activities:		
Net change in time certificates of deposit	459,060	(1,566)
Interest received on interest bearing deposits	15,402	46,239
Loan originations, net	<u>(4,548,069)</u>	<u>(1,939,809)</u>
Net cash used for investing activities	<u>(4,073,607)</u>	<u>(1,895,136)</u>
Cash flows from noncapital financing activities:		
Other income received	1,515	4,600
Cash received from the grantor	1,500,000	-
Capital contribution from the Republic of Palau	5,739,306	-
Subsidy paid for energy program	9,830	(846)
Subsidy paid for Housing Development Loan Project program	(175,000)	-
Cash received from sale of solar system	<u>-</u>	<u>69</u>
Net cash provided by noncapital financing activities	<u>7,075,651</u>	<u>3,823</u>
Net decrease in cash and cash equivalents	2,783,609	(2,362,816)
Cash and cash equivalents at beginning of year	<u>6,066,759</u>	<u>8,429,575</u>
Cash and cash equivalents at end of year	<u>\$ 8,850,368</u>	<u>\$ 6,066,759</u>
Reconciliation of operating (loss) income to net cash provided by operating activities:		
Operating (loss) income	\$ (1,190,455)	\$ 1,606,303
Adjustments to reconcile operating (loss) income to net cash provided by operating activities:		
Depreciation	42,525	44,194
Provision for (recovery of) loan losses and doubtful accounts	2,507,873	(532,566)
Noncash pension cost	154,772	89,116
(Increase) decrease in assets:		
Accrued interest receivable	(225,953)	(8,757)
Other receivables	19,549	(1,590)
Prepaid expenses	6,039	6,546
Increase in liabilities:		
Accounts payable and other liabilities	<u>76,765</u>	<u>161,972</u>
Net cash provided by operating activities	<u>\$ 1,391,115</u>	<u>\$ 1,365,218</u>
Supplemental schedule of noncash investing activities:		
Increase in foreclosed property	\$ -	\$ 200,000
Decrease in loans receivable	<u>-</u>	<u>(200,000)</u>
	<u>\$ -</u>	<u>\$ -</u>
Subsidy for Energy Loan Program:		
Increase in Energy Loan Program expense	\$ 67,439	\$ 69
Decrease in inventory	<u>(67,439)</u>	<u>(69)</u>
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(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.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

Concentrations of Credit Risk, Continued

At September 30, 2020 and 2019, 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, 2020 and 2019, concentrations of credit risk result from receivables from significant customers and receivable from a related party which represent 15% of total receivables. 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 \$8,910,502 and \$6,583,861 at September 30, 2020 and 2019, respectively. Of this amount, bank deposits of \$750,000 were FDIC insured at September 30, 2020 and 2019. 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 no restricted cash and cash equivalents as of September 30, 2020 and 2019 to comprise this reserve. There were no commercial loan guarantees as of September 30, 2020. 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 \$551,009 and \$545,082 as of September 30, 2020 and 2019, respectively. Additionally, \$150,752 and \$140,980 of cash received from grantor agencies was internally restricted at September 30, 2020 and 2019, respectively. The Bank has restricted cash balance of \$2,863,801 for Housing Development Loan Project (HDLP) funds as of September 30, 2020. Refer to note 9.

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, reduced by an allowance for loan losses.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

Loans and Allowance for Loan Losses, Continued

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

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

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 \$26,337 and \$93,776 as of September 30, 2020 and 2019, 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.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

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.

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.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

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 \$544,783 and \$865,119 at September 30, 2020 and 2019, 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, 2020 and 2019 were \$61,000 and \$70,000, respectively. Accrued leave benefits recorded as part of accounts payable and accrued expenses amounted to \$35,333 and \$30,303 as of September 30, 2020 and 2019, 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, 2020 and 2019, 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, 2020 and 2019.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 84, 89, 90, 91, 92 and 93 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. In accordance with GASB Statement No. 95, management has elected to postpone implementation of these statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. This Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 84 will be effective for fiscal year ending September 30, 2021.

In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. Management believes that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 87 will be effective for fiscal year ending September 30, 2022.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 89 will be effective for fiscal year ending September 30, 2022.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2018, GASB issued Statement No. 90, *Majority Equity Interests - An Amendment of GASB Statements No. 14 and 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 90 will be effective for fiscal year ending September 30, 2021.

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.

In January 2020, GASB issued statement No. 92, *Omnibus 2020*. The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about the effective date of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, for interim financial reports, the terminology used to refer to derivative instruments and the applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefits. The requirements related to the effective date of GASB Statement No. 87 and Implementation Guide 2019-3, reissuance recoveries and terminology used to refer to derivative instruments are effective upon issuance. The remaining requirements of GASB Statement No. 92 is effective for the fiscal year ending September 30, 2022.

In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. The primary objective of this statement is to address those and other accounting and financial reporting implications of the replacement of an IBOR. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 93 will be effective for fiscal year ending September 30, 2022.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. This statement also provides guidance for accounting and financial reporting for availability payment arrangements. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

In June 2020, GASB issued Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans - an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 97 will be effective for fiscal year ending September 30, 2022.

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.

Reclassifications

Certain reclassifications have been made to the 2019 financial statements to conform to the 2020 presentation.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(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 csspp@palaunet.com or call (680) 488-2523.

Plan Membership. As of October 1, 2019, the valuation date, plan membership consisted of the following:

Inactive members currently receiving benefits	1,629
Inactive members entitled to but not yet receiving benefits	1,252
Active members	<u>3,480</u>
Total members	<u>6,361</u>

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.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Pension Benefits, Continued

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.

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:

<u>Factor</u>	<u>If the Spouse or Beneficiary is:</u>
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

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Pension Benefits, Continued

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:

- $1/12^{\text{th}}$ per year for the first 3 years before age 60;
- plus an additional $1/18^{\text{th}}$ per year for the next 3 years;
- plus an additional $1/24^{\text{th}}$ per year for the next 5 years; and
- plus an additional $1/50^{\text{th}}$ 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.
- 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.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Pension Benefits, Continued

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.

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, 2020 and 2019 were \$28,035 and \$28,320, 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, 2019, for the same measurement date, using the following actuarial assumptions:

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Actuarial Assumptions, Continued

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:	6.74% per year, net of investment expenses	
Inflation:	2.5%	
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% for ages 20 to 39; none all other ages	
Disability:	<u>Age</u>	<u>Disability</u>
	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.	

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

Actuarial Assumptions, Continued

Duty vs Non-duty related disability: 100% Duty related

Refund of Contributions: 80% of terminated vested members elect a refund of contributions

Investment Rate of Return

The long-term expected rate of return on the Bank's investments of 6.74% was determined using log-normal distribution analysis, creating a best-estimate range for each asset class.

As of September 30, 2019, the arithmetic real rates of return for each major investment class are as follows:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Expected Rate of Return</u>
US Large Cap Value Equity	10%	8.70%
US Large Cap Growth Equity	10%	9.13%
International Equity	15%	9.19%
Emerging Markets	10%	12.52%
US Aggregate Fixed Income	35%	3.82%
Global Broad Fixed Income	10%	3.40%
Global REIT	<u>10%</u>	8.33%
	<u>100%</u>	

Discount Rate

The discount rate used to measure the total pension liability was 2.85% at the current measurement date and 4.16% 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 2024 for the 2019 measurement date. For years on or after 2024, a discount rate of 2.81% is used. This rate is based on the Bond Buyer General Obligation 20-year Municipal Bond Index Rate.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(3) Employees' Retirement Plan, Continued

Defined Benefit Plan, Continued

A. General Information About the Pension Plan, Continued:

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, 2019, calculated using the discount rate of 2.85%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1.00% lower (1.85%) or 1.00% higher (3.85%) from the current rate.

<u>1% Decrease 1.85%</u>	<u>Current Single Discount Rate Assumption 2.85%</u>	<u>1% Increase 3.85%</u>
\$ 2,825,797	\$ 2,428,960	\$ 2,100,697

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

Pension Liability. At September 30, 2020 and 2019, the Bank reported a liability of \$2,428,960 and \$1,954,037, 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, 2020 and 2019, the Bank's proportion was 0.7874% and 0.7789%, respectively.

Pension Expense. For the years ended September 30, 2020 and 2019, the Bank recognized pension expense of \$182,720 and \$117,404, respectively.

	<u>2020</u>			
	<u>Salary and Other Benefits</u>	<u>Pension Expense</u>		<u>Total</u>
		<u>Total Contributions</u>	<u>Others</u>	
Personnel and fringe benefits	\$ <u>604,595</u>	\$ <u>28,035</u>	\$ <u>154,685</u>	\$ <u>787,315</u>
	<u>2019</u>			
	<u>Salary and Other Benefits</u>	<u>Pension Expense</u>		<u>Total</u>
		<u>Total Contributions</u>	<u>Others</u>	
Personnel and fringe benefits	\$ <u>589,153</u>	\$ <u>28,320</u>	\$ <u>89,084</u>	\$ <u>706,557</u>

Deferred Outflows and Inflows of Resources. At September 30, 2020 and 2019, the Bank reported total deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(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

Deferred Outflows and Inflows of Resources, Continued

	2020		2019	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 123,522	\$ 94,694	\$ 154,094	\$ 29,179
Change of assumptions	504,087	221,436	174,712	269,715
Net difference between projected and actual earnings on pension plan investments	6,755	5,766	5,562	8,515
The Bank's contributions subsequent to measurement date	28,035	-	28,320	-
Changes in proportion and difference between the Bank's contributions and proportionate share of contributions	<u>140,459</u>	<u>65,434</u>	<u>146,871</u>	<u>106,773</u>
	<u>\$ 802,858</u>	<u>\$ 387,330</u>	<u>\$ 509,559</u>	<u>\$ 414,182</u>

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, 2020 will be recognized in pension expense as follows:

Year ending September 30,

2021	\$ 71,887
2022	\$ 73,453
2023	\$ 74,102
2024	\$ 53,645
2025	\$ 57,613
Thereafter	\$ 56,793

(4) Economic Development Loans and Allowance for Loan Losses

Major classifications of loans receivable as of September 30, 2020 and 2019 are as follows:

	2020	2019
Housing	\$ 16,617,624	\$ 14,039,969
Commercial	10,629,046	9,529,582
Agriculture	1,645,246	1,717,111
Fishing	<u>827,766</u>	<u>457,470</u>
Loans receivable	29,719,682	25,744,132
Less allowance for loan losses	<u>(3,344,356)</u>	<u>(1,409,002)</u>
	<u>\$ 26,375,326</u>	<u>\$ 24,335,130</u>

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

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

Maturities of the above principal balances subsequent to September 30, 2020, will be as follows:

	<u>2020</u>	<u>2019</u>
Fully matured and others	\$ 168,130	\$ 2,803
1 - 6 months	1,331,660	1,231,420
7 - 18 months	2,871,066	2,441,678
19 months - 3 years	3,814,799	3,440,267
After 3 years	<u>21,534,027</u>	<u>18,627,964</u>
	<u>\$ 29,719,682</u>	<u>\$ 25,744,132</u>

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

	<u>2020</u>	<u>2019</u>
Balance - beginning of year	\$ 1,409,002	\$ 1,104,300
Recoveries of loan previously charged-off	137,742	755,468
Provision for (recovery of) loan losses and doubtful accounts	2,507,873	(332,566)
Loans charged-off	<u>(710,261)</u>	<u>(118,200)</u>
Balance - end of year	<u>\$ 3,344,356</u>	<u>\$ 1,409,002</u>

Additionally, in an effort to constructively work with borrowers affected by the COVID-19 pandemic, the Bank initiated temporary programs beginning in March 2020 to allow for deferrals of principal and interest payments from three to twelve months. Loans totaling approximately \$4.35 million were granted temporary payment deferrals under the programs and are not considered to be troubled debt restructuring.

(5) Capital Assets

A summary of capital assets as of September 30, 2020 and 2019, is as follows:

	Estimated <u>Useful Lives</u>	Balance at October <u>1, 2019</u>	<u>Additions</u>	<u>Deletions</u>	Balance at September <u>30, 2020</u>
Depreciable assets:					
Leasehold rights	39 - 50 years	\$ 568,577	\$ 17,263	\$ -	\$ 585,840
Leasehold improvements	5 years	319,227	-	-	319,227
Furniture, fixtures and equipment	2 - 20 years	132,813	5,185	-	137,998
Vehicles	5 years	<u>109,910</u>	<u>-</u>	<u>-</u>	<u>109,910</u>
		1,130,527	22,448	-	1,152,975
Less accumulated depreciation		<u>(447,863)</u>	<u>(42,525)</u>	<u>-</u>	<u>(490,388)</u>
		<u>\$ 682,664</u>	<u>\$ (20,077)</u>	<u>\$ -</u>	<u>\$ 662,587</u>
	Estimated <u>Useful Lives</u>	Balance at October <u>1, 2018</u>	<u>Additions</u>	<u>Deletions</u>	Balance at September <u>30, 2019</u>
Depreciable assets:					
Leasehold rights	39 - 50 years	\$ 524,915	\$ 43,662	\$ -	\$ 568,577
Leasehold improvements	5 years	319,227	-	-	319,227
Furniture, fixtures and equipment	2 - 20 years	133,202	5,205	(5,594)	132,813
Vehicles	5 years	<u>113,110</u>	<u>16,200</u>	<u>(19,400)</u>	<u>109,910</u>
		1,090,454	65,067	(24,994)	1,130,527
Less accumulated depreciation		<u>(428,663)</u>	<u>(44,194)</u>	<u>24,994</u>	<u>(447,863)</u>
		<u>\$ 661,791</u>	<u>\$ 20,873</u>	<u>\$ -</u>	<u>\$ 682,664</u>

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(6) Foreclosed Real Estate

A summary of the changes in foreclosed real estate as of September 30, 2020 and 2019 is as follows:

	<u>2020</u>	<u>2019</u>
Balance at beginning of year	\$ 547,199	\$ 407,199
Additions	-	200,000
Deletions	<u>(200,011)</u>	<u>(60,000)</u>
Balance at end of year	\$ <u>347,188</u>	\$ <u>547,199</u>

Title to foreclosed real estate is in the Bank's name as of September 30, 2020 and 2019. At September 30, 2020, foreclosed real estate excludes certain real properties to which the Bank has obtained de-facto ownership but has not obtained clear legal title (see note 11).

(7) Loans Payable

Direct Borrowings:

Republic of Palau Social Security Retirement Fund

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 was 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 outstanding balance of the loan was \$2,075,322 and \$2,402,787 with interest at 4.5% as of September 30, 2020 and 2019, respectively. The loan is collateralized by the full faith and credit of the ROP Government. Also, the loan contains a provision that in an event of default, and at the option of the Fund, all obligations shall immediately become due and payable without further action of any kind.

Mega International Commercial Bank Co., Ltd. (MICB)

On March 5, 2004, the Bank entered into a loan with MICB (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.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(7) Loans Payable, Continued

Direct Borrowings, Continued:

Mega International Commercial Bank Co., Ltd. (MICB), Continued

The loan agreement contains a provision that in an event of default, the Lender may by written notice to the Bank cancel the loan agreement and/or the entire loan and other sums payable may be declared to become immediately due and payable and the loan and such other sums shall become due and payable without presentment, demand, protest or notice of any kind (other than the notice specifically required by the loan agreement), all of which are hereby expressly waived by the Bank. The outstanding balance is \$1,142,834 and \$1,428,550 at September 30, 2020 and 2019, respectively.

European Investment Bank (EIB)

On December 5, 2006, the Bank entered into an agreement with the EIB to borrow up to 5,000,000 euros, which was 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, 2020 and 2019, 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 loan contains (1) a provision that in an event of default, the timing of repayment of outstanding amounts may become immediately due if: the capital to total assets ratio is not above 20%; nonperforming loans to total loans ratio exceeds 10%; provision for loan losses to nonperforming loans ratio is less than 90%, and (2) a provision that the Bank shall repay the loan or any part thereof, together with accrued interest and other accrued sums immediately, forthwith upon demand by the Lender if:

- a. the Bank fails on due date to repay any part of the loan, to pay interest thereon or to make any other payment to the Lender;
- b. the Bank is unable to pay its debts, or makes or seeks to make a composition with its creditors;
- c. an order is made or an effective resolution is passed for the winding up of the Bank, or the Bank takes steps towards a substantial reduction in its capital, is declared insolvent or ceases or resolves to cease to carry on the whole or any substantial part of its business or activities;
- d. an incumbrancer takes possession of, or a receiver, liquidator, administrator, administrative receiver or similar officer is appointed, whether by a court of competent jurisdiction or by any competent administrative authority or by any person, any part of the business or assets; if any distress, execution, sequestration, or other process is levied or enforced upon the property of the Bank and is not discharged or stayed within 14 days; or if any event occurs which is likely to jeopardize the servicing of the loan or adversely affect any security therefor;

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(7) Loans Payable, Continued

Direct Borrowings, Continued:

European Investment Bank (EIB), Continued

- e. if any other financial indebtedness is either not paid when due, or following any default in relation thereto, is capable of being declared due and payable prior to its scheduled maturity;
- f. if the Bank is liable, by reason of any default, to be required to effect immediate prepayment of any loan granted to it by the lender from the resources of the bank or of the European Community.

The outstanding balance at September 30, 2020 and 2019 is \$435,163 and \$852,921, respectively.

Republic of Palau

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. Interest and principal are 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 loan agreement contains a provision that in an event of default, ROP may, at its option, declare immediately due and payable without presentation, protest or notice of any kind, all of which are hereby waived, the outstanding principal of and interest on the loan and the note and any other sums payable pursuant hereto or pursuant to any loan document, upon happening of monetary default, nonperformance of agreements, representations and warranties in the loan agreement and false statements.

The outstanding balance outstanding at September 30, 2020 and 2019 is \$250,934 and \$397,532, 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 3.07200% and 3.06438% as of September 30, 2020 and 2019, respectively), interest only payable semi-annually until September 30, 2018 with the first semi-annual principal installment of \$142,857 payable on March 31, 2019. Annual expected principal payments are \$285,714. The loan agreement does not contain a provision on acceleration clause in an event of default. The outstanding balance is \$4,428,572 and \$4,714,286 at September 30, 2020 and 2019, respectively.

At September 30, 2020 and 2019, the Bank does not have any unused lines of credit or have any assets pledged as collateral.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(7) Loans Payable, Continued

Direct Borrowings, Continued:

International Cooperation and Development Fund (Taiwan ICDF)

On March 30, 2020, ROP and Taiwan ICDF agreed to implement the Women and Youth Entrepreneurs and Micro and Small and Medium Enterprises Re-lending Project. Taiwan ICDF agreed to provide a long-term loan not exceeding \$5 million to ROP to on-lend the proceeds of the loan to NDBP for project implementation. The loan is uncollateralized and is due on March 2040, with interest based on Libor plus 1% capped at 4% per annum, payable in semi-annual installments as advised by Taiwan ICDF and guaranteed by ROP. Interest is payable semi-annually and commences six months after the drawdown. As of September 30, 2020, NDBP has not received proceeds in relation to the loan.

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2021	\$ 1,492,993	\$ 264,697	\$ 1,757,690
2022	1,032,353	209,330	1,241,683
2023	946,910	174,546	1,121,456
2024	963,867	140,151	1,104,018
2025	896,700	109,259	1,005,959
2026 - 2030	1,428,570	316,573	1,745,143
2031 - 2035	1,428,570	124,719	1,553,289
2036	<u>142,862</u>	<u>1,925</u>	<u>144,787</u>
	<u>\$ 8,332,825</u>	<u>\$ 1,341,200</u>	<u>\$ 9,674,025</u>

Changes in loans payable for the years ended September 30, 2020 and 2019, are as follows:

	Balance October 1, 2019	Additions	Reductions	Balance September 30, 2020	Due Within One Year
Republic of Palau Social Security					
Retirement Fund	\$ 2,402,787	\$ -	\$ (327,465)	\$ 2,075,322	\$ 337,251
ROP Government	5,111,818	-	(432,312)	4,679,506	434,863
Mega International Commercial Bank	1,428,550	-	(285,716)	1,142,834	285,716
European Investment Bank	<u>852,921</u>	<u>-</u>	<u>(417,758)</u>	<u>435,163</u>	<u>435,163</u>
	<u>\$ 9,796,076</u>	<u>\$ -</u>	<u>\$ (1,463,251)</u>	<u>\$ 8,332,825</u>	<u>\$ 1,492,993</u>
	Balance October 1, 2018	Additions	Reductions	Balance September 30, 2019	Due Within One Year
Republic of Palau Social Security					
Retirement Fund	\$ 2,680,142	\$ -	\$ (277,355)	\$ 2,402,787	\$ 359,704
ROP Government	5,541,229	-	(429,411)	5,111,818	432,291
Mega International Commercial Bank	1,714,266	-	(285,716)	1,428,550	285,716
European Investment Bank	<u>1,253,987</u>	<u>-</u>	<u>(401,066)</u>	<u>852,921</u>	<u>417,758</u>
	<u>\$ 11,189,624</u>	<u>\$ -</u>	<u>\$ (1,393,548)</u>	<u>\$ 9,796,076</u>	<u>\$ 1,495,469</u>

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(8) Other Long-Term Liability

Changes in the Bank's other long-term liability for the years ended September 30, 2020 and 2019, are as follows:

	Balance October <u>1, 2019</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2020</u>	Due Within <u>One Year</u>
Net pension liability	\$ <u>1,954,037</u>	\$ <u>474,923</u>	\$ <u>-</u>	\$ <u>2,428,960</u>	\$ <u>-</u>
	Balance October <u>1, 2018</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2019</u>	Due Within <u>One Year</u>
Net pension liability	\$ <u>1,831,279</u>	\$ <u>122,758</u>	\$ <u>-</u>	\$ <u>1,954,037</u>	\$ <u>-</u>

(9) 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 \$934,259 and \$870,405 as of September 30, 2020 and 2019, respectively. Loans receivables from an affiliate amount to \$1,308,684 and \$1,535,133 as of September 30, 2020 and 2019, 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.

On June 12, 2019, RPPL No. 10-36 was passed into law creating the HDLP administered by the National Housing Commission (NHC), financed by MICB through Ministry of Finance (MOF). Palau Housing Authority (PHA) and the Bank are assigned to distribute the proceeds of the loan. On August 28, 2019, NHC, MOF, PHA and the Bank entered into a subsidiary loan agreement. On November 25, 2020, the parties amended the subsidiary loan agreement and agreed to rescind the repayment obligation to MOF in relation to the HDLP. For the year ended September 30, 2020, the Bank received \$5,739,306 capital contribution from ROP for the HDLP fund. As of September 30, 2020, the Bank has disbursed \$2.71 million loans receivables and subsidized \$0.17 million in relation to the HDLP.

Pursuant to RPPL-10-56 (the CROSS Act), ROP and the Bank entered into funding agreement for CROSS Act business loans to be lent to qualified borrowers for loan assistance. Funds provided to the Bank shall not be repayable to ROP. The Bank recognized \$1,500,000 grant revenues for the year ended September 30, 2020 related to the CROSS Act.

(10) Commitments

Loans Approved

At September 30, 2020 and 2019, \$9,457,378 and \$10,537,474, respectively, of approved loans was undisbursed. Of undisbursed loans as of September 30, 2020 and 2019, \$4,918,115 and \$5,717,602, respectively, relate to performance bonds on various construction contracts where the Bank acts as the insurer and \$223,447 and \$98,586, respectively, relate to letters of credit. At September 30, 2020 and 2019, no performance bonds have been called.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(10) Commitments, Continued

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. On May 27, 2011, the lessor accepted the Bank's right, title and interest on a parcel of land with an appraised value of \$73,000, as credit to the lease rent until March 20, 2034. The lease was extended for another forty-nine years expiring on March 19, 2107.

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

Years ending September 30,

2031 - 2035	\$ 14,025
2036 - 2040	34,410
2041 - 2045	34,410
2046 - 2050	34,410
2051 - 2055	34,410
2056 - 2058	<u>17,205</u>
Total future minimum payments	\$ <u>168,870</u>

The premises will be appraised on the 50th and 70th year of the lease and the lease payments may be increased.

(11) 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 eighty-one loans aggregating \$4,050,705 at September 30, 2020. Unpaid interest and subsidies related to the loan guarantees as of September 30, 2020 amounted to \$52,816 and \$971,147, respectively, for which the Bank becomes liable once the borrower defaults and a demand notice is issued. As of September 30, 2020, no demand notice has been received by the Bank.

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.

NATIONAL DEVELOPMENT BANK OF PALAU

Notes to Financial Statements
September 30, 2020 and 2019

(11) Contingencies, Continued

On December 14, 2018, the Bank won the foreclosure of the delinquent borrower's leasehold property thru a credit bid. The land's ownership is uncertain and has ongoing legal proceedings. On May 24, 2019, the Bank entered into a sublease agreement with a related party which is contingent upon the approval of the sublease agreement by the lessor. The parties agreed that upon the final court order to the effect that the lessor is the fee simple owner of the land, the Bank will assign to the related party and the related party will purchase all of the rights, title and interest of the Bank in and to the Lessor Assignment of Lease and the previous assignor for \$1,800,000, deducting all payments made during the lease term. Payment of \$200,000 was received from the affiliate in connection with the sublease agreement and has been recorded as a deduction from foreclosed properties in 2020 and was recognized as a component of recovery of previously charged off loan in 2019 (see note 6). As of September 30, 2020, the sublease approval and final court order has not been obtained.

(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) Risks Related to COVID-19

The spread of novel coronavirus (COVID-19) has been and continues to be a complex and rapidly-evolving situation with governments and businesses imposing restrictions and to varying degrees, bans on travel, limitation on gatherings, closures or operating limitations on certain businesses. The extent to which COVID-19 impacts the Bank will depend on numerous evolving factors that are difficult to predict, including duration and magnitude of its impact on unemployment rates and consumer discretionary spending, demand for travel, transient and group business, and government actions.

COVID-19 and its consequences have dramatically reduced travel and demand for the Bank's business and earnings, which has and will continue to affect the Bank's revenue and probability of collection. In addition, the Bank has increased provision for allowance for loan losses to reflect the risks associated with uncertainty of collections.

NATIONAL DEVELOPMENT BANK OF PALAU

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

	September 30,						
	2019 <u>Valuation</u>	2018 <u>Valuation</u>	2017 <u>Valuation</u>	2016 <u>Valuation</u>	2015 <u>Valuation</u>	2014 <u>Valuation</u>	2013 <u>Valuation</u>
Civil Service Pension Trust Fund (Plan) total net pension liability	\$ 308,480,463	\$ 250,868,784	\$ 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	\$ 2,428,958	\$ 1,954,037	\$ 1,831,279	\$ 1,837,001	\$ 1,630,006	\$ 1,566,428	\$ 1,523,284
The Bank's proportion of the net pension liability	0.787%	0.779%	0.706%	0.736%	0.756%	0.767%	0.837%
The Bank's covered employee payroll**	\$ 470,550	\$ 456,950	\$ 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	516.20%	427.63%	447.75%	470.99%	444.45%	434.56%	435.85%
Plan fiduciary net position as a percentage of the total pension liability	8.26%	10.24%	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,						
	2019 <u>Valuation</u>	2018 <u>Valuation</u>	2017 <u>Valuation</u>	2016 <u>Valuation</u>	2015 <u>Valuation</u>	2014 <u>Valuation</u>	2013 <u>Valuation</u>
Actuarially determined contribution	\$ 110,950	\$ 134,847	\$ 121,283	\$ 106,170	\$ 82,427	\$ 81,456	\$ 84,209
Contribution in relation to the actuarially determined contribution	<u>28,233</u>	<u>27,417</u>	<u>24,540</u>	<u>23,081</u>	<u>21,858</u>	<u>21,226</u>	<u>21,048</u>
Contribution (excess) deficiency	<u>\$ 82,717</u>	<u>\$ 107,430</u>	<u>\$ 96,743</u>	<u>\$ 83,089</u>	<u>\$ 60,569</u>	<u>\$ 60,230</u>	<u>\$ 63,161</u>
The Bank's covered-employee payroll**	<u>\$ 470,550</u>	<u>\$ 456,950</u>	<u>\$ 409,000</u>	<u>\$ 390,026</u>	<u>\$ 366,745</u>	<u>\$ 360,465</u>	<u>\$ 349,499</u>
Contribution as a percentage of covered-employee payroll	6.00%	6.00%	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.