**FINANCIAL STATEMENTS**
**DECEMBER 31, 2019 AND 2018**

**AND**

**SCHEDULE OF APPROPRIATED EXPENDITURES**
**BIENNIUM ENDED JUNE 30, 2019**

BND

Bank *of* North Dakota

**BANK OF NORTH DAKOTA**

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**Independent Auditor's Report**

Governor of North Dakota
and the Legislative Assembly
State of North Dakota
Bismarck, North Dakota

**Report on the Financial Statements**

We have audited the accompanying financial statements of the Bank of North Dakota, an enterprise fund of the State of North Dakota, which comprise the statements of net position as of December 31, 2019 and 2018, and the related statements of revenues, expenses and changes in fund net position and 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 an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 Bank of North Dakota as of December 31, 2019 and 2018, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**Emphasis of Matters**

*Reporting Entity*
As discussed in Note 1, the financial statements of the Bank of North Dakota are intended to present the financial position, the changes in financial position and cash flows of only that portion of the State of North Dakota that is attributable to the transactions of the Bank of North Dakota. They do not purport to, and do not, present fairly the financial position of the State of North Dakota as of December 31, 2019 and 2018 and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

*Financial Statement Presentation*
As discussed in Note 1 to the financial statements, the Bank of North Dakota elected to present an unclassified statement of net position because current assets are not matched with current liabilities. Presentation of a classified statement of net position would give the false impression that there is a liquidity problem at the bank. Presentation of a classified statement of net position for the Bank of North Dakota would be misleading to the extent that the financial statements may be materially misstated.

**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 4–11, the schedule of bank's share of net pension liability and the schedule of bank contributions on page 54 and the schedule of bank's share of net OPEB liability and schedule of bank contributions on page 55 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 Information*
Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The schedule of appropriated expenditures is presented for purposes of additional analysis and is not a required part of the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the audit requirements of Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Costs Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), and is not a required part of the financial statements.

The schedule of appropriated expenditures and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of appropriated expenditures and the schedule of expenditures of federal awards are fairly stated, in all material respects, in relation to the financial statements as a whole.

**Other Reporting Required by *Government Auditing Standards***
In accordance with *Government Auditing Standards*, we have also issued a report dated April 6, 2020 on our consideration of the Bank of North Dakota's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 of North Dakota'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 of North Dakota's internal control over financial reporting and compliance.

Eide Bailly LLP

Bismarck, North Dakota
April 6, 2020

The discussion and analysis which follows provides an overview of the Bank of North Dakota's (Bank) financial performance for the calendar years ended December 31, 2019, 2018 and 2017. Please read it in conjunction with the financial statements of the Bank.

FINANCIAL HIGHLIGHTS:

On an aggregate basis, the loan portfolio decreased by $55,000 or 1.2% to $4,422,000 at December 31, 2019. In 2018, the loan portfolio decreased by $332,000 or 6.9% to $4,477,000. In 2017, the loan portfolio grew by $116,000 or 2.5%.

Total assets increased by $36,000 or 0.5% at December 31, 2019. The increase was primarily attributable to investment purchases. In 2018, total assets increased by $13,000 or 0.2% to $7,002,000. The increase was largely attributable to investment purchases offset by the sale of the federal student loan portfolio. In 2017, total assets decreased by $289,000 or 4.0% to $6,989,000. The decrease was largely attributable to a reduction in the securities portfolio, coupled with an offsetting increase in loan demand.

The tier one leverage ratio is 13.60% compared to 12.48% and 12.05% in the prior two years. The leverage ratio is a measure of strength. Well capitalized per federal regulations requires this percentage to be a minimum of 5%.

REQUIRED FINANCIAL STATEMENTS:

The Bank is an enterprise fund and uses the accrual basis of accounting. The Bank's basic financial statements include the statements of net position, statements of revenues, expenses and changes in fund net position, and statements of cash flows. The statement of net position provides the basis for computing rate of return, evaluating the net position of the Bank and assessing the liquidity and financial flexibility of the Bank. The statements of revenues, expenses and changes in fund net position identify the operating performance of the Bank for the calendar year. The statement of cash flows identifies cash flows from operating activities, non-capital financing activities, capital and related financing activities and investing activities. It also provides answers to such questions as where did the cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

(continued on next page)

**(In Thousands)**

## CONDENSED STATEMENTS OF NET POSITION

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| ASSETS | | | |
| Cash and cash equivalents | **$ 498,374** | $ 509,692 | $ 414,597 |
| Interest receivable | **56,926** | 56,865 | 53,525 |
| Securities | **1,982,467** | 1,853,806 | 1,600,296 |
| FHLB Restricted Stock | **33,659** | 52,539 | 59,316 |
| Loans, net | **4,422,003** | 4,477,449 | 4,809,971 |
| Other assets | **34,979** | 41,198 | 40,332 |
| Capital assets, net | **9,773** | 10,249 | 10,919 |
| Total assets | **7,038,182** | 7,001,798 | 6,988,954 |
| DEFERRED OUTFLOWS OF RESOURCES | **30,462** | 9,592 | 12,273 |
| TOTAL ASSETS AND DEFERRED OUTFLOWS | **$ 7,068,644** | $ 7,011,390 | $ 7,001,227 |
| LIABILITIES | | | |
| Federal funds purchased and repurchase agreements | **$ 365,335** | $ 271,505 | $ 299,775 |
| Non-interest bearing deposits | **628,257** | 567,352 | 555,020 |
| Interest bearing deposits | **4,460,836** | 4,202,467 | 4,049,938 |
| Interest payable | **2,545** | 1,366 | 1,697 |
| Other liabilities | **44,035** | 25,472 | 25,641 |
| Short and long-term debt | **631,030** | 1,103,436 | 1,263,569 |
| Total liabilities | **6,132,037** | 6,171,598 | 6,195,640 |
| DEFERRED INFLOWS OF RESOURCES | **14,628** | 14,022 | 7,418 |
| NET POSITION | | | |
| Invested in capital assets | **9,773** | 10,249 | 10,919 |
| Restricted for pledging purposes | **829,880** | 470,185 | 459,911 |
| Unrestricted | **82,327** | 345,336 | 327,339 |
| Total net position | **921,980** | 825,770 | 798,169 |
| TOTAL LIABILITIES, DEFERRED INFLOWS AND NET POSITION | **$ 7,068,644** | $ 7,011,390 | $ 7,001,227 |

*Securities*

Securities totaled $1,982,000 at December 31, 2019 compared to $1,854,000 at December 31, 2018 and $1,600,000 at December 31, 2017. The increase in 2019 is the result of investment purchases. The increase in 2018 is the result of investment purchases from the proceeds of the federal student loan sale. The majority of the securities portfolio consists of AAA rated U.S. government/agency securities. The primary objective of the securities portfolio is to provide liquidity.

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**(In Thousands)**

*Loans*

On an aggregate basis, the loan portfolio decreased by $55,000, or 1.2% at year-end 2019 from $4,477,000 at year-end 2018 and $4,810,000 at year-end 2017. There are four major categories of loans at the Bank:

Student loans decreased by $6,400 in 2019 compared to a decrease of $221,500 in 2018 and an increase of $28,700 in 2017. In 2019, new student loans totaled $78,100 and new consolidation loans were $42,700. Decreases were from $127,200 in loan payments including loans paid in full through consolidation. In 2018, new student loans totaled $83,700 and new consolidation loans were $48,500. Decreases were from $245,700 in federal student loan sales and $108,000 in loan payments including loans paid in full through consolidation. In 2017, new student loans totaled $86,000 and new consolidation loans were $91,700. Decreases were from $149,000 in loan payments including loans paid in full through consolidation.

Residential loans decreased by $66,300 in 2019, decreased by $67,900 in 2018, and increased by $23,000 in 2017. In 2018, the Bank sold $26,500 in residential loans. New and refinanced loans made in 2019, 2018, and 2017 totaled $24,400, $47,700, and $121,600, respectively, while normal loan payments and refinancing payoffs were $90,700, $89,100, and $98,600, respectively.

Commercial loans increased by $38,800 in 2019, decreased by $32,100 in 2018, and increased by $89,300 in 2017.

Farm loans decreased by $18,600 in 2019, decreased by $3,200 in 2018 and decreased by $18,600 in 2017.

*Loan Delinquencies and Allowance for Credit Losses*

When the collectability of any loan becomes uncertain due to delinquency, the financial condition of the borrower, or other factors which cause the Bank to deem itself unsecured, the loan is considered nonperforming and interest is no longer accrued on the loan.

The allowance for credit losses are established by charges to income and are decreased by loans charged off, net of recoveries. Adequacy of the allowance is determined by the credit quality of outstanding loans, which are assigned specific ratings commensurate with risk on a case-by-case basis. Management currently reviews the allowance for credit losses for adequacy on a monthly basis. As of December 31, 2019, 37% of the overall loan portfolio is federally or state guaranteed compared to 37% at December 31, 2018 and 40% at December 31, 2017.

The following sets forth certain information with respect to the Bank's loan loss experience:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| Gross loans at end of year | **$ 4,517,693** | $ 4,570,199 | $ 4,894,928 |
| Allowance for credit losses | | | |
| Balance, beginning of year | **$ 92,750** | $ 84,958 | $ 78,747 |
| Provision charged to operations | **6,000** | 12,000 | 12,000 |
| Loans charged off | **(4,697)** | (6,157) | (6,584) |
| Recoveries | **1,637** | 1,949 | 795 |
| Balance, end of year | **$ 95,690** | $ 92,750 | $ 84,958 |

(continued on next page)

**(In Thousands)**

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| Net loan charge-offs to total loans at the end of period | **0.07%** | 0.09% | 0.12% |
| Net loan charge-offs to non-guaranteed loans at the end of period | **0.11%** | 0.15% | 0.20% |
| Allowance at end of period to total loans at end of period | **2.12%** | 2.03% | 1.86% |
| Allowance at end of period to non-guaranteed loans at the end of period | **3.36%** | 3.25% | 3.13% |

*Capital Assets*

Bank of North Dakota had $9,800 in bank premises, equipment, and software at year-end 2019, $10,200 at year-end 2018, and $10,900 at year-end 2017. Capital expenditures totaled $147 in 2019 compared to $143 in 2018 and $300 in 2017. This year's expenditures were mainly related to software purchases. (See Note 7 to the financial statements.)

*Deposits*

Noninterest bearing deposits are $628,300 at December 31, 2019 compared to $567,400 at December 31, 2018 and $555,000 at December 31, 2017. Noninterest bearing deposits are primarily related to the amount of check clearing activities of respondent banks. Interest-bearing deposits totaled $4,461,000 at December 31, 2019 compared to $4,202,000 at December 31, 2018 and $4,050,000 at December 31, 2017. This fluctuation is due to state deposits and the economic status of the state.

*Short-Term Borrowings*

Short-term borrowings are from North Dakota financial institutions investing in overnight federal funds at the Bank, customer investments in repurchase agreements with the Bank and overnight borrowings from the Federal Home Loan Bank (FHLB). Short-term borrowings were $790,300 at December 31, 2019 comprised of $425,000 in FHLB borrowings and $365,300 in federal funds. Borrowings were $948,500 at December 31, 2018 comprised of $677,000 in FHLB borrowings and $271,500 in federal funds. Borrowings were $1,100,000 at December 31, 2017 comprised of $800,000 in FHLB borrowings and $300,000 in federal funds.

*Long-Term Debt*

FHLB long-term debt is $206,000 at December 31, 2019 compared to $426,400 at December 31, 2018 and $463,400 at December 31, 2017. FHLB long-term debt is one funding source utilized to fund long-term fixed rate loans. (See Note 10 to the financial statements.)

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*Net Position*

The Bank has a tier one capital leverage ratio of 13.60%, 12.48%, and 12.05% as of December 31, 2019, 2018, and 2017, respectively. The leverage ratio is a measure of strength. Well capitalized per federal regulations requires this percentage to be a minimum of 5%. The total net position of the Bank is affected by several factors, some of which are external to the Bank's operations. The State Legislature, representing the ownership interest in the Bank, makes transfers to the State's General Fund or other programs. By statute, however, in no event is the Bank's net position to be reduced below $175,000.

*Asset/Liability Management - Interest Rate Risk*

The Bank's principal objective for interest rate risk management is to control exposure of net interest income to risks associated with interest rate movements. Interest rate risk is measured and reported to the Bank's Funds Management Committee through the use of traditional gap analysis which measures the difference between assets and liabilities that reprice in a given time period, and simulation modeling which produces projections of net interest income under various interest rate scenarios and statement of net position strategies.

It is the Bank's policy to maintain a low interest rate risk position by monitoring the amount of forecasted net interest income at risk over a 12-month and 24-month period assuming several interest rate scenarios. Forecasted results are sensitive to many assumptions, including estimates of the timing of changes in rates which are determined by reference to market indices, such as prime or the Treasury market curve, relative to each other and relative to rates which are determined by the Bank subject to competitive factors.

*Liquidity Management*

The objective of liquidity management is to ensure the continuous availability of funds to meet the demands of depositors and borrowers. The Bank's Funds Management Committee, within its Funds Management Policy, establishes contingency funding guidelines that seek to provide sufficient funding sources to meet these demands while achieving the Bank's financial objectives. The committee meets regularly to review the Bank's liquidity position, taking into consideration available funding sources, current and forecasted loan demand and projected investment balances.

(continued on next page)

**(In Thousands)**

**CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION**

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| INTEREST INCOME | **$ 255,950** | $ 244,456 | $ 214,875 |
| INTEREST EXPENSE | **58,515** | 46,441 | 37,865 |
| NET INTEREST INCOME | **197,434** | 198,015 | 177,010 |
| Provision for credit losses | **6,000** | 12,000 | 12,000 |
| NET INTEREST INCOME AFTER PROVISION | **191,434** | 186,015 | 165,010 |
| Noninterest income | **23,352** | 2,228 | 3,292 |
| Noninterest expense | **38,467** | 32,028 | 33,116 |
| INCOME BEFORE TRANSFERS | **176,319** | 156,215 | 135,186 |
| TRANSFERS OUT | **(80,109)** | (128,614) | (186,932) |
| CHANGE IN NET POSITION | **96,210** | 27,601 | (51,746) |
| NET POSITION - BEGINNING | **825,770** | 798,169 | 849,915 |
| NET POSITION - ENDING | **$ 921,980** | $ 825,770 | $ 798,169 |

*Earnings Summary*

The Bank's income before transfers was $176,300 in 2019 compared to $156,200 in 2018 and $135,200 in 2017.

*Net Interest Income*

Results of operations are primarily dependent upon the level of net interest income, which is affected by the mix of earning assets (loans, securities, and federal funds sold) and the interest rates earned thereon; and the amount of interest-bearing liabilities (deposits, federal funds purchased and other funds borrowed) on which interest is paid and the rates of interest paid thereon. Net interest income decreased $600 from 2018 to 2019, and increased $21,000 from 2017 to 2018.

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**(In Thousands)**

The following table shows the average rates earned and paid for 2019, 2018, and 2017:

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| Annualized average interest rate earned | | | |
| Federal funds sold | **2.48%** | 2.02% | 1.23% |
| Securities | **2.63%** | 2.15% | 1.70% |
| Loans | **4.66%** | 4.36% | 3.94% |
| Weighted average interest rates earned | **3.95%** | 3.67% | 3.27% |
| Annualized average interest rate paid | | | |
| Deposits | **0.60%** | 0.37% | 0.25% |
| Federal funds purchased and repurchase agreements | **2.14%** | 1.73% | 0.96% |
| Short and long-term debt | **2.76%** | 2.77% | 2.23% |
| Weighted average interest rates paid | **1.06%** | 0.85% | 0.68% |
| Net interest spread | **2.89%** | 2.82% | 2.59% |
| Net interest margin | **3.07%** | 2.95% | 2.71% |

*Provision for Credit Losses*

The provision for credit losses was $6,000 in 2019, $12,000 in 2018, and $12,000 in 2017. The Bank continually evaluates its allowance for credit loss position and any additional provision that would be needed.

*Noninterest Income*

Overall, noninterest income increased by $21,100 in 2019 and decreased by $1,100 in 2018. The main drivers in the fluctuation of noninterest income are changes in the fair value of securities as well as amortization and accretion of securities.

*Noninterest Expense*

Noninterest expense increased by $6,400 in 2019 and decreased by $1,100 in 2018. Noninterest expense includes salaries and benefits, occupancy and equipment, data processing, and other operating expenses.

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ECONOMIC CONDITION AND OUTLOOK

In October of 2019, Standard and Poor's published a ratings report for the Bank, in which the Bank received a credit rating of "A+" and "A-1" for long-term and short-term credit, respectively. The report noted the long and stable history of the Bank, very strong capital ratios, high loan credit quality, and conservative management as major rating factors.

As reported on previous pages, the Bank's capital position is as strong as it has ever been with a tier one capital leverage ratio of 13.60%, much higher than the "well capitalized" threshold of 5% as defined by federal banking regulations.

CONTACTING BANK OF NORTH DAKOTA'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Bank's finances and to demonstrate the Bank's accountability for the money it receives. If you have any questions about this report or need additional financial information, you can contact Bank of North Dakota by mail at P.O. Box 5509, Bismarck, North Dakota 58506-5509. If you wish to visit the Bank for information, the physical address is 1200 Memorial Hwy, Bismarck, ND 58504.

**BANK OF NORTH DAKOTA**
**STATEMENTS OF NET POSITION**
**DECEMBER 31, 2019 AND 2018**
**(In Thousands)**

| | **2019** | 2018 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | | |
| Restricted | **$ 67,501** | $ 54,506 |
| Unrestricted | **420,188** | 415,721 |
| Federal funds sold | **10,685** | 39,465 |
| Cash and cash equivalents | **498,374** | 509,692 |
| Interest receivable | | |
| Due from other funds | **254** | 835 |
| Other | **56,672** | 56,030 |
| | **56,926** | 56,865 |
| Securities | **1,982,467** | 1,853,806 |
| Federal Home Loan Bank restricted stock | **33,659** | 52,539 |
| Loans held for investment | | |
| Restricted | **1,359,720** | 1,466,515 |
| Unrestricted | **3,157,973** | 3,103,684 |
| Less allowance for credit losses | **(95,690)** | (92,750) |
| | **4,422,003** | 4,477,449 |
| Other assets | | |
| Due from other funds | **9,910** | 10,893 |
| Other | **25,068** | 30,305 |
| | **34,979** | 41,198 |
| Capital assets | | |
| Land | **2,449** | 2,449 |
| Building and equipment, net | **7,111** | 7,358 |
| Intangibles, net | **213** | 442 |
| | **9,773** | 10,249 |
| Total assets | **7,038,182** | 7,001,798 |
| DEFERRED OUTFLOWS OF RESOURCES | **30,462** | 9,592 |
| TOTAL ASSETS AND DEFERRED OUTFLOWS | **$ 7,068,644** | $ 7,011,390 |

| | 2019 | 2018 |
|---|---|---|
| LIABILITIES | | |
| Federal funds purchased | **$ 365,335** | $ 271,505 |
| Deposits | | |
| Non-interest bearing | **536,513** | 487,531 |
| Non-interest bearing - of other funds | **91,743** | 79,821 |
| Interest bearing | **207,158** | 235,207 |
| Interest bearing - of other funds | **4,253,677** | 3,967,260 |
| | **5,089,092** | 4,769,819 |
| Interest payable | | |
| Due to other funds | **2,203** | 1,079 |
| Other | **342** | 287 |
| | **2,545** | 1,366 |
| Other liabilities | | |
| Due to other funds | **155** | 161 |
| Net pension and OPEB liability | **12,845** | 17,962 |
| Other | **31,035** | 7,349 |
| | **44,035** | 25,472 |
| Short and long-term debt | | |
| Current portion | **445,020** | 445,020 |
| Long-term portion | **186,010** | 658,416 |
| | **631,030** | 1,103,436 |
| Total liabilities | **6,132,037** | 6,171,598 |
| DEFERRED INFLOWS OF RESOURCES | **14,628** | 14,022 |
| NET POSITION | | |
| Invested in capital assets | **9,773** | 10,249 |
| Restricted for pledging purposes | **829,880** | 470,185 |
| Unrestricted | **82,327** | 345,336 |
| Total net position | **921,980** | 825,770 |
| TOTAL LIABILITIES, DEFERRED INFLOWS AND NET POSITION | **$ 7,068,644** | $ 7,011,390 |

# BANK OF NORTH DAKOTA
## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
## YEARS ENDED DECEMBER 31, 2019 AND 2018
## (In Thousands)

| | 2019 | 2018 |
|---|---|---|
| INTEREST INCOME | | |
| Federal funds sold | **$ 584** | $ 1,091 |
| Securities | **53,010** | 44,464 |
| Loans | **202,356** | 198,901 |
| Total interest income | **255,950** | 244,456 |
| INTEREST EXPENSE | | |
| Deposits | **28,349** | 17,341 |
| Federal funds purchased and repurchase agreements | **6,417** | 4,705 |
| Short and long-term debt | **23,749** | 24,395 |
| Total interest expense | **58,515** | 46,441 |
| NET INTEREST INCOME | **197,434** | 198,015 |
| PROVISION FOR CREDIT LOSSES | **6,000** | 12,000 |
| NET INTEREST AFTER PROVISION FOR CREDIT LOSSES | **191,434** | 186,015 |
| NONINTEREST INCOME | | |
| Service fees and other | **6,847** | 7,170 |
| Net decrease in the fair value of securities | **16,505** | (4,942) |
| Total noninterest income | **23,352** | 2,228 |
| NONINTEREST EXPENSE | | |
| Salaries and benefits | **18,802** | 18,933 |
| Data processing | **5,488** | 5,253 |
| Occupancy and equipment | **728** | 932 |
| Long-term debt prepayment fee | **6,352** | - |
| Other operating expenses | **7,098** | 6,909 |
| Total noninterest expenses | **38,467** | 32,028 |
| INCOME BEFORE TRANSFERS | **176,319** | 156,215 |
| TRANSFERS OUT | **(80,109)** | (128,614) |
| CHANGE IN NET POSITION | **96,210** | 27,601 |
| TOTAL NET POSITION - BEGINNING OF YEAR | **825,770** | 798,169 |
| TOTAL NET POSITION - END OF YEAR | **$ 921,980** | $ 825,770 |

# BANK OF NORTH DAKOTA
## STATEMENTS OF CASH FLOWS
## YEARS ENDED DECEMBER 31, 2019 AND 2018
## (In Thousands)

| | 2019 | 2018 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Receipt of service fees and other income from other funds | **$ 2,494** | $ 2,130 |
| Receipt of service fees and other income from other entities | **2,047** | 8,194 |
| Payment of salaries and benefits | **(17,418)** | (15,472) |
| Payment of data processing expenses | **(5,060)** | (5,015) |
| Payment of occupancy and equipment | **(377)** | (512) |
| Payment of other operating expenses | **(6,717)** | (10,736) |
| NET CASH USED FOR OPERATING ACTIVITIES | **(25,031)** | (21,411) |
| NON-CAPITAL FINANCING ACTIVITIES | | |
| Net increase in non-interest bearing deposits | **60,904** | 12,332 |
| Net increase in interest bearing deposits | **258,369** | 152,529 |
| Interest payments on deposits | **(27,189)** | (16,948) |
| Net increase (decrease) in federal fund purchased and repurchase agreements | **93,830** | (28,270) |
| Interest payments on federal funds purchased and repurchase agreements | **(6,461)** | (4,692) |
| Proceeds from issuance of short and long-term debt | **6,330,775** | 6,377,000 |
| Payment of short and long-term debt | **(6,803,181)** | (6,537,133) |
| Interest payments on short and long-term debt | **(30,041)** | (25,128) |
| Payment of transfers | **(80,109)** | (128,614) |
| NET CASH USED FOR NON-CAPITAL FINANCING ACTIVITIES | **(203,103)** | (198,924) |
| CAPITAL AND RELATED FINANCING ACTIVITY | | |
| Purchases of capital assets | **(147)** | (143) |
| INVESTING ACTIVITIES | | |
| Securities available for sale transactions | | |
| Purchase of securities | **(1,047,971)** | (861,167) |
| Proceeds from sales, maturities, and principal repayments | **935,746** | 603,033 |
| Purchase of Federal Home Loan Bank stock | **(248,815)** | (250,080) |
| Sale of Federal Home Loan Bank stock | **267,695** | 256,857 |
| Purchase of other venture capital assets | **(234)** | (1,787) |
| Sale of other venture capital assets | **6,632** | 712 |
| Investment income received | **53,763** | 42,910 |
| Proceeds from sales of loans | **-** | 283,647 |
| Net decrease in loans | **35,178** | 36,204 |
| Loan income received | **208,441** | 197,991 |
| Payments from rebuilders loan program | **963** | 3,394 |
| Proceeds from sale of other real estate and property owned | **5,565** | 3,859 |
| NET CASH FROM INVESTING ACTIVITIES | **216,963** | 315,573 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | **(11,318)** | 95,095 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | **509,692** | 414,597 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | **$ 498,374** | $ 509,692 |

See Notes to Financial Statements

## STATEMENT OF CASH FLOWS – PAGE 2

| | | |
|---|---|---|
| RECONCILIATION OF INCOME BEFORE OPERATING TRANSFERS TO NET CASH USED FOR OPERATING ACTIVITIES | | |
| Income before operating transfers | **$ 176,319** | $ 156,215 |
| Adjustments to reconcile income before operating transfers to net cash used for operating activities | | |
| Depreciation and amortization | **623** | 813 |
| Provision for credit losses | **6,000** | 12,000 |
| Gain on sale of loans | **-** | (1,620) |
| Gain on sale of other real estate and property owned | **(2,264)** | (705) |
| Net (increase) decrease in the fair value of securities | **(16,505)** | 4,942 |
| Reclassification of interest income and expense to other activities | **(197,434)** | (198,015) |
| (Increase) decrease in other assets | **5,237** | (4,174) |
| Decrease in due from other funds | **982** | 3,308 |
| (Increase) decrease in deferred outflows | **(20,870)** | 2,680 |
| Decrease in due to other funds | **(6)** | (4) |
| Increase (decrease) in other liabilities | **22,281** | (3,455) |
| Increase in deferred inflows | **606** | 6,604 |
| NET CASH USED FOR OPERATING ACTIVITIES | **$ (25,031)** | $ (21,411) |
| | | |
| SUPPLEMENTAL SCHEDULE OF NON-CASH TRANSACTIONS | | |
| Transfers from net position | **$ 80,109** | $ 128,614 |

## NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

*Nature of Operations*

Bank of North Dakota (BND) is owned and operated by the State of North Dakota under the supervision of the Industrial Commission as provided by Chapter 6-09 of the North Dakota Century Code. BND is a unique institution combining elements of banking, fiduciary, investment management services, and other financial services, and state government with a primary role in financing economic development. BND is a participation lender; the vast majority of its loans are purchased from financial institutions throughout the State of North Dakota. BND's primary deposit products are interest-bearing accounts for state and political subdivisions.

*Reporting Entity*

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 61, *The Financial Reporting Entity: Omnibus*, Bank of North Dakota should include all component units over which the Bank of North Dakota exercises such aspects as (1) appointing a voting majority of an organization's governing body and (2) has the ability to impose its will on that organization or (3) the potential for the organization to provide specific financial benefits to, or impose specific burdens on, the Bank.

Based on that criteria, no organizations were determined to be part of the reporting entity. The Bank of North Dakota is included as part of the primary government of the State of North Dakota's reporting entity.

*Accounting Standards*

The Bank follows the pronouncements of the Governmental Accounting Standards Board, which is the nationally accepted standard setting body for establishing generally accepted accounting principles for governmental entities.

GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments,* requires assets and liabilities of enterprise funds be presented in a classified format to distinguish between current and long-term assets and liabilities. The Bank of North Dakota is the only government-owned bank in the United States. Banks do not present a classified statement of net position because current assets are not matched with current liabilities. Presentation of a classified statement of net position would give the false impression that there is a liquidity problem at the Bank. Presentation of a classified statement of net position for the Bank of North Dakota would be misleading to the extent that the financial statements may be materially misstated. Therefore, the statement of net position of Bank of North Dakota presents assets and liabilities in order of their relative liquidity, rather than in a classified format.

The Bank's Statements of Revenues, Expenses and Changes in Fund Net Position are presented in a format consistent with industry practice for financial institutions. Operating revenues are those revenues that are generated from the primary operations of the Bank, which include interest and noninterest income. Operating expenses are those expenses that are essential to the primary operations of the Bank, which include interest and noninterest expenses. All other revenues and expenses are reported as non-operating.

*Fund Accounting*

The Bank is an enterprise fund and uses the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

(continued on next page)

*Basis of Accounting and Measurement Focus*

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All enterprise funds are accounted for using the economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of these funds are included on the statement of net position. Net position is segregated into (1) net invested in capital assets, (2) restricted (distinguishing between major categories of restrictions) and (3) unrestricted. The statements of revenues, expenses and changes in fund net position present increases (e.g., revenues) and decreases (e.g., expenses) in total net position. The statements of cash flows present the cash flows for operating activities, non-capital financing activities, capital and related financing activities, and investing activities.

*Use of Estimates*

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of net position and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for credit losses and the fair value of interest rate swaps.

*Significant Group Concentrations of Credit Risk*

Most of the Bank's lending activities are with customers within the state of North Dakota. The Bank's loan portfolio is comprised of the following concentrations as of December 31, 2019 and 2018:

| | **2019** | 2018 |
|---|---|---|
| Commercial loans, of which 1% and 2% are federally guaranteed | **46%** | 45% |
| Student loans, of which 100% and 99% are guaranteed | **26%** | 26% |
| Residential loans, of which 66% and 68% are federally guaranteed | **14%** | 15% |
| Agricultural loans, of which 5% and 4% are federally guaranteed | **14%** | 14% |
| | **100%** | 100% |

*Cash and Cash Equivalents*

For purposes of the statements of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold, all with original maturities of three months or less.

*Securities*

Investments in debt and equity securities are carried at fair value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*. Unrealized gains and losses due to fluctuations in fair value are included in noninterest income. Gains and losses on the sale of securities are recorded on the trade date in noninterest income and are determined using the specific identification method.

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*Federal Home Loan Bank Stock*

In order to borrow from the Federal Home Loan Bank (FHLB), the Bank is required to hold FHLB stock. The amount of stock that the Bank must hold is equal to .12% of total bank assets plus 4% of total FHLB advances. Since ownership of this stock is restricted, the stock is carried at cost and evaluated periodically for impairment. The FHLB stock is pledged on the FHLB advances (Note 10).

*Loans Held For Sale*

Loans held for sale are carried at the lower of aggregate cost or market value. Gains or losses on sale of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold. Loans held for sale are not carried at fair value because they do not meet the definition of an investment in accordance with GASB 72.

*Loans*

Loans are reported at the outstanding unpaid principal balances, adjusted for charge-offs and premiums or discounts on purchased loans. Interest income on loans is accrued at the specific rate on the unpaid principal balance. Discounts and premiums are amortized to income over the estimated life of the loan using the interest or straight line method. Loans are not carried at fair value because they do not meet the definition of an investment in accordance with GASB 72.

The accrual of interest is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income. Future payments are generally applied against principal until the loan balance is at zero. Any further payments are then recorded as interest income on the cash basis. Loans can be returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

*Allowance for Credit Losses*

The Bank uses the allowance method in providing for credit losses. Accordingly, the allowance is increased by the current year's provision for credit losses charged to operations and reduced by net charge-offs. Credit losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The adequacy of the allowance for credit losses and the provision for credit losses charged to operations are based on management's evaluation of a number of factors, including recent credit loss experience, continuous evaluation of the loan portfolio quality, current and anticipated economic conditions, and other pertinent factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and amount of the shortfall in relation to the principal and interest owed.

Impairment is measured on a loan-by-loan basis for commercial, agricultural, farm real estate, state institution and bank stock loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual guaranteed student and residential loans for impairment disclosures, except for such loans that are placed on nonaccrual.

*Loan Charge-Offs*

Loans are generally fully or partially charged down to the fair value of collateral securing the asset when:

- An unsecured loan that has principal or interest 120 or more days past due.
- A loan secured by a commercial real estate mortgage, farm real estate mortgage, conventional real estate mortgage, or by other than real property that has principal or interest 120 or more days past due.
- A loan classified as a "loss" by the North Dakota Department of Financial Institutions.
- A loan where there is a recognized loss in conjunction with the acquisition of real estate by the Bank.
- A loan where the Bank deems itself insecure due to the financial condition of the borrower.
- A loan or portion of a loan has been forgiven.

*Credit Related Financial Instruments*

In the ordinary course of business, the Bank has entered into commitments to extend credit and financial standby letters of credit. Such financial instruments are recorded when they are funded.

*Transfers of Financial Assets*

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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*Deferred Outflows/Inflows of Resources*

In addition to assets, the statement of net position reports a separate section of 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(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. In addition to liabilities, the statement of net position reports 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(s) and so will not be recognized as an inflow of resources (revenue) until that time. See Note 11 for additional information.

*Capital Assets*

Capital assets, which include intangibles (software), are stated at cost less accumulated depreciation or amortization. Capital assets with a purchase price of $5 (for software that is internally developed, the threshold is $50) or more are capitalized and reported in the accompanying financial statements. Depreciation and amortization are provided over the estimated useful lives of the individual assets using the straight-line method.

*Foreclosed Assets*

Foreclosed assets, which are included in other assets, represent assets acquired through loan foreclosure or other proceedings. Foreclosed assets are recorded at the lower of the amount of the loan or fair market value of the assets. Any write-down to fair market value at the time of the transfer to foreclosed assets is charged to the allowance for credit losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and change in the valuation allowance are included in other operating expenses. Foreclosed assets totaled $8,903 and $4,152 as of December 31, 2019 and 2018, respectively.

*Compensated Absences Payable*

Annual Leave: Bank employees accrue vested annual leave at a variable rate based on years of service. The amount of annual leave earned ranges between 1 and 2 days per month, and is fixed by the employing unit per section 56-06-14 of the North Dakota Century Code. Accrued annual leave cannot exceed 30 days at April 30 of each year. Employees are paid for unused annual leave upon termination or retirement.

Sick Leave: Bank employees accrue sick leave at the rate of one working day per month of employment without limitation on the amount that can be accumulated. Per North Dakota Century Code section 54-06-14, employees vest at 10 years of continuous service at which time the Bank is liable for 10 percent of the employee's accumulated unused sick leave.

The Bank's liability for accumulated unpaid annual leave and sick leave is reported in other liabilities and will be funded by the Bank's appropriation when the liability is to be liquidated. The net change in the liability is recorded in salaries and benefits.

*Pensions*

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the North Dakota Public Employees Retirement System (NDPERS) and additions to/deductions from NDPERS' fiduciary net position have been determined on the same basis as they are reported by NDPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

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*Other Postemployment Benefits (OPEB)*

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of the North Dakota Public Employees Retirement System (NDPERS) and additions to/deductions from NDPERS' fiduciary net position have been determined on the same basis as they are reported by NDPERS. For this purpose, benefit payments are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

*Restricted Assets and Restricted Net Position*

Certain Bank assets and net position carry a restricted classification because they are pledged on short and long-term debt, securities sold under agreements to repurchase and other required pledging purposes. If an expense is incurred that qualifies for use of either restricted or unrestricted resources, the Bank will first apply restricted resources.

*Interest Rate Swaps*

The Bank enters into interest rate swap agreements to modify interest rates on certain liabilities. The fair values of both hedging derivatives and investment derivatives (if any) are presented on the Statement of Net Position, either as a derivative liability (negative fair value) or as a derivative asset (positive fair value). The change in the total fair value of derivatives that are determined to be effective hedges is recorded as a deferred inflow or outflow of resources on the Statement of Net Position. If a derivative were determined to be an ineffective hedge, it would be classified as an investment derivative, and the change in the total fair value would be presented as part of investment earnings. The Bank currently has one type of derivative outstanding, interest rate swaps which are deemed effective hedges, therefore having no effect on net position.

*Income Taxes*

Bank of North Dakota is a governmental agency of the State of North Dakota and, as such, is not subject to federal or state income taxes.

## NOTE 2 - RESTRICTION ON CASH AND DUE FROM BANKS

Federal Reserve Board regulations require the Bank to maintain reserve balances with the Federal Reserve Bank. The average reserve balances maintained at the Federal Reserve Bank were approximately $62,347 in 2019 and $73,917 in 2018.

## NOTE 3 - DEPOSITS AND INVESTMENTS

*Deposits*

The Bank has depository relationships where it is a requirement of the other institution to have a business relationship. On other significant depository relationships, the Bank requires the depository financial institution to have a minimum short-term rating of A-1 or P-1 as established by the rating agency.

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Bank will not be able to recover deposits that are in the possession of an outside party. The Bank does not have a formal policy that limits custodial credit risk for deposits. All of the Bank's deposits are insured up to $250,000 with the Federal Deposit Insurance Company except for deposits at the Federal Reserve Bank and the Federal Home Loan Bank. The remaining deposits with these financial institutions are uncollateralized.

The following summary presents the amount of the Bank's deposits as of December 31, 2019 and 2018:

(continued on next page)

| | | **2019** | | 2018 |
|---|---|---|---|---|
| Covered by depository insurance | | | | |
| Due from banks | **$** | **1,538** | $ | 799 |
| Uncollateralized | | | | |
| Due from banks | | **186,053** | | 155,813 |
| Federal funds sold | | **10,685** | | 39,465 |
| Total bank balances | **$** | **198,276** | $ | 196,077 |

*Investments*

The Bank's investment policy provides guidelines for security custody, approved security dealers, investment authority, variance from the approved investment selection and purchase process, required investment data to be obtained and maintained, investment guidelines, investment management parameters, investment intent, and federal funds management.

The Bank's investment policy indicates that the Bank is authorized to own the following types of securities: U.S. Treasury securities, Federal agency securities, mortgaged-backed securities, collateralized mortgage obligations, corporate securities, asset-backed securities, state and municipal securities, money market securities, and capital stock of government sponsored agencies.

The composition of the investment portfolio, related credit quality rating (based on Moody's Investors Service), custody, and duration as of December 31, 2019 is provided below:

| | Rating | Custody | Duration (In Years) | **2019** |
|---|---|---|---|---|
| Mortgage-backed | **Aaa** | **(1) & (2)** | **3.02** | **$ 1,026,777** |
| Federal agency | **Aaa** | **(1) & (2)** | **2.47** | **954,690** |
| State and municipal | **Not rated** | **(2) & (3)** | **9.00** | **1,000** |
| | | | | **$ 1,982,467** |

The composition of the investment portfolio, related credit quality rating (based on Moody's Investors Service), custody, and duration as of December 31, 2018 is provided below:

| | Rating | Custody | Duration (In Years) | 2018 |
|---|---|---|---|---|
| Mortgage-backed | Aaa | (1) & (2) | 2.14 | 671,001 |
| Federal agency | Aaa | (1) & (2) | 2.58 | 1,181,805 |
| State and municipal | Not rated | (2) & (3) | 11.94 | 1,000 |
| | | | | $ 1,853,806 |

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Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Bank will not be able to recover the value of the investment that is in the possession of an outside party. The Bank does not have a formal policy that limits custodial credit risk for investments. The Bank is not exposed to any custodial credit risk for its investment portfolio. Custody of investments indicated above is as follows:

(1) These are fed-book entry securities.
(2) These are held by a DTC correspondent.
(3) Registered in the name of the Bank and held in the Bank's vault.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Bank's investment policy provides for a duration range of one to four years which will serve to decrease interest rate risk. The duration for the Bank's investments is provided in the table provided above using the modified duration method. The average duration for the Bank's entire investment portfolio was 2.8 years and 2.4 years as of December 31, 2019 and 2018, respectively.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Concentration of credit risk for investments is the risk of loss attributed to the magnitude of the Bank's investment in a single issuer. The Bank's investment policy provides the following minimum credit quality ratings for its investments and the following asset allocation range for investments as a percentage of the total portfolio:

| | Minimum Credit Quality Ratings | | Asset Allocation Range | |
|---|---|---|---|---|
| | Moody's | S & P | Minimum | Maximum |
| U.S. Treasury securities | Aaa | AAA | 0% | 100% |
| Federal agency securities | Aaa | AAA | 0% | 100% |
| Step-up agency securities | Aaa | AAA | 0% | 20% |
| Agency Mortgaged-backed securities | Aaa | AAA | 0% | 75% |
| Agency collateralized mortgage obligations | Aaa | AAA | 0% | 50% |
| Non-agency collateralized mortgage obligations | Aaa | AAA | 0% | 20% |
| Corporate securities | A2 | A | 0% | 20% |
| Municipal obligations | None | None | 0% | 20% |
| Money market securities | P1 | A1 | 0% | 20% |

(continued on next page) 

Investments in any one issuer that represent 5% or more of total investments as of December 31, 2019 and 2018, are as follows:

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Amount** | **Percent** | Amount | Percent |
| Federal agency | | | | |
| Federal Home Loan Bank | **$ 244,471** | **12.3%** | $ 353,171 | 19.1% |
| Small Business Administration | **221,472** | **11.2%** | 269,264 | 14.5% |
| Farm Credit | **346,450** | **17.5%** | 267,650 | 14.4% |
| Freddie Mac | **30,079** | **1.5%** | 165,635 | 8.9% |
| Fannie Mae | **65,192** | **3.3%** | 79,707 | 4.3% |
| Mortgage-backed | | | | |
| Fannie Mae | **626,574** | **31.6%** | 344,003 | 18.6% |
| Freddie Mac | **391,742** | **19.8%** | 313,416 | 16.9% |
| Others less than 5% | **56,487** | **2.8%** | 60,960 | 3.3% |
| | **$ 1,982,467** | **100.0%** | $ 1,853,806 | 100.0% |

There were no securities pledged as of December 31, 2019 and 2018 for repurchase agreements. There were $905,554 and $435,162 of securities pledged as of December 31, 2019 and 2018, respectively, for other required pledging purposes.

The maturity distribution of debt securities at December 31, 2019, is shown below. The distribution of mortgage-backed securities is based on average expected maturities. Actual maturities may differ because issuers may have the right to call or prepay obligations.

| | |
|---|---|
| Within one year | $ 358,849 |
| Over one year through five years | 1,334,742 |
| Over five years through ten years | 210,403 |
| Over ten years | 78,473 |
| | $ 1,982,467 |

For the years ended December 31, 2019 and 2018, proceeds from the sales of securities amounted to $0 and $25,522, respectively.

## NOTE 4 - INTERFUND TRANSACTIONS

The Bank, because of its unique relationship with the State of North Dakota, is a party in many business transactions with other entities of state government. All state funds and funds of all state penal, education, and industrial institutions must be deposited in the Bank under state law. These transactions are a normal part of bank business and, accordingly, are included in the Bank's financial statements.

See Note 6 for disclosure relating to loans sold to other state funds and/or loans serviced for other state funds, including the North Dakota Student Loan Trust.

Dakota Education Alternative Loans are fully guaranteed by the North Dakota Guaranteed Student Loan Program, which is administered by the Bank. The outstanding principal balance of these loans was $1,163,196 and $1,169,613 at December 31, 2019 and 2018, respectively. Administrative fees paid by the Bank to the North Dakota Guaranteed Student Loan Program were $8,503 and $5,537 for the years ended December 31, 2019 and 2018.

(continued on next page)

In the ordinary course of business, the Bank holds loans and deposits of principal officers and directors and their affiliates. Outstanding principal balances of these loans held by the Bank at December 31, 2019 and 2018 amounted to $31,123 and $27,646, respectively. Deposits and short term borrowings held by the Bank were $5,232 and $4,995.

The Bank also made transfers to the Rebuilders Loan Program to fund loans to owners of homes damaged in the 2011 floods. These funds will be repaid to the Bank as payments are received from the borrowers. At year end December 31, 2019 and 2018, the Bank had a receivable resulting from these transfers for $9,325 and $10,288, respectively.

LOANS AND INTEREST RECEIVABLE – DUE FROM OTHER FUNDS – See NOTE 5

| | **2019** | 2018 |
|---|---|---|
| OTHER ASSETS - Due from other funds (accounts receivable - current, unless noted otherwise) | | |
| Rebuilders Loan Program ($7,555 and $8,410 non-current in 2019 and 2018) | **$ 9,324** | $ 10,288 |
| North Dakota Guaranteed Student Loan Program | **15** | 126 |
| Community Water Facility Loan Fund | **25** | 27 |
| Department of Human Services | **5** | 6 |
| Information Technology Department | **5** | 6 |
| Board of University and School Lands | **49** | 39 |
| School Construction Assistance Revolving Loan Fund | **287** | 226 |
| Medical Facility Infrastructure Loan Program | **56** | 57 |
| State Water Commission | **28** | 29 |
| Infrastructure Revolving Fund | **116** | 89 |
| | **$ 9,910** | $ 10,893 |
| OTHER LIABILITIES - Due to other funds (trade accounts payable - all current) | | |
| Information Technology Department | **$ 145** | $ 145 |
| Attorney General | **10** | 10 |
| North Dakota Guaranteed Student Loan Program | **-** | 6 |
| | **$ 155** | $ 161 |
| OPERATING TRANSFERS - Out | | |
| General Fund | **$ 35,000** | $ 70,000 |
| Infrastructure Revolving Loan Fund | **8,000** | 40,000 |
| PACE Fund | **13,450** | 11,850 |
| School Construction Buydown | **356** | 3,461 |
| Beginning Farmer Revolving Loan Fund | **4,700** | 2,750 |
| Ag PACE Fund | **1,250** | 500 |
| Industrial Commission | **53** | 53 |
| ND Development Fund | **15,000** | - |
| Department of Agriculture | **2,000** | - |
| ND University System | **200** | - |
| Innovation Loan Fund | **100** | - |
| | **$ 80,109** | $ 128,614 |
| COMPONENT UNITS OF THE STATE OF NORTH DAKOTA | | |
| LONG TERM DEBT | | |
| NDPFA (to fund irrigation and waste management loans - $30 and $31 current in 2019 and 2018) | **$ 30** | $ 61 |
| INTEREST PAYABLE (NDPFA - all current) | **$ 0** | $ 1 |

(continued on next page)

## NOTE 5 - LOANS

The composition of the loan portfolio at December 31, 2019 and 2018 is as follows:

| | **2019** | 2018 |
|---|---|---|
| Commercial | **$ 2,079,032** | $ 2,040,257 |
| Student | **1,163,234** | 1,169,656 |
| Residential loans | **628,319** | 694,577 |
| Agricultural | **647,108** | 665,709 |
| | **4,517,693** | 4,570,199 |
| Allowance for credit losses | **(95,690)** | (92,750) |
| | **$ 4,422,003** | $ 4,477,449 |
| Current portion | **$ 852,400** | $ 698,557 |

Net unamortized loan premiums and discounts on residential loans totaled $725 and $904 as of December 31, 2019 and 2018, respectively.

In the normal course of business, overdrafts of deposit accounts are reclassified as loans. There were no overdrafts of deposit accounts at December 31, 2019 and 2018.

The composition of State Institution loans at December 31, 2019 and 2018 is as follows:

| | **2019** | | 2018 | |
|---|---|---|---|---|
| | **Principal** | **Interest** | Principal | Interest |
| Mill and Elevator (annual operating) | **$ 46,509** | **$ 7** | $ 52,000 | $ 156 |
| Office of the Adjutant General | **13,362** | **241** | 14,778 | 623 |
| Williston State College | **2,176** | **6** | 2,225 | 4 |
| State Water Commission | **-** | **-** | 36,672 | 8 |
| | **$ 62,047** | **$ 254** | $ 105,675 | $ 791 |
| Current portion | **$ 62,047** | **$ 254** | $ 69,003 | $ 791 |

(continued on next page)

Management has an established methodology to determine the adequacy of the allowance for credit losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for credit losses, the Bank has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, agricultural, residential real estate, and student loans. The Bank also sub-segments the commercial and agricultural segments into classes based on the associated risks within those segments. Commercial loans are divided into three classes: commercial participations, bank stock, and all other business loans (including PACE). Agricultural loans are also divided into three classes: farm & ranch, farm real estate, and all other farm loans. Each class of loan exercises significant judgment to determine the estimation method that fits the credit risk characteristics of its portfolio segment.

The adequacy of the allowance for credit losses and the provision for credit losses charged to operations are based on management's evaluation of a number of factors, including recent credit loss experience, continuous evaluation of the loan portfolio quality, current and anticipated economic conditions, and other pertinent factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Changes in the allowance for credit losses and the related provision expense can materially affect net income.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The total allowance reflects management's estimate of credit losses inherent in the loan portfolio at the statement of net position date. The Bank considers the allowance for credit losses of $95,690 and $92,750 adequate to cover loan losses inherent in the loan portfolio at December 31, 2019 and 2018. The following tables represent, by portfolio segment, the changes in the allowance for credit losses and the recorded investment in loans.

| | **2019** | | | | |
|---|---|---|---|---|---|
| | **Commercial** | **Agricultural** | **Residential** | **Student** | **TOTAL** |
| Beginning Balance: | **$ 72,618** | **$ 16,984** | **$ 3,105** | **$ 43** | **$ 92,750** |
| Charge-offs | **(4,317)** | **-** | **(334)** | **(46)** | **(4,697)** |
| Recoveries | **1,635** | **-** | **-** | **2** | **1,637** |
| Provision | **6,208** | **(273)** | **27** | **38** | **6,000** |
| Ending Balance | **$ 76,144** | **$ 16,711** | **$ 2,798** | **$ 37** | **$ 95,690** |

| | 2018 | | | | |
|---|---|---|---|---|---|
| | Commercial | Agricultural | Residential | Student | TOTAL |
| Beginning Balance: | $ 65,712 | $ 16,395 | $ 2,490 | $ 361 | $ 84,958 |
| Charge-offs | (5,977) | - | (131) | (49) | (6,157) |
| Recoveries | 1,944 | 1 | 2 | 2 | 1,949 |
| Provision | 10,939 | 588 | 744 | (271) | 12,000 |
| Ending Balance | $ 72,618 | $ 16,984 | $ 3,105 | $ 43 | $ 92,750 |

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Management considers a loan to be impaired when, based on current information and events, it is determined that the Bank will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

A loan which meets any of the following criteria must be placed in a non-accrual status:

- The following loans on which the principal and interest is 90 or more days past due: Unsecured loans, loans secured by other than real property, loans secured by a mortgage on commercial real estate, loans secured by a farm real estate mortgage, loans secured by a conventional residential real estate mortgage.
- A loan where the borrower has filed for bankruptcy or where the lead bank or the Bank deems itself insecure due to the financial condition of the borrower.
- A loan which the North Dakota Department of Financial Institutions recommends to be placed in a non-accrual status.

A loan which meets the criteria for non-accrual status may be retained in accrual status if it is (1) guaranteed or insured by the state or federal government or secured by collateral with a fair market value sufficient to discharge the outstanding principal and interest and (2) in the process of collection supported by a document source of collection.

A loan which has been placed in a non-accrual status may be returned to an accrual status only if principal and interest are no longer due and unpaid and if current principal and interest appear to be collectable. In addition, the loan must either be secured by collateral with a fair market value sufficient to discharge the outstanding principal and interest or the borrower must demonstrate through a documented repayment plan the ability to discharge the outstanding principal and interest.

The Bank's loan portfolio also includes certain loans that have been modified in a Trouble Debt Restructuring (TDR), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Bank's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

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When the Bank modifies a loan, management evaluates any possible impairment based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases management uses the current fair value of the collateral, less selling costs, instead of discounted cash flows. If management determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized by segment or class of loan, as applicable, through an allowance estimate or a charge-off to the allowance. Segment and class status is determined by the loan's classification at origination.

## NOTE 6 - LOAN SALES AND LOAN SERVICING

A summary of the Bank's loan sales during 2019 and 2018 follows:

| | **2019** | 2018 |
|---|---|---|
| Student loans sold on the secondary market | **$ -** | $ 245,663 |
| Residential loans sold on the secondary market | **-** | 28,905 |
| | **-** | 274,568 |

BND had no loan sales in 2019. The Bank recognized gains on sale of loans of $1,620 in 2018 which are included in noninterest income on the Statements of Revenues, Expenses and Changes in Fund Net Position.

The Bank has contracts to provide servicing of loans for others. These loans are not included in the accompanying statement of net position. The unpaid principal balances of loans serviced for others as of December 31, 2019 and 2018 were as follows:

| | **2019** | 2018 |
|---|---|---|
| Student loans | | |
| North Dakota Student Loan Trust | **$ 894** | $ 1,033 |
| Residential loans | | |
| Fannie Mae | **42,477** | 44,523 |
| Other state fund loans | | |
| School Construction Assistance Revolving Loan Fund | **233,578** | 188,000 |
| Western Area Water | **74,500** | 74,500 |
| Infrastructure Revolving Loan Fund | **96,320** | 77,896 |
| Medical Facility Infrastructure Loan Fund | **44,714** | 45,836 |
| Rebuilders Loan Program | **24,985** | 28,152 |
| State Water Commission | **23,124** | 24,137 |
| Community Water Facility Loan Fund | **20,116** | 21,344 |
| Board of University and School Lands | **10,415** | 13,560 |
| Information Technology Department | **4,247** | 4,753 |
| Department of Human Services | **4,246** | 4,622 |
| Addiction Counseling Internship Loan Program | **110** | 123 |
| Workforce Safety | **84** | 93 |
| | **$ 579,810** | $ 528,572 |

Under existing student loan servicing agreements, the Bank generally agrees to reimburse lenders for all principal, accrued interest and special allowance which the lender has been denied if the denial resulted from the actions or inactions of the Bank. Under the existing residential loan servicing agreement with Fannie Mae, the Bank will indemnify Fannie Mae and hold them harmless against all losses, damages, judgments or legal expenses that result from the Bank's failure in any way to perform its services and duties.

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## NOTE 7 - CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2019 is as follows:

| | Balance 2018 | Additions | Retirements | Balance 2019 |
|---|---|---|---|---|
| Capital assets not being depreciated: | | | | |
| Land | **$ 2,449** | **$ -** | **$ -** | **$ 2,449** |
| Capital assets being depreciated: | | | | |
| Building | **$ 10,317** | **$ -** | **$ -** | **$ 10,317** |
| Equipment | **731** | **86** | **85** | **732** |
| Furniture | **777** | **33** | **7** | **803** |
| Hardware | **173** | **-** | **6** | **167** |
| Intangibles - software | **6,243** | **28** | **542** | **5,729** |
| | **18,241** | **147** | **640** | **17,748** |
| Less accumulated depreciation for | | | | |
| Building | **3,122** | **270** | **-** | **3,392** |
| Equipment | **665** | **69** | **85** | **649** |
| Furniture | **694** | **12** | **7** | **699** |
| Hardware | **159** | **16** | **6** | **169** |
| Intangibles - software | **5,801** | **257** | **542** | **5,516** |
| Total accumulated depreciation | **10,441** | **624** | **640** | **10,425** |
| Capital assets being depreciated, net | **$ 7,800** | **$ (477)** | **$ -** | **$ 7,323** |

Depreciation and amortization expense on the above assets amounted to $624 in 2019.

Capital asset activity for the year ended December 31, 2018 is as follows:

| | Balance 2017 | Additions | Retirements | Balance 2018 |
|---|---|---|---|---|
| Capital assets not being depreciated: | | | | |
| Land | $ 2,449 | $ - | $ - | $ 2,449 |
| Capital assets being depreciated: | | | | |
| Building | $ 10,317 | $ - | $ - | $ 10,317 |
| Equipment | 736 | 22 | 27 | 731 |
| Furniture | 777 | - | - | 777 |
| Hardware | 173 | - | - | 173 |
| Intangibles - software | 6,122 | 121 | - | 6,243 |
| | 18,125 | 143 | 27 | 18,241 |
| Less accumulated depreciation for | | | | |
| Building | 2,852 | 270 | - | 3,122 |
| Equipment | 585 | 107 | 27 | 665 |
| Furniture | 651 | 43 | - | 694 |
| Hardware | 127 | 32 | - | 159 |
| Intangibles - software | 5,440 | 361 | - | 5,801 |
| Total accumulated depreciation | 9,655 | 813 | 27 | 10,441 |
| Capital assets, net | $ 8,470 | $ (670) | $ - | $ 7,800 |

Depreciation and amortization expense on the above assets amounted to $813 in 2018.

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## NOTE 8 - DEPOSITS

At December 31, 2019, the scheduled maturities of certificates of deposits are as follows:

| | | |
|---|---|---|
| One year or less | $ | 2,661,796 |
| One to three years | | 86,333 |
| Over three years | | 111,371 |
| | $ | 2,859,500 |

## NOTE 9 - FEDERAL FUNDS PURCHASED AND REPURCHASE AGREEMENTS

| | **December 31, 2019** | |
|---|---|---|
| | Federal Funds Purchased | Repurchase Agreements |
| Ending balance | **$ 365,335** | **$ -** |
| Highest month-end balance | **396,820** | **-** |
| Average daily balance | **299,382** | **3** |
| Interest rate as of year-end | **1.500%** | **0.00%** |
| Weighted average interest rate paid during year | **2.140%** | **3.04%** |

| | December 31, 2018 | |
|---|---|---|
| | Federal Funds Purchased | Repurchase Agreements |
| Ending balance | $ 271,505 | $ - |
| Highest month-end balance | 462,695 | - |
| Average daily balance | 272,206 | 3 |
| Interest rate as of year-end | 2.375% | 0.00% |
| Weighted average interest rate paid during year | 1.730% | 2.61% |

The purpose of federal funds purchased and repurchase agreements is to provide continuous short-term investments for the Bank's customers. A schedule disclosing the increases and decreases of federal funds purchased and repurchase agreements has not been provided since this information would not provide any useful information to the users of the financial statements.

Federal funds purchased generally mature the day following the date of purchase. The Bank enters into repurchase agreements, which are a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying agreements to repurchase normally exceeds the cash received, providing the dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the Bank or provide securities or cash of equal value, the Bank would suffer an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. There was no credit exposure as of December 31, 2019 and 2018 because the dealer did not take control of the securities. The Bank had not incurred any losses on these agreements in 2019 and 2018. All sales of investments under agreements to repurchase are for fixed terms. In investing the proceeds of agreements to repurchase, the Bank policy is for the term to maturity of the investment to be the same as the term of the agreement to repurchase. Such matching existed at year-end.

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## NOTE 10 - SHORT AND LONG-TERM LIBILITIES

Activity for short and long-term liabilities for the year ended December 31, 2019 was as follows:

| | Balance 2018 | Additions | Reductions | Balance 2019 | Amounts Due Within One Year |
|---|---|---|---|---|---|
| SHORT AND LONG-TERM LIABILITIES | | | | | |
| Federal Home Loan Bank advances | **$1,103,375** | **$ 6,330,775** | **$ 6,803,150** | **$ 631,000** | **$ 444,990** |
| ND Public Finance Authority | **61** | **-** | **31** | **30** | **30** |
| Compensated absences | **1,223** | **816** | **814** | **1,225** | **1,030** |
| Total long-term liabilities | **$1,104,659** | **$ 6,331,591** | **$ 6,803,995** | **$ 632,255** | **$ 446,050** |

Activity for short and long-term liabilities for the year ended December 31, 2018 was as follows:

| | Balance 2017 | Additions | Reductions | Balance 2018 | Amounts Due Within One Year |
|---|---|---|---|---|---|
| SHORT AND LONG-TERM LIABILITIES | | | | | |
| Federal Home Loan Bank advances | $ 1,263,449 | $ 6,377,001 | $ 6,537,075 | $ 1,103,375 | $ 444,989 |
| ND Public Finance Authority | 120 | - | 59 | 61 | 31 |
| Compensated absences | 1,175 | 1,241 | 1,193 | 1,223 | 1,181 |
| Total long-term liabilities | $ 1,264,744 | $ 6,378,242 | $ 6,538,327 | $ 1,104,659 | $ 446,201 |

As of December 31, 2019, a summary, by years, of future minimum payments required to amortize the outstanding short and long-term debt is as follows:

| | Principal | Interest | Total |
|---|---|---|---|
| 2020 | $ 445,020 | $ 5,444 | $ 450,464 |
| 2021 | 78,010 | 4,591 | 82,601 |
| 2022 | 53,000 | 1,922 | 54,922 |
| 2023 | 40,000 | 763 | 40,763 |
| 2024 | 15,000 | 102 | 15,102 |
| Totals | $ 631,030 | $ 12,822 | $ 643,852 |

The FHLB long-term advances outstanding at December 31, 2019, mature from February 2020 through March 2024. The FHLB long-term advances have fixed rate interest, ranging from 1.61% to 5.56%. The advances must be secured by minimum qualifying collateral maintenance levels. Residential, student, agriculture, and commercial loans with carrying values of $1,359,720 and $1,466,515 at December 31, 2019 and 2018, respectively, are currently being used as security to meet these minimum levels.

The ND Public Finance Authority long-term borrowing is unsecured. Proceeds from the long-term borrowings are used to make irrigation and livestock waste program loans at Bank of North Dakota.

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## NOTE 11 - DEFERRED OUTFLOWS AND INFLOWS OF RESOURCES

Deferred Outflows of Resources and Deferred Inflows of Resources are grouped into one line item on the face of the financial statements. Details as of December 31, 2019 and 2018 are provided as follows:

| | 2019 | 2018 |
|---|---|---|
| Deferred Outflows of Resources | | |
| Unrealized loss on interest rate swap | $ 24,839 | $ 2,545 |
| Derived from pension | 5,438 | 6,889 |
| Derived from other postemployment benefits | 185 | 158 |
| | $ 30,462 | $ 9,592 |
| Deferred Inflows of Resources | | |
| Unrealized gain on interest rate swaps | $ 8,381 | $ 12,846 |
| Derived from pension | 6,200 | 1,115 |
| Derived from other postemployment benefits | 47 | 61 |
| | $ 14,628 | $ 14,022 |

Notes 12, 13 and 16 of the financial statements contain details of the pension plan, other postemployment benefits, and interest rate swaps, respectively.

## NOTE 12 - PENSION PLAN

*North Dakota Public Employees Retirement System (Main System)*

The following brief description of NDPERS is provided for general information purposes only. Participants should refer to NDCC Chapter 54-52 for more complete information.

NDPERS is a cost-sharing multiple-employer defined benefit pension plan that covers substantially all employees of the State of North Dakota, its agencies and various participating political subdivisions. NDPERS provides for pension, death and disability benefits. The cost to administer the plan is financed through the contributions and investment earnings of the plan.

Responsibility for administration of the NDPERS defined benefit pension plan is assigned to a Board comprised of nine members. The Board consists of a Chairman, who is appointed by the Governor; one member appointed by the Attorney General; one member appointed by the State Health Officer; three members elected by the active membership of the NDPERS system, one member elected by the retired public employees, and two members of the legislative assembly appointed by the chairman of the legislative management.

*Pension Benefits*

Benefits are set by statute. NDPERS has no provisions or policies with respect to automatic and ad hoc post-retirement benefit increases. Members of the Main System are entitled to unreduced monthly pension benefits beginning when the sum of age and years of credited service equal or exceed 85 (Rule of 85), or at normal retirement age (65). For members hired on or after January 1, 2016 the Rule of 85 will be replaced with the Rule of 90 with a minimum age of 60. The monthly pension benefit is equal to 2.00% of their average monthly salary, using the highest 36 months out of the last 180 months of service, for each year of service. For members hired on or after January 1, 2020, the 2.00% multiplier was replaced with a 1.75% multiplier. The plan permits early retirement at ages 55-64 with three or more years of service.

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Members may elect to receive the pension benefits in the form of a single life, joint and survivor, term-certain annuity, or partial lump sum with ongoing annuity. Members may elect to receive the value of their accumulated contributions, plus interest, as a lump sum distribution upon retirement or termination, or they may elect to receive their benefits in the form of an annuity. For each member electing an annuity, total payment will not be less than the members' accumulated contributions plus interest.

*Death and Disability Benefits*

Death and disability benefits are set by statute. If an active member dies with less than three years of service for the Main System, a death benefit equal to the value of the member's accumulated contributions, plus interest, is paid to the member's beneficiary. If the member has earned more than three years of credited service for the Main System, the surviving spouse will be entitled to a single payment refund, life-time monthly payments in an amount equal to 50% of the member's accrued normal retirement benefit, or monthly payments in an amount equal to the member's accrued 100% Joint and Survivor retirement benefit if the member had reached normal retirement age prior to date of death. If the surviving spouse dies before the member's accumulated pension benefits are paid, the balance will be payable to the surviving spouse's designated beneficiary.

Eligible members who become totally disabled after a minimum of 180 days of service, receive monthly disability benefits equal to 25% of their final average salary with a minimum benefit of $100. To qualify under this section, the member has to become disabled during the period of eligible employment and apply for benefits within one year of termination. The definition for disabled is set by the NDPERS in the North Dakota Administrative Code.

*Refunds of Member Account Balance*

Upon termination, if a member of the Main System is not vested (is not 65 or does not have three years of service), they will receive the accumulated member contributions and vested employer contributions, plus interest, or may elect to receive this amount at a later date. If the member has vested, they have the option of applying for a refund or can remain as a terminated vested participant. If a member terminated and withdrew their accumulated member contribution and is subsequently reemployed, they have the option of repurchasing their previous service.

*Member and Employer Contributions*

Member and employer contributions paid to NDPERS are set by statute and are established as a percent of salaries and wages. Member contribution rates are 7% and employer contribution rates are 7.12% of covered compensation.

The member's account balance includes the vested employer contributions equal to the member's contributions to an eligible deferred compensation plan. The minimum member contribution is $25 and the maximum may not exceed the following:

- 1 to 12 months of service – Greater of one percent of monthly salary or $25
- 13 to 24 months of service – Greater of two percent of monthly salary or $25
- 25 to 36 months of service – Greater of three percent of monthly salary or $25
- Longer than 36 months of service – Greater of four percent of monthly salary or $25

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

At December 31, 2019 and 2018, the Bank reported a liability of $12,031 and $17,152, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2019 and 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Bank's proportion of the net pension liability was based on the Bank's share of covered payroll in the Main System pension plan relative to the covered payroll of all participating Main System employers. At June 30, 2019, the Bank's portion was 1.026477 percent. At June 30, 2018, the Bank's portion was 1.016377 percent.

For the years ended December 31, 2019 and 2018 the Bank recognized pension expense of $2,828 and $3,488, respectively. At December 31, 2019 and 2018, the Bank reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | **2019** | |
|---|---|---|
| | Deferred Outflows of Resources | Deferred Inflows of Resources |
| Differences between expected and actual experience | **$ 7** | **$ 2,183** |
| Changes of assumptions | **4,496** | **3,860** |
| Net difference between projected and actual earnings on pension plan investments | **210** | **-** |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | **307** | **157** |
| Employer contributions subsequent to the measurement date (see below) | **418** | **-** |
| | **$ 5,438** | **$ 6,200** |

The employer contributions subsequent to the measurement date of $418 reported as deferred outflows of resources relate to Bank contributions subsequent to the measurement date and will be recognized as a reduction of the net pension liability in the year ended December 31, 2020.

| | 2018 | |
|---|---|---|
| | Deferred Outflows of Resources | Deferred Inflows of Resources |
| Differences between expected and actual experience | $ 45 | $ 584 |
| Changes of assumptions | 6,192 | 245 |
| Net difference between projected and actual earnings on pension plan investments | - | 83 |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | 236 | 203 |
| Employer contributions subsequent to the measurement date (see below) | 416 | - |
| | $ 6,889 | $ 1,115 |

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The employer contributions subsequent to the measurement date of $416 reported as deferred outflows of resources relate to Bank contributions subsequent to the measurement date and were recognized as a reduction of the net pension liability in the year ended December 31, 2019.

Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

| | | |
|---|---|---|
| Year ended December 31: | | |
| 2020 | $ | 464 |
| 2021 | | 186 |
| 2022 | | (409) |
| 2023 | | (1,086) |
| 2024 | | (335) |
| Thereafter | | - |

*Actuarial Assumptions*

The total pension liability in the July 1, 2019 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation 2.50%

| Salary Increases | Service at Beginning of Year | State Employee | Non-State Employee |
|---|---|---|---|
| | 0 | 12.00% | 15.00% |
| | 1 | 9.50% | 10.00% |
| | 2 | 7.25% | 8.00% |
| | Age* | | |
| | Under 30 | 7.25% | 10.00% |
| | 30-39 | 6.50% | 7.50% |
| | 40-49 | 6.25% | 6.75% |
| | 50-59 | 5.75% | 6.50% |
| | 60+ | 5.00% | 5.25% |

*Age-based salary increase rates apply for employees with three or more years of service

Investment rate of return 7.50%, net of investment expenses
Cost-of-living adjustments None

For active members, inactive members and healthy retirees, mortality rates were based on the RP-2000 Combined Healthy Mortality Table set back two years for males and three years for females, projected generationally using the SSA 2014 Intermediate Cost scale from 2014. For disabled retirees, mortality rates were based on the RP-2000 Disabled Mortality Table set back one year for males (no setback for females) multiplied by 125%.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the Fund's target asset allocation are summarized in the following table:

(continued on next page)

| Asset Class | Target Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Domestic Equity | 30% | 6.30% |
| International Equity | 21% | 6.93% |
| Private Equity | 7% | 10.15% |
| Domestic Fixed Income | 23% | 2.11% |
| Global Real Assets | 19% | 5.41% |
| Cash Equivalents | 0% | 0.25% |

*Discount Rate*

For PERS, GASB Statement No. 67 includes a specific requirement for the discount rate that is used for the purpose of the measurement of the Total Pension Liability. This rate considers the ability of the System to meet benefit obligations in the future. To make this determination, employer contributions, employee contributions, benefit payments, expenses and investment returns are projected into the future. The current employer and employee fixed rate contributions are assumed to be made in each future year. The Plan Net Position (assets) in future years can then be determined and compared to its obligation to make benefit payments in those years. In years where assets are not projected to be sufficient to meet benefit payments, which is the case for the PERS plan, the use of a municipal bond rate is required.

The Single Discount Rate (SDR) is equivalent to applying these two rates to the benefits that are projected to be paid during the different time periods. The SDR reflects (1) the long-term expected rate of return on pension plan investments (during the period in which the fiduciary net position is projected to be sufficient to pay benefits) and (2) a tax-exempt municipal bond rate based on an index of 20-year general obligation bonds with an average AA credit rating as of the measurement date (to the extent that the contributions for use with the long-term expected rate of return are not met).

For the purpose of this valuation, the expected rate of return on pension plan investments is 7.50%; the municipal bond rate is 3.13%; and the resulting Single Discount Rate is 7.50%.

*Sensitivity of the Bank's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate*

The following presents the Bank's proportionate share of the net pension liability calculated using the discount rate of 7.50 percent, as well as what the Bank's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.50 percent) or 1-percentage-point higher (8.50 percent) than the current rate:

| | 1% Decrease (6.50%) | Current Discount Rate (7.50%) | 1% Increase (8.50%) |
|---|---|---|---|
| Bank's proportionate share of the net pension liability | $ 17,250 | $ 12,031 | $ 7,646 |

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*Pension Plan Fiduciary Net Position*

Detailed information about the pension plan's fiduciary net position is available in the separately issued NDPERS financial report. NDPERS issues a publicly available financial statement that includes financial statements and the required supplementary information for NDPERS. That report may be obtained by writing to NDPERS; 400 East Broadway, Suite 505; PO Box 1657; Bismarck, ND 58502-1657.

## NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS (OPEB)

*North Dakota Public Employees Retirement System*

The following brief description of NDPERS is provided for general information purposes only. Participants should refer to NDAC Chapter 71-06 for more complete information.

NDPERS OPEB plan is a cost-sharing multiple-employer defined benefit OPEB plan that covers members receiving retirement benefits from the PERS, the HPRS, and Judges retired under Chapter 27-17 of the North Dakota Century Code a credit toward their monthly health insurance premium under the state health plan based upon the member's years of credited service. Effective July 1, 2015, the credit is also available to apply towards monthly premiums under the state dental, vision and long-term care plan and any other health insurance plan. The Retiree Health Insurance Credit Fund is advance-funded on an actuarially determined basis.

Responsibility for administration of the NDPERS defined benefit OPEB plan is assigned to a Board comprised of nine members. The Board consists of a Chairman, who is appointed by the Governor; one member appointed by the Attorney General; one member appointed by the State Health Officer; three members elected by the active membership of the NDPERS system, one member elected by the retired public employees and two members of the legislative assembly appointed by the chairman of the legislative management.

*OPEB Benefits*

The employer contribution for the PERS, the HPRS and the Defined Contribution Plan is set by statute at 1.14% of covered compensation. The employer contribution for employees of the state board of career and technical education is 2.99% of covered compensation for a period of eight years ending October 1, 2015. Employees participating in the retirement plan as part-time/temporary members are required to contribute 1.14% of their covered compensation to the Retiree Health Insurance Credit Fund. Employees purchasing previous service credit are also required to make an employee contribution to the Fund. The benefit amount applied each year is shown as *"prefunded credit applied"* on the Statement of Changes in Plan Net Position for the OPEB trust funds. Beginning January 1, 2020, members first enrolled in the NDPERS Main System and the Defined Contribution Plan on or after that date will not be eligible to participate in RHIC. Therefore, RHIC will become for the most part a closed plan. There were no other benefit changes during the year.

Retiree health insurance credit benefits and death and disability benefits are set by statute. There are no provisions or policies with respect to automatic and ad hoc post-retirement benefit increases. Employees who are receiving monthly retirement benefits from the PERS, the HPRS, the Defined Contribution Plan, the Chapter 27-17 judges or an employee receiving disability benefits, or the spouse of a deceased annuitant receiving a surviving spouse benefit or if the member selected a joint and survivor option are eligible to receive a credit toward their monthly health insurance premium under the state health plan.

Effective July 1, 2015, the credit is also available to apply towards monthly premiums under the state dental, vision and long-term care plan and any other health insurance plan. The benefits are equal to $5.00 for each of the employee's, or deceased employee's years of credited service not to exceed the premium in effect for selected coverage. The retiree health insurance credit is also available for early retirement with reduced benefits.

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*OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB*

At December 31, 2019 and 2018, the Bank reported a liability of $814 and $810, respectively, for its proportionate share of the net OPEB liability. The net OPEB liability was measured at June 30, 2019 and 2018, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date. The Bank's proportion of the net OPEB liability was based on the Bank's share of covered payroll in the OPEB plan relative to the covered payroll of all participating OPEB employers. At June 30, 2019, the Bank's proportion was 1.013680 percent. At June 30, 2018, the Bank's proportion was 1.028534 percent.

For the years ended December 31, 2019 and 2018, the Bank recognized OPEB expense of $97 and $106, respectively. At December 31, 2019 and 2018, the Bank reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

| | **2019** | |
|---|---|---|
| | Deferred Outflows of Resources | Deferred Inflows of Resources |
| Differences between expected and actual experience | **$ 20** | **$ 25** |
| Changes of assumptions | **97** | **-** |
| Net difference between projected and actual earnings on OPEB plan investments | **1** | **-** |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | **-** | **22** |
| Employer contributions subsequent to the measurement date (see below) | **67** | **-** |
| | **$ 185** | **$ 47** |

The employer contributions subsequent to the measurement date of $67 reported as deferred outflows of resources relate to Bank contributions subsequent to the measurement date and will be recognized as a reduction of the net OPEB liability in the year ended December 31, 2020.

| | 2018 | |
|---|---|---|
| | Deferred Outflows of Resources | Deferred Inflows of Resources |
| Differences between expected and actual experience | $ 24 | $ 17 |
| Changes of assumptions | 67 | - |
| Net difference between projected and actual earnings on pension plan investments | - | 17 |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | - | 27 |
| Employer contributions subsequent to the measurement date (see below) | 67 | - |
| | $ 158 | $ 61 |

The employer contributions subsequent to the measurement date of $67 reported as deferred outflows of resources relate to Bank contributions subsequent to the measurement date and were recognized as a reduction of the net OPEB liability in the year ended December 31, 2019.

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Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEBs will be recognized in OPEB expense as follows:

| Year ended December 31: | | |
|---|---|---|
| 2020 | $ | 10 |
| 2021 | | 10 |
| 2022 | | 18 |
| 2023 | | 17 |
| 2024 | | 9 |
| 2025 | | 5 |
| Thereafter | | 2 |

*Actuarial Assumptions*

The total OPEB liability in the July 1, 2019 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

| | |
|---|---|
| Inflation | 2.50% |
| Salary increases | Not applicable |
| Investment rate of return | 7.25%, net of investment expenses |
| Cost of living adjustments | None |

For active members, inactive members and healthy retirees, mortality rates were based on the RP-2000 Combined Healthy Mortality Table set back two years for males and three years for females, projected generationally using the SSA 2014 Intermediate Cost scale from 2014. For disabled retirees, mortality rates were based on the RP-2000 Disabled Mortality Table set back one year for males (no setback for females) multiplied by 125%.

The long-term expected investment rate of return assumption for the RHIC fund was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of RHIC investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Estimates of arithmetic real rates of return, for each major asset class included in the RHIC's target asset allocation as of July 1, 2019 are summarized in the following table:

| Asset Class | Target Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Large Cap Domestic Equities | 33% | 7.31% |
| Small Cap Domestic Equities | 6% | 10.40% |
| International Equities | 21% | 7.32% |
| U.S. High Yield | 4% | 6.13% |
| Emerging Markets Debt | 4% | 7.45% |
| Core-Plus Fixed Income | 32% | 4.26% |

*Discount Rate*

The discount rate used to measure the total OPEB liability was 7.25%. The projection of cash flows used to determine the discount rate assumed plan member and statutory/Board approved employer contributions will be made at rates equal to those based on the July 1, 2019, and July 1, 2018, HPRS actuarial valuation reports. For this purpose, only employer contributions that are intended to fund benefits of current RHIC members and their beneficiaries are included. Projected employer contributions that are intended to fund the service costs of future plan members and their beneficiaries are not included. Based on those assumptions, the RHIC fiduciary net position was projected to be sufficient to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on RHIC investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

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*Sensitivity of the Employer's Proportionate Share of the Net OPEB Liability to Changes in the Discount Rate*

The following presents the net OPEB liability of the Plans as of June 30, 2019, calculated using the discount rate of 7.25%, as well as what the RHIC net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.25 percent) or 1-percentage-point higher (8.25 percent) than the current rate:

| | 1% Decrease (6.25%) | Current Discount Rate (7.25%) | 1% Increase (8.25%) |
|---|---|---|---|
| Bank's proportionate share of the net pension liability | $ 1,039 | $ 814 | $ 622 |

*OPEB Plan Fiduciary Net Position*

Detailed information about the pension plan's fiduciary net position is available in the separately issued NDPERS financial report. NDPERS issues a publicly available financial statement that includes financial statements and the required supplementary information for NDPERS. That report may be obtained by writing to NDPERS; 400 East Broadway, Suite 505; PO Box 1657; Bismarck, ND 58502-1657.

## NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES

*Legislative Action* – Various legislative bills provide state agencies the authority to borrow money from the Bank of North Dakota during the biennium beginning July 1, 2019 and ending June 30, 2021. Following is a summary of legislative action and/or North Dakota Statute in effect:

H.B. 1014, Section 9 – The industrial commission shall transfer to the general fund $140,000 from the current earnings and the accumulated undivided profits of the Bank of North Dakota during the biennium beginning July 1, 2019 and ending June 30, 2021. The moneys must be transferred in the amounts and at the times requested by the Director of the Office of Management and Budget after consultation with the Bank of North Dakota president. As of December 31, 2019, the Bank had transferred $35,000.

H.B. 1014, Section 10 – The Bank shall transfer up to $26,000 from its current earnings and undivided profits to the Partnership in Assisting Community Expansion Fund. As of December 31, 2019, the Bank had transferred $7,000.

H.B. 1014, Section 11 – The Bank shall transfer up to $4,000 from its current earnings and undivided profits to the Agriculture Partnership in Assisting Community Expansion Fund. As of December 31, 2019, the Bank had transferred $750.

H.B. 1014, Section 12 – The Bank shall transfer up to $1,000 from its current earnings and undivided profits to the Biofuels Partnership in Assisting Community Expansion Fund. As of December 31, 2019, the Bank had transferred $0.

H.B. 1014, Section 13 – The Bank shall transfer up to $6,000 from its current earnings and undivided profits to the Beginning Farmer Revolving Loan Fund. As of December 31, 2019, the Bank had transferred $1,750.

H.B. 1014, Section 14 – The Bank shall transfer the sum of $15,000 or so much of the sum as may be necessary from its current earnings and undivided profits to the North Dakota Development Fund to purchase existing venture capital assets held by the Bank for the biennium beginning July 1, 2019 and ending June 30, 2021. As of December 31, 2019, the Bank had transferred $15,000.

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H.B. 1014, Section 23 – The Bank shall transfer the sum of $20,000 from its current earnings and undivided profits to the Statewide Interoperable Radio Network Fund (SIREN) once SIREN has accessed and utilized the $80,000 line of credit from the Bank for the biennium beginning July 1, 2019 and ending June 30, 2021. As of December 31, 2019, the Bank had transferred $0.

H.B. 1435, Section 6 – The Bank shall extend a line of credit not to exceed $80,000 to the Information Technology Department at the prevailing interest rate charged to North Dakota governmental entities for the purpose of defraying the expenses of the statewide interoperable radio network for the biennium beginning July 1, 2019 and ending June 30, 2021. The term of the loan may not exceed 20 years. As of December 31, 2019, there was no outstanding loan balance.

S.B. 2014, Section 22 – The Bank of North Dakota's budget approved during the 2015-2017 Session included $17,000 from the assets of the Bank of North Dakota which could be used for the purpose of constructing a North Dakota Financial Center on a site adjacent to the existing building on which the Bank is located. Legislation passed during that Session stated that the Bank may spend the funding only if the Bank's net income, reported in accordance with Financial Accounting Standards Board accounting standards, for calendar year 2015 exceeds $125,000. The Bank's net income exceeded this threshold as of December 31, 2015. During the 2017-2019 Session, language was modified to state that the funding appropriated for this purpose is available through June 30, 2021. No costs have been incurred through December 31, 2019 and 2018.

H.B. 1003, Section 29 – The Bank shall transfer the sum of $10,000 or so much of the sum as may be necessary from its current earnings and undivided profits to institutions under the control of the State Board of Higher Education for TIER II capital building funds as requested by the Commissioner of Higher Education for the biennium beginning July 1, 2019 and ending June 30, 2021. As of December 31, 2019, the Bank had transferred $0.

H.B. 1003, Section 30 – The Bank shall transfer the sum of $7,000 or so much of the sum as may be necessary from its current earnings and undivided profits to the North Dakota University System to the TIER III capital building fund pool as requested by the Commissioner of Higher Education for the biennium beginning July 1, 2019 and ending June 30, 2021. As of December 31, 2019, the Bank had transferred $0.

H.B. 1003, Section 32 – The Bank shall transfer to the University of North Dakota a total of $1,500, or so much as the sum as may be necessary and to North Dakota State University a total of $1,500, or so much as the sum as may be necessary, from the current earnings and accumulated profits of the Bank for campus network upgrades, for the biennium beginning July 1, 2019 and ending June 30, 2021, as requested by the Commissioner of Higher Education. As of December 31, 2019, the Bank had transferred $0.

H.B. 1012, Section 7 – The Department of Transportation may borrow from the Bank, up to $50,000, which is appropriated to the Department for matching federal funds that may become available, for the biennium beginning July 1, 2019 and ending June 30, 2021. As of December 31, 2019, there was no outstanding balance.

H.B. 1171, Section 3 & 4 – The Bank shall transfer to the Skilled Workforce Student Loan Repayment Program $3,000, or so much as the sum as may be necessary and to the Skilled Workforce Scholarship Fund a total of $3,000, or so much as the sum as may be necessary from the current earnings and accumulated profits of the Bank during the effective date of this act and ending June 30, 2021. As of December 31, 2019, the Bank had transferred a total of $200.

H.B. 1333, Section 2 – The Bank shall transfer the sum of $15,000 or so much of the sum as may be necessary from its current earnings and undivided profits to the Innovation Loan Fund to support technology advancement for the purpose of providing technology loans during the biennium beginning July 1, 2019 and ending June 30, 2021. As of December 31, 2019, the Bank had transferred $100.

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S.B. 2020, Section 17 – The Bank shall extend a line of credit not to exceed $75,000 at a rate of one and one-half percent over the three-month London interbank offered rate but may not exceed three percent to the State Water Commission. The State Water Commission shall repay the line of credit from funds available in the Resources Trust Fund, Water Development Trust Fund, or other funds, as appropriated by the legislative assembly. The State Water Commission may access the line of credit, as necessary, to provide funding as authorized by the legislative assembly for water supply projects approved before June 30, 2021, and flood control projects that have approval for funding before June 30, 2021. As of December 31, 2019, there was no outstanding loan balance.

S.B. 2009, Section 9 – The Bank shall transfer the sum of $2,000 or so much of the sum as may be necessary from its current earnings and undivided profits to the Agriculture Commissioner for deposit in the Agriculture Products Utilization Commission Fund during the biennium beginning July 1, 2019 and ending June 30, 2021. As of December 31, 2019, the Bank had transferred $2,000.

S.B. 2019, Section 12 – The Parks and Recreation Department may borrow from the Bank $3,000 or the sum as may be necessary, which is appropriated to the Parks and Recreation Department for matching nonstate funds that may become available for capital projects at the International Peace Garden, for the biennium beginning July 1, 2019 and ending June 30, 2021. The Parks and Recreation Department shall request from the sixty-seventh legislative assembly an appropriation to repay any outstanding loans authorized. As of December 31, 2019, there was no outstanding balance.

S.B. 2024, Section 3 – It is the intent of the sixty-sixth legislative assembly that the Attorney General seek reimbursement from the federal government for the costs of responding to unlawful activity associated with the construction of the Dakota Access Pipeline. It is further the intent of the sixty-sixth legislative assembly that these reimbursements be used to repay the Bank of North Dakota loans authorized by the Emergency Commission and the Legislative Assembly which were obtained to provide the funding necessary to respond to the unlawful activity associated with the construction of the Dakota Access Pipeline. It is the further intent of the sixty-sixth legislative assembly that the provisions of section 54-16-13 apply to the loans, except that Emergency Commission approval does not apply. The unpaid principal balance as of December 31, 2019 and 2018 was $13,362 and $14,778, respectively.

S.B. 2124, Section 1 – The Bank of North Dakota shall adopt rules to administer, manage, promote, and market the North Dakota Achieving a Better Life Experience Plan. The Bank shall ensure the North Dakota Achieving a Better Life Experience Plan is maintained in compliance with internal revenue service standards for qualified state disability expense programs. The Bank, as trustee of the North Dakota Achieving a Better Life Experience Plan, may impose an annual administrative fee to recover expenses incurred in connection with operation of the plan. Administrative fees received by the Bank are appropriated to the Bank on a continuing basis to be used as provided under this section. Money and assets in North Dakota Achieving a Better Life Experience Plan accounts or in qualified Achieving a Better Life Experience plan accounts in any state may not be considered for the purpose of determining eligibility to receive, or the amount of, any assistance or benefits from local or state means-tested programs.

S.B. 2178, Section 1 – This bill is an amendment to Section 6-09-49 regarding the Infrastructure Revolving Loan Fund and provide definition for “essential infrastructure projects”. No new funding was provided, and no other changes to the program were made. The Infrastructure Revolving Loan Fund is a special fund in the State Treasury from which the Bank of North Dakota shall provide loans to political subdivisions for essential infrastructure projects. The Bank shall administer the Infrastructure Revolving Loan Fund. The maximum term of a loan made under this section is thirty years. A loan made from the Fund under this section must have an interest rate that does not exceed two percent per year. For purposes of this section, "essential infrastructure projects" means capital construction projects for the following: (a) New or replacement of existing water treatment plants; (b) New or replacement of existing wastewater treatment plants; (c) New or replacement of existing sewer lines and water lines; and (d) New or replacement of existing storm water and transportation infrastructure, including curb and gutter construction. As of December 31, 2019, outstanding loans totaled $96,320.

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S.B. 2272, Section 3 – In addition to any construction loans made available under section 15.1-36-02, the Bank of North Dakota may provide up to $250,000 to eligible school districts for school construction loans until June 30, 2017. After June 30, 2017, no new loans may be provided under this section. With the advice and consent of the Superintendent of Public Instruction, the Bank of North Dakota shall award the loans in accordance with a prioritization system that is based on a review of all applications filed during the twelve-month period preceding April 1st. The term of a loan under this section is twenty years, unless a shorter term is requested by the board of a school district in its application. The interest rate on a loan under this section may not exceed two percent, until July 1, 2025. Thereafter, the interest rate on the loan is subject to change. The maximum loan amount to which a school district is entitled under this section is $20,000. As of December 31, 2019, the outstanding balance was $61,739.

S.B. 2272, Section 4 – Provides for the creation of the School Construction Assistance Revolving Loan Fund. The School Construction Assistance Revolving Loan Fund is a special revolving loan fund administered by the Bank of North Dakota. The Fund consists of all moneys appropriated or transferred to the Fund by the Legislative Assembly and all interest or other earnings of the Fund, and all repayments of loans made from the Fund. Moneys in the Fund, interest upon the moneys in the Fund, and payments to the Fund of principal and interest are appropriated to the Bank of North Dakota on a continuing basis for the purpose of providing low-interest school construction loans and for paying administrative costs, in accordance with this section. With the advice and consent of the Superintendent of Public Instruction, the Bank of North Dakota shall award the loans in accordance with a prioritization system that is based on a review of all applications filed during the twelve-month period preceding April 1st. The maximum loan amount for which a school district may qualify is $10,000. The term of the loan is twenty years, unless the board of the school district requests a shorter term in the written loan application. The interest rate of the loan may not exceed two percent per year. The Bank may adopt policies and establish guidelines to administer this loan program in accordance with this section. The Bank of North Dakota may use a portion of the interest paid on the outstanding loans as a servicing fee to pay for administration costs which may not exceed one - half of one percent of the amount of the interest payment. The Bank of North Dakota shall deposit principal and interest payments made by school districts for loans under this section in the School Construction Assistance Revolving Loan Fund. The Bank of North Dakota shall arrange for the conduct of an annual audit of the School Construction Assistance Revolving Loan Fund, the cost of which must be paid from the Fund and which must be conducted by an independent accounting firm. As of December 31, 2019, outstanding loans in the School Construction Assistance Revolving Loan Fund totaled $233,578.

S.B. 2214, Section 1 – The Office of Management and Budget shall transfer the sum of $75,000 from the Foundation Aid Stabilization Fund to the School Construction Assistance Revolving Loan Fund during the biennium July 1, 2019 and ending June 30, 2021. Of the $75,000 transferred from the Foundation Aid Stabilization Fund, $35,000 is from funding available in the Fund on June 30, 2019, and $40,000 is from earnings anticipated to be deposited into the Fund during the biennium beginning July 1, 2019 and ending June 30, 2021. Pursuant to the continuing appropriation authority under section 15.1-36-08, $5,000, or so much of the sum as may be necessary, is available from the School Construction Assistance Revolving Fund to the Bank to provide interest rate buydowns associated with loans issued under section 15.1-36-06. In addition, provided sufficient funding is available for loans to local school districts, the Bank may utilize funding from the School Construction Assistance Revolving Loan Fund to repay a portion of the outstanding principal balance of loans issued under section 15.1-36-06 for the purpose of transferring a portion of the loans issued under that section from the Bank to the School Construction Assistance Revolving Loan Fund. As of December 31, 2019, the Office of Management and Budget transferred $35,000 to the School Construction Assistance Revolving Loan Fund. As of December 31, 2019, $57,849 in school construction assistance revolving loans have been transferred from the Bank to the School Construction Assistance Revolving Loan Fund.

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S.B. 2311, Section 1 – The Bank of North Dakota shall provide a letter of credit to a city, in the northwest corner of the state with a population over twenty thousand residents, which is constructing an airport and is subject to the bonding requirements under section 52-04-06.1. The letter of credit shall cover the length of the construction term not to exceed five years. The Bank of North Dakota shall charge a one-time fee of no more than three quarters of one percent of the total amount of the letter of credit. The city obtaining the letter of credit assumes all liability for the letter of credit, the fee to be paid to the Bank of North Dakota, and any other requirements under section 52-04-06.1. As of December 31, 2019, the letter of credit has been provided.

S.B. 2008, Section 4 – The Bank of North Dakota shall transfer from the Beginning Farmer Revolving Loan Fund to the Public Service Commission the sum of $900, or so much of the sum as may be necessary, included in the estimated income line item in section 1 of this Act to pay for costs associated with a rail rate complaint case. Transfers must be made during the biennium beginning July 1, 2019, and ending June 30, 2021, upon order of the Commission. If any amounts are spent pursuant to this section, the Public Service Commission shall reimburse the Beginning Farmer Revolving Loan Fund using amounts available from damages or proceeds received, net of legal fees, from a successful outcome of a rail complaint case. As of December 31, 2019, the Bank had transferred $0.

*State Water Commission*

Under chapter 61-02.1-04 of North Dakota Century Code, principal and interest on bonds issued are payable from transfers to be made and appropriated by the Legislative Assembly from the Water Development Trust Fund as provided in section 61-02.1-05, then from transfers to be made and appropriated by the Legislative Assembly from revenues in the Resources Trust Fund other than revenues from state taxes, then from appropriations of other available revenues in the then current biennium, and then from any other revenues the State Water Commission makes available during the then current biennium for that purpose, including any federal moneys received by the state for the construction of flood control or reduction projects to pay bonds issued for that project. If sufficient funds from these sources are not available, then from transfers to be made and appropriated by the Legislative Assembly from the first available current biennial earnings of the Bank of North Dakota not to exceed $6,500 per biennium prorated with any other bonds payable from transfers to be made and appropriated by the Legislative Assembly from the available current biennial earnings of the Bank of North Dakota, to be credited by the Trustee to the Fund established for paying principal and interest on the bonds under a trust indenture. If the Bank has to provide a transfer to the State Water Commission to make principal and interest payments on these bonds, the State Water Commission would then have to request from the next Legislative Assembly funding to repay the transfer made by the bank. As of December 31, 2019, the Bank has provided no such transfers.

*Farm Real Estate Loan Guarantee Program*

Chapter 6-09.7-09 provides that the Bank of North Dakota may guarantee the loan of money by banks, credit unions, lending institutions that are part of the farm credit system, and savings and loan associations in this state to eligible persons for the purchase of agricultural real estate or the restructuring of agricultural real estate loans, provided the transactions do not exceed a loan to value ratio of 80% and further provided that no single loan exceeds $400. The Bank may have no more than $8,000 in outstanding loan guarantees under this Program. The Bank may guarantee up to 75% of the amount of principal due the lender. The guarantee term may not exceed 5 years. As of December 31, 2019, and 2018, the Bank has guarantees outstanding totaling $508 and $807, respectively, and had no guarantee commitments outstanding, respectively, included in commitments to extend credit. The Bank has not recorded a contingent liability related to the guarantee loan program as of December 31, 2019 and 2018.

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*Self-Insurance Health Plan – Bank of North Dakota Line of Credit*

Chapter 54-52.1 provides that the Bank shall extend to the Public Employees' Retirement Board a line of credit not to exceed $50,000. The Board shall repay the line of credit from health insurance premium revenue or repay the line of credit from other funds appropriated by the Legislative Assembly. The Board may access the line of credit to the extent necessary to provide adequate claims payment funds, to purchase stop-loss coverage, and to defray other expenditures of administration of the self-insurance health plan. As of December 31, 2019, the outstanding loan balance was $0.

*Invisible Reinsurance Pool – Bank of North Dakota Line of Credit*

Chapter 26.1-36.7-.07 provides that the Bank shall extend to the Reinsurance Association of North Dakota a line of credit not to exceed $25,000. The Association shall repay the line of credit from assessments against insurers writing or otherwise issuing group health benefit plans in this state or from other funds appropriated by the Legislative Assembly. As of December 31, 2019, the outstanding loan balance was $0.

*Theodore Roosevelt Presidential Library Museum Endowment Fund – Bank of North Dakota Loan*

Chapter 54-08-03.8 the Governor may obtain a loan from the Bank in an amount not to exceed $35,000. The term may not exceed six years and the interest rate must be set at the prevailing interest rate charged by the Bank to other governmental entities. The Governor shall repay the loan from funds appropriated by the Legislative Assembly. As of December 31, 2019, the outstanding loan balance was $0.

*Establishment and Maintenance of Adequate Guarantee Funds – Use of Strategic Investment and Improvement Funds*

Chapter 6-.09.7-05 provides that the Bank shall establish and at all times maintain an adequate guarantee reserve fund in a special account at the Bank. The Bank may request the Director of the Office of Management and Budget to transfer funds from the Strategic Investment and Improvement Fund (SIIF) created by this section 15-08.1-08 to maintain one hundred percent of the guarantee reserve fund balance. Transfers from SIIF may not exceed a total of $50,000. Moneys in the guarantee reserve fund are available to reimburse lenders for guaranteed loans in default. The securities in which the moneys in the reserve fund may be invested must meet the same requirements as those authorized for investment under the State Investment Board. The income from such investments must be made available for the costs of administering the program and must be deposited in the reserve fund. The amount of the reserves for all guaranteed loans must be determined by a formula that will assure, as determined by the Bank, an adequate amount of reserve. As of December 31, 2019, the balance in the reserve fund was $0.

*Beginning Entrepreneur Loan Guarantee Program*

Chapter 6-09.15 provides that the Bank of North Dakota provide a Beginning Entrepreneur Loan Guarantee Program. The Program includes an agreement with a lender that in the event of default by a beginning entrepreneur under a note and mortgage or other loan or financing agreement, the Bank shall pay the lender the amount agreed upon up to 85% of the amount of principal due the lender on a loan at the time the claim is approved. The total outstanding loans that the Bank may guarantee cannot exceed 5% of the Bank’s tier one capital as defined by the Department of Financial Institutions. A lender may apply to the Bank for a loan guarantee for a loan up to $500. The term of the guarantee may not exceed five years. As of December 31, 2019, and 2018, the Bank has guarantees outstanding totaling $7,053 and $8,070, respectively, and had guarantee commitments outstanding of $328 and $613, respectively, included in commitments to extend credit. The Bank has not recorded a contingent liability related to the guarantee loan program as of December 31, 2019 and 2018.

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## NOTE 15 - OFF-BALANCE-SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, financial standby letters of credit, and guarantees related to loan programs as discussed in Note 14. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2019 and 2018, the following financial instruments were outstanding where contract amounts represent credit risk:

| | Contract Amount | |
|---|---|---|
| | **2019** | 2018 |
| Commitments to extend credit | **$ 911,809** | $ 861,421 |
| Financial standby letters of credit | **415,755** | 412,614 |
| Guarantees provided | **7,889** | 9,490 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained by the Bank upon extension of credit is based on management's credit evaluation of the customer. Collateral held may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

Financial standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank has segmented this category into three components: (1) letters of credit, (2) confirming letters of credit, and (3) letters of credit pledged for public deposits to North Dakota financial institutions.

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party which require this type of facility. The maturities for these letters of credit range from one month to ten years, and the likelihood of funding any of these letters of credit is considered to be remote. The Bank holds collateral supporting those commitments. The Bank also has letters of credit with the North Dakota Public Finance Authority (NDPFA) with maturities ranging from 17 months to 29 years. If the letters issued to the NDPFA were ever drawn upon, the NDPFA is legally obligated to reimburse the Bank from funds legally available, or from any appropriation made available from the Legislative Assembly after certification by the Industrial Commission. The likelihood of funding any of these letters of credit is also considered to be remote. Outstanding issued letters of credit as of December 31, 2019 and 2018 were $108,645 and $106,834, respectively.

Confirming letters of credit are issued to North Dakota financial institutions to support letters of credit they have issued but are still in need of backing from an institution with a long-term, high quality bond rating. In the event these letters were to be drawn upon, based on the terms of the agreement, the Bank would immediately withdraw funds from the institution's correspondent bank account held at the Bank to cover the amount drawn. These agreements generally have terms of 12 months or less. The likelihood of funding any of these confirming letters of credit is also considered to be remote. Outstanding issued confirming letters of credit as of December 31, 2019 and 2018 were $3,950 and $3,525, respectively.

(continued on next page)

Letters of credit pledged for public deposits to North Dakota financial institutions are issued to support public borrowing arrangements. These letters are fully collateralized by a pool of loans pledged to the Bank. These agreements generally have terms of 12 months or less. Financial standby letters for public deposits by North Dakota banks totaled $303,160 and $302,255 at December 31, 2019 and 2018, respectively. The likelihood of funding any of these letters of credit is also considered to be remote. These letters of credit are an authorized form of collateral for public deposits per North Dakota Century Code 21-04-09.

The Bank has not recorded a contingent liability related to off-balance-sheet activity as of December 31, 2019 and 2018.

## NOTE 16 - INTEREST RATE SWAP CONTRACTS

*Objective of the Interest Rate Swap*

The Bank has outstanding interest rate swap agreements with a notional amount $545,000 to convert variable rate federal funds and variable LIBOR-indexed deposits into fixed-rate instruments over the term of the contract. The following table summarizes the terms of the interest rate swap contracts:

| Trade Date | Maturity Date | Notional Amount | Pay Fixed | Receive Variable |
|---|---|---|---|---|
| June 5, 2014 | June 1, 2029 | $50,000 | 2.86% | Fed Funds |
| April 14, 2015 | May 1, 2030 | $50,000 | 1.92% | Fed Funds |
| August 11, 2016 | September 1, 2031 | $50,000 | 1.48% | 1 Month LIBOR |
| April 5, 2017 | May 1, 2032 | $50,000 | 2.39% | 1 Month LIBOR |
| June 15, 2017 | July 1, 2032 | $50,000 | 1.99% | Fed Funds |
| March 27, 2018 | April 1, 2033 | $50,000 | 2.47% | Fed Funds |
| June 28, 2018 | July 1, 2033 | $50,000 | 2.52% | Fed Funds |
| April 25, 2019 | May 1, 2034 | $50,000 | 2.36% | Fed Funds |
| September 3, 2019 | October 1, 2034 | $50,000 | 1.15% | Fed Funds |
| October 2, 2019 | November 1, 2034 | $50,000 | 1.38% | Fed Funds |
| December 5, 2019 | October 1, 2023 | $45,000 | 1.33% | Fed Funds |

*Termination Risk and Fair Value*

Either the Bank or its counterparties may terminate the interest rate swap if the other party fails to perform under the terms of the contract. Termination could result in the Bank being required to make a payment of the fair value of the swap to the counterparty. The following table summarizes the derivative financial instruments utilized at December 31, 2019:

| | | Fair Value | | Changes in Fair Value | |
|---|---|---|---|---|---|
| | Amount | Classification | Amount | Classification | Amount |
| June 2014 Swap | $ 50,000 | Other liabilities | $ (5,468) | Deferred outflow | $ (3,288) |
| April 2015 Swap | $ 50,000 | Other liabilities | $ (1,278) | Deferred outflow | $ (3,770) |
| August 2016 Swap | $ 50,000 | Other assets | $ 1,722 | Deferred inflow | $ (4,518) |
| April 2017 Swap | $ 50,000 | Other liabilities | $ (3,173) | Deferred outflow | $ (4,577) |
| June 2017 Swap | $ 50,000 | Other liabilities | $ (1,600) | Deferred outflow | $ (4,310) |
| March 2018 Swap | $ 50,000 | Other liabilities | $ (4,493) | Deferred outflow | $ (4,448) |
| June 2018 Swap | $ 50,000 | Other liabilities | $ (4,826) | Deferred outflow | $ (4,506) |
| April 2019 Swap | $ 50,000 | Other liabilities | $ (4,001) | Deferred outflow | $ (4,001) |
| September 2019 Swap | $ 50,000 | Other assets | $ 4,003 | Deferred inflow | $ 4,003 |
| October 2019 Swap | $ 50,000 | Other assets | $ 2,462 | Deferred inflow | $ 2,462 |
| December 2019 Swap | $ 45,000 | Other assets | $ 194 | Deferred inflow | $ 194 |

(continued on next page)

The following table summarizes the derivative financial instruments utilized at December 31, 2018:

| | | Fair Value | | Changes in Fair Value | |
|---|---|---|---|---|---|
| | Amount | Classification | Amount | Classification | Amount |
| June 2014 Swap | $ 50,000 | Other liabilities | $ (2,180) | Deferred outflow | $ 1,921 |
| April 2015 Swap | $ 50,000 | Other assets | $ 2,492 | Deferred inflow | $ 1,598 |
| August 2016 Swap | $ 50,000 | Other assets | $ 6,240 | Deferred inflow | $ 1,018 |
| April 2017 Swap | $ 50,000 | Other assets | $ 1,404 | Deferred inflow | $ 1,530 |
| June 2017 Swap | $ 50,000 | Other assets | $ 2,710 | Deferred inflow | $ 1,930 |
| March 2018 Swap | $ 50,000 | Other liabilities | $ (45) | Deferred outflow | $ (45) |
| June 2018 Swap | $ 50,000 | Other liabilities | $ (320) | Deferred outflow | $ (320) |

*Credit Risk*

At December 31, 2019 and 2018, the Bank was not exposed to material credit risk because each counterparty is required to fully collateralize the fair value of the swaps within $250 of daily mark-to-market valuations by depositing funds with the other counterparty.

Amongst all swap counterparties for the transactions noted above, the Bank holds a net $20,470 in cash pledged under collateral arrangements related to the interest rate swaps at December 31, 2018, to satisfy the collateral requirements.

Amongst all swap counterparties for the transactions noted above, the Bank held a net $12,150 in cash under collateral arrangements related to the interest rate swaps at December 31, 2018, to satisfy the collateral requirements.

*Interest Rate Risk*

The Bank is exposed to interest rate risk on its swap agreements. On its pay-fixed, receive variable interest rate swaps, the Bank's net payment increases as the USD-FEDERAL FUNDS-H.15 and USD-1 MONTH LIBOR-BBA interest rates decrease.

*Swap Payments and Hedged Debt*

Using rates as of December 31, 2019, the interest expense of the variable rate federal funds, variable rate 1 month LIBOR and the net swap payments are as follows. As rates vary, the federal fund and 1 month LIBOR interest expense and the net swap payments will vary.

| | Pay Fixed | Receive Variable | | |
|---|---|---|---|---|
| Year ended December 31: | Contract Interest | Federal Fund Interest | 1-Month LIBOR Interest | Interest Rate Swap, net |
| 2020 | $ 10,856 | $ 6,898 | $ 1,800 | $ 2,158 |
| 2021 | $ 10,856 | $ 6,898 | $ 1,800 | $ 2,158 |
| 2022 | $ 10,856 | $ 6,898 | $ 1,800 | $ 2,158 |
| 2023 | $ 10,706 | $ 6,724 | $ 1,800 | $ 2,183 |
| 2024 | $ 10,258 | $ 6,200 | $ 1,800 | $ 2,258 |
| 2025-2029 | $ 51,300 | $ 31,000 | $ 9,000 | $ 11,300 |
| 2030-2034 | 27,026 | $ 18,535 | $ 3,600 | $ 4,891 |
| | $ 131,856 | $ 83,153 | $ 21,600 | $ 27,103 |

(continued on next page)

## NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value measurements are used to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures.

*Fair Value Hierarchy*

Under GASB Statement No. 72, assets and liabilities are grouped at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 – Valuation is based upon quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2 – Valuation is based upon quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

*Determination of Fair Value*

Under GASB Statement No. 72, fair values are based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is Bank policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

*Securities*

Securities consist primarily of Federal agencies and mortgage backed securities. Securities are recorded at fair value on a recurring basis. Fair value is based upon quoted prices, if available. If quoted market prices are not available, fair values are measured using observable market prices from independent pricing models, or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded in an active market; examples would include U.S. Treasury securities and Agency securities. Level 2 securities as defined above would include mortgage-backed securities, collateralized mortgage obligations, and state and political subdivision securities.

*Interest Rate Swap Agreements*

Fair values for interest rate swap agreements are based upon the settlement value adjusted by estimated nonperformance risk.

*Assets and Liabilities Recorded at Fair Value on a Recurring Basis*

The following tables present the balances of assets and liabilities measured at fair value on a recurring basis at December 31, 2019 and 2018:

(continued on next page)

| | 2019 | | | |
|---|---|---|---|---|
| | **Total** | **Quoted Prices in Active Markets Level 1** | **Significant Other Observable Inputs Level 2** | **Significant Unobservable Inputs Level 3** |
| ASSETS | | | | |
| Available-for-sale debt securities | | | | |
| Mortgage-backed securities | | | | |
| Agency | **$ 81,375** | **$ -** | **$ 81,375** | **$ -** |
| Collateralized mortgage obligations | | | | |
| Agency | **945,390** | **-** | **945,390** | **-** |
| Non-agency | **12** | **-** | **12** | **-** |
| Agency bonds | **954,690** | **954,690** | **-** | **-** |
| Municipal bonds | **1,000** | **-** | **1,000** | **-** |
| Interest rate swap | **8,381** | **-** | **8,381** | **-** |
| Totals | **$ 1,990,848** | **$ 954,690** | **$ 1,036,158** | **$ -** |
| LIABILITIES | | | | |
| Interest rate swap | **$ (24,839)** | **$ -** | **$ (24,839)** | **$ -** |
| Totals | **$ (24,839)** | **$ -** | **$ (24,839)** | **$ -** |

| | 2018 | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
| ASSETS | | | | |
| Available-for-sale debt securities | | | | |
| Mortgage-backed securities | | | | |
| Agency | $ 153,591 | $ - | $ 153,591 | $ - |
| Collateralized mortgage obligations | | | | |
| Agency | 517,387 | - | 517,387 | - |
| Non-agency | 23 | - | 23 | - |
| Agency bonds | 1,181,805 | 1,181,805 | - | - |
| Municipal bonds | 1,000 | - | 1,000 | - |
| Interest rate swap | 12,846 | - | 12,846 | - |
| Totals | $ 1,866,652 | $ 1,181,805 | $ 684,847 | $ - |
| LIABILITIES | | | | |
| Interest rate swap | $ 2,545 | $ - | $ 2,545 | $ - |
| Totals | $ 2,545 | $ - | $ 2,545 | $ - |

(continued on next page)

## NOTE 18 - 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 following are funds/pools established by the state for risk management issues:

The 1995 Legislative Session established the Risk Management Fund (RMF), an internal service fund, to provide a self-insurance vehicle for funding the liability exposures of State Agencies resulting from the elimination of the State's sovereign immunity. The RMF manages the tort liability of the State, its agencies' employees, and the University System. All State agencies participating in the RMF and their fund contribution was determined using a projected cost allocation approach. The statutory liability of the State is limited to a total of $250,000 per person and $1,000,000 per occurrence.

The Bank also participates in the North Dakota Fire and Tornado Fund and the State Bonding Fund. The Bank pays an annual premium to the Fire and Tornado Fund to cover property damage to building and personal property. Replacement cost coverage is provided by estimating replacement cost in consultation with the Fire and Tornado Fund. The Fire and Tornado Fund is reimbursed by a third party insurance carrier for losses in excess of $1 million per occurrence during a 12-month period. The State Bonding Fund currently provides the agency with blanket employee fidelity bond coverage in the amount of $2,000,000. The State Bonding Fund does not currently charge any premium for this coverage. There have been no significant reductions in insurance coverage from the prior year and settled claims resulting from these risks have not exceeded insurance coverage in any of the past three fiscal years.

## NOTE 19 - SUBSEQUENT EVENTS

The Bank evaluated its December 31, 2019 financial statements for subsequent events through the date the financial statements were issued. As a result of the spread of the COVID-19 coronavirus, economic uncertainties have arisen which are likely to negatively impact net interest income. Other financial impact could occur though such potential impact is unknown at this time.

**(In Thousands)**

## Schedule of Bank's Share of Net Pension Liability
## ND Public Employees Retirement System
## Last 10 Fiscal Years*

| | **2019** | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|---|
| 1. Bank's proportion of the net pension liability (asset) | **1.026477%** | 1.016377% | 1.040712% | 0.997523% | 0.997523% | 0.995461% |
| 2. Bank's proportionate share of the net pension liability (asset) | **$12,031** | $17,152 | $16,728 | $9,722 | $6,769 | $6,245 |
| 3. Bank's covered-employee payroll | **$10,677** | $10,441 | $10,624 | $10,053 | $8,868 | $8,288 |
| 4. Bank's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll | 112.68% | 164.28% | 157.45% | 96.71% | 76.33% | 75.35% |
| 5. Plan fiduciary net position as a percentage of the total pension liability | **71.66%** | 62.80% | 61.98% | 70.46% | 77.15% | 77.70% |

*Complete data for this schedule is not available prior to 2014.

Data reported is measured as of 7/1/2019, 7/1/2018, 7/1/2017, 7/1/2016, 7/1/2015 and 7/1/2014.

## Schedule of Bank Contributions
## ND Public Employees Retirement System
## Last 10 Fiscal Years*

| | **2019** | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|---|
| 1. Statutorily required contribution | **$777** | $769 | $770 | $728 | $674 | $590 |
| 2. Contribution in relation to the statutorily required contribution | **($837)** | ($757) | ($762) | ($707) | ($717) | ($674) |
| 3. Contribution deficiency (excess) | ($60) | $12 | $8 | $21 | ($43) | ($84) |
| 4. Bank's covered-employee payroll | $10,677 | $10,441 | $10,624 | $10,053 | $8,868 | $8,288 |
| 5. Contributions as a percentage of covered-employee payroll | 7.84% | 7.25% | 7.17% | 7.03% | 8.09% | 8.13% |

*Complete data for this schedule is not available prior to 2014.

Data reported is measured as of 7/1/2019, 7/1/2018, 7/1/2017, 7/1/2016, 7/1/2015 and 7/1/2014.

**(In Thousands)**

## Schedule of Bank's Share of Net OPEB Liability
## ND Public Employees Retirement System
## Last 10 Fiscal Years*

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| 1. Bank's proportion of the net OPEB liability (asset) | **1.013680%** | 1.028534% | 1.044284% |
| 2. Bank's proportionate share of the net OPEB liability (asset) | **$814** | $810 | $826 |
| 3. Bank's covered-employee payroll | **$11,311** | $11,254 | $11,297 |
| 4. Bank's proportionate share of the net OPEB liability (asset) as a percentage of its covered-employee payroll | **7.20%** | 7.20% | 7.31% |
| 5. Plan fiduciary net position as a percentage of the total OPEB liability | **63.13%** | 61.89% | 59.78% |

*Complete data for this schedule is not available prior to 2017.

Data reported is measured as of 7/1/2019, 7/1/2018 and 7/1/2017.

## Schedule of Bank Contributions
## ND Public Employees Retirement System
## Last 10 Fiscal Years*

| | **2019** | 2018 | 2017 |
|---|---|---|---|
| 1. Statutorily required contribution | **$132** | $132 | $131 |
| 2. Contribution in relation to the statutorily required contribution | **($142)** | ($121) | ($122) |
| 3. Contribution deficiency (excess) | **($10)** | $11 | $9 |
| 4. Bank's covered-employee payroll | **$11,311** | $11,254 | $11,297 |
| 5. Contributions as a percentage of covered-employee payroll | **1.26%** | 1.08% | 1.08% |

*Complete data for this schedule is not available prior to 2017.

Data reported is measured as of 7/1/2019, 7/1/2018 and 7/1/2017.

### *Changes of Pension Benefit Terms*

The interest rate earned on member contributions will decrease from 7.25 percent to 7.00 percent effective January 1, 2020 (based on the adopted decrease in the investment return assumption). New Main System members who are hired on or after January 1, 2020 will have a benefit multiplier of 1.75 percent (compared to the current benefit multiplier of 2.00 percent). The fixed employer contribution for new members of the Main System will increase from 7.12 percent to 8.26 percent. For members who terminate after December 31, 2019, final average salary is the higher of the final average salary calculated on December 31, 2019 or the average salary earned in the three highest periods of twelve consecutive months employed during the last 180 months of employment. There have been no other changes in plan provisions since the previous actuarial valuation as of July 1, 2018.

### *Changes of Pension Assumptions*

The Board approved the following changes to the actuarial assumptions beginning with the July 1, 2019 valuation:

- The investment return assumption was lowered from 7.75% to 7.50%

All other actuarial assumptions and the actuarial cost method are unchanged from the last actuarial valuation as of July 1, 2018.

### *Changes of Other Post Employment Benefit Terms*

Beginning January 1, 2020, members first enrolled in the NDPERS Main System and the Defined Contribution Plan on or after that date will not be eligible to participate in RHIC. Therefore, RHIC will become for the most part a closed plan. There have been no other changes in plan provisions since the previous actuarial valuation as of July 1, 2018.

### *Changes of Other Post Employment Benefit Assumptions*

The Board approved the following changes to the actuarial assumptions beginning with the July 1, 2019 valuation:

- The investment return assumption was lowered from 7.50% to 7.25%

All other actuarial assumptions and the actuarial cost method are unchanged from the last actuarial valuation as of July 1, 2018.

# BANK OF NORTH DAKOTA
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS** **EXHIBIT A-1**
**YEAR ENDED DECEMBER 31, 2019**

| Federal Grantor/Program Title | Federal CFDA Number | Expenditures |
|---|---|---|
| DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT | | |
| Direct Program: | | |
| Federal Housing Administration (FHA) Loan Program | 14.117 | |
| Guaranteed Loans: | | |
| Previous year balance of loans on which there are continuing compliance requirements | | 359,540,502 |
| FHA loan principal disbursed during the fiscal year | | 7,873,766 |
| Total guaranteed loans (Note 3) | | 367,414,268 |
| Total Department of Housing and Urban Development | | 367,414,268 |
| DEPARTMENT OF DEFENSE | | |
| Direct Program: | | |
| Veteran's Benefits Administration (VA) Loan Program | 64.114 | |
| Guaranteed Loans: | | |
| Previous year balance of loans from on which there are continuing compliance requirements | | 215,731,113 |
| VA loan principal disbursed during the fiscal year | | 10,217,642 |
| Total guaranteed loans (Note 4) | | 225,948,755 |
| Total Department of Defense | | 225,948,755 |
| DEPARTMENT OF JUSTICE | | |
| Direct Program: | | |
| John R. Justice Prosecutors and Defenders Incentive Act | 16.816 | |
| Grant for loan forgiveness | | 31,618 |
| Department of Justice | | 31,618 |
| TOTAL FEDERAL AWARDS | | $ 593,394,641 |

**NOTE 1 -** The schedule of expenditures of federal awards includes the federal grant activity of the Bank of North Dakota and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. No federal financial assistance has been provided to a subrecipient.

The Bank has not elected to use the 10% de minimis cost rate.

**NOTE 2 -** The outstanding balance of guaranteed FHA residential loans on which there are continuing compliance requirements totaled $316,776,111 as of December 31, 2019.

**NOTE 3 -** The outstanding balance of guaranteed VA residential loans on which there are continuing compliance requirements totaled $198,909,504 as of December 31, 2019.

CPAs & BUSINESS ADVISORS

**EXHIBIT A-2**

**Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards***

Governor of North Dakota
and the Legislative Assembly
State of North Dakota
Bismarck, North Dakota

We have audited, 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, the financial statements of the Bank of North Dakota, an enterprise fund of the State of North Dakota, as of and for the year ended December 31, 2019, and the related notes to the financial statements, which collectively comprise the Bank of North Dakota's basic financial statements, and have issued our report thereon dated April 6, 2020.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Bank of North Dakota's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank of North Dakota's internal control. Accordingly, we do not express an opinion on the effectiveness of the Bank of North Dakota's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.





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**Compliance and Other Matters**
As part of obtaining reasonable assurance about whether the Bank of North Dakota's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**Purpose of this Report**
The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Bank of North Dakota’s internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Eide Bailly LLP

Bismarck, North Dakota
April 6, 2020

EideBailly

CPAs & BUSINESS ADVISORS

**Independent Auditor's Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance Required by the Uniform Guidance**

Governor of North Dakota
and the Legislative Assembly
State of North Dakota
Bismarck, North Dakota

**Report on Compliance for Each Major Federal Program**
We have audited the Bank of North Dakota's, an enterprise fund of the State of North Dakota, compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Bank of North Dakota's major federal programs for the year ended December 31, 2019. The Bank of North Dakota's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

**Management's Responsibility**
Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

**Auditor's Responsibility**
Our responsibility is to express an opinion on the compliance for each of the Bank of North Dakota's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Bank of North Dakota's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Bank of North Dakota's compliance.

**Opinion on Each Major Federal Program**
In our opinion, the Bank of North Dakota complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2019.

**Report on Internal Control over Compliance**
Management of the Bank of North Dakota is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Bank of North Dakota's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Bank of North Dakota's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Eide Bailly LLP

Bismarck, North Dakota
April 6, 2020

## Section I – Summary of Auditor's Results

### Financial Statements

| | |
|---|---|
| Type of auditor's report issued | Unmodified |
| Internal control over financial reporting: | |
| Material weakness identified | No |
| Significant deficiencies identified not considered to be material weaknesses | None reported |
| Noncompliance material to financial statements noted | No |

### Federal Awards

| | |
|---|---|
| Internal control over federal programs: | |
| Material weakness identified | No |
| Significant deficiencies identified not considered to be material weaknesses | None Reported |
| Type of auditor's report issued on compliance with major programs | Unmodified |
| Any audit findings disclosed that are required to be reported in accordance with Uniform Guidance 2 CFR 200.516 | No |

**Identification of major programs:**

| Name of Federal Program | CFDA number |
|---|---|
| Federal Housing Administration (FHA) Loan Program | 14.117 |
| Veterans Housing – Guaranteed and Insured Loans | 64.114 |

| | |
|---|---|
| Dollar threshold used to distinguish between Type A and Type B programs | $750,000 |
| Auditee qualified as low-risk auditee | No |

## Section II – Financial Statement Findings

No financial statement findings reported in the current year.

## Section III – Federal Award Findings and Questioned Costs

No federal award findings or questioned costs reported in the current year.

CPAs & BUSINESS ADVISORS

**Bank of North Dakota**
**Independent Auditor's Comments Requested by the North Dakota Legislative Audit and Fiscal Review Committee**
**Year Ended December 31, 2019**

Governor of North Dakota
and the Legislative Assembly
State of North Dakota
Bismarck, North Dakota

The Legislative Audit and Fiscal Review Committee requires that certain items be addressed by independent certified public accountants performing audits of state agencies. The items and our responses regarding the December 31, 2019 audit of Bank of North Dakota are as follows:

**Audit Report Communications:**

1. What type of opinion was issued on the financial statements?

   Unmodified

2. Was there compliance with statutes, laws, rules and regulations under which the Agency was created and is functioning?

   Yes

3. Was internal control adequate and functioning effectively?

   Yes

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

   No

5. Was action taken on prior audit findings and recommendations?

   There was one internal control deficiency identified related to the financial statement audit in the prior year which was corrected in the current year.

6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.

   No



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**Audit Committee Communications:**

1. Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.

   None

2. Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of these estimates.

   Bank of North Dakota has a significant accounting estimate in their determination of the allowance for credit losses. The allowance for credit losses is maintained at an amount considered by management to adequately provide for probable losses in the loan portfolio at the statement of net position date. The allowance for credit losses is based on management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. We evaluated the key factors and assumptions used to develop the allowance for credit losses in determining that it is reasonable in relation to the financial statements taken as a whole.

   The Bank of North Dakota also has a significant estimate in their determination of the net pension liability. The net pension liability is based on an actuary's calculation in accordance with the plan provisions and census data for plan participants. We evaluated the key factors and assumptions used to develop the net pension liability in determining that it is reasonable in relation to the financial statements taken as a whole.

3. Identify any significant audit adjustments.

   None

4. Identify any disagreements with management, whether or not resolved to the auditor's satisfaction, relating to financial accounting, reporting, or auditing matter that could be significant to the financial statements.

   None

5. Identify any significant difficulties encountered in performing the audit.

   None

6. Identify any major issues discussed with management prior to retention.

   None

7. Identify any management consultations with other accountants about auditing and accounting matters.

   None

8. Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission or whether any exceptions identified in the six audit report questions addressed above are directly related to the operations of an information technology system.

   Based on the audit procedures performed, Bank of North Dakota's critical information technology system is the Fiserv system. There were no exceptions identified that were directly related to this application.

This report is intended solely for the information and use of the Governor or North Dakota, Legislative Assembly, Industrial Commission, Advisory Board of the Bank of North Dakota, and management of the Bank of North Dakota and is not intended to be and should not be used by anyone other than these specified parties.

Eide Bailly LLP

Bismarck, North Dakota
April 6, 2020

# BANK OF NORTH DAKOTA
## SCHEDULE OF APPROPRIATED EXPENDITURES — EXHIBIT B-1
## BIENNIUM ENDED JUNE 30, 2019
## (In Thousands)

| | Biennium Appropriation July 1, 2017 to June 30, 2019 | Expenditures for Year Ended June 30, 2019 | Expenditures for Year Ended June 30, 2018 | Unexpended Appropriations |
|---|---|---|---|---|
| APPROPRIATED EXPENDITURES: | | | | |
| Operating Expenses | $ 58,489 | $ 25,867 | $ 25,309 | $ 7,313 |
| Capital Assets | 810 | 251 | 115 | 444 |
| | $ 59,299 | $ 26,118 | $ 25,424 | $ 7,757 |
| * **Expenditures Reconciliation:** | | | | |
| Total expenses per financial statements- | | | | |
| Interest expense | | $ 58,515 | $ 46,441 | |
| Provision for loan losses | | 6,000 | 12,000 | |
| Operating expenses | | 38,467 | 32,028 | |
| | | 102,982 | 90,469 | |
| Non-appropriated expenditures: | | | | |
| Interest expense | | 58,515 | 46,441 | |
| Provision for loan losses | | 6,000 | 12,000 | |
| Correspondent fees | | 790 | 800 | |
| Depreciation and amortization | | 624 | 813 | |
| Other real estate expense | | 270 | 328 | |
| Loan collection expenses | | 390 | 521 | |
| Loan servicing fee expense | | 834 | 915 | |
| Other expenses | | 1,053 | 373 | |
| Nonappropriated expenditures | | 68,476 | 62,191 | |
| Equipment & furniture capitalized | | 86 | 22 | |
| Facility capitalized | | - | - | |
| Hardware capitalized | | - | - | |
| Software capitalized | | 28 | 121 | |
| Salaries capitalized | | - | - | |
| | | 114 | 143 | |
| Timing differences for appropriated expenditures: | | | | |
| July 1, 2019 to December 31, 2019 | | (12,906) | - | |
| July 1, 2018 to December 31, 2018 | | 4,404 | (19,278) | |
| July 1, 2017 to December 31, 2017 | | - | 16,281 | |
| | | (8,502) | (2,997) | |
| Appropriated Expenditures for the fiscal year | | $ 26,118 | $ 25,424 | |

The continuing appropriation for non-appropriated expenditures are authorized by the Industrial Commission and come under the continuing appropriation authority provided by Article 10, Section 12 of the North Dakota Constitution.

# BANK OF NORTH DAKOTA
## DETAILED SCHEDULE OF APPROPRIATED EXPENDITURES — EXHIBIT B-2
## YEAR ENDED JUNE 30, 2019

| | 2019 | 2018 | Total |
|---|---|---|---|
| Operating | | | |
| Salaries and wages | **$ 11,977** | $ 11,814 | $ 23,791 |
| Social security | **909** | 883 | 1,792 |
| Hospital insurance | **2,770** | 2,528 | 5,298 |
| State retirement contribution | **1,408** | 1,384 | 2,792 |
| Vacation and sick leave benefits | **224** | 98 | 322 |
| Unemployment insurance and worker's compensation premium | **18** | 15 | 33 |
| Building expenses | **386** | 318 | 704 |
| Furniture and equipment expenses | **112** | 83 | 195 |
| Processing and development expenses | **1,608** | 1,619 | 3,227 |
| Software/IT supplies | **152** | 218 | 370 |
| Contractual services/repairs | **2,983** | 2,955 | 5,938 |
| IT equipment < $5,000 | **301** | 189 | 490 |
| Telephone | **206** | 239 | 445 |
| Marketing | **503** | 569 | 1,072 |
| Professional services | **953** | 1,015 | 1,968 |
| Travel | **209** | 198 | 407 |
| Dues and publications | **237** | 217 | 454 |
| Supplies | **115** | 116 | 231 |
| Postage | **277** | 388 | 665 |
| Other operating expenses | **519** | 463 | 982 |
| | **25,867** | 25,309 | 51,176 |
| Capital assets | **251** | 115 | 366 |
| | **$ 26,118** | $ 25,424 | $ 51,542 |

CPAs & BUSINESS ADVISORS

April 6, 2020

Governor of North Dakota
and the Legislative Assembly
State of North Dakota
Bismarck, North Dakota

We have audited the financial statements, prepared following the Governmental Accounting Standards Board (GASB) accounting standards, of the Bank of North Dakota as of and for the year ended December 31, 2019, and have issued our report thereon dated April 6, 2020. Professional standards require that we advise you of the following matters relating to our audit.

**Our Responsibility in Relation to the Financial Statement Audit under Generally Accepted Auditing Standards and *Government Auditing Standards* and our Compliance Audit under the Uniform Guidance**

As communicated in our letter dated November 4, 2019, our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America and to express an opinion on whether the Bank of North Dakota complied with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Bank of North Dakota's major federal programs. Our audit of the financial statements and major program compliance does not relieve you or management of its respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the Bank of North Dakota solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.



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Our responsibility, as prescribed by professional standards as it relates to the audit of the Bank of North Dakota's major federal program compliance, is to express an opinion on the compliance for each of the Bank of North Dakota's major federal programs based on our audit of the types of compliance requirements referred to above. An audit of major program compliance includes consideration of internal control over compliance with the types of compliance requirements referred to above as a basis for designing audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, as a part of our major program compliance audit, we considered internal control over compliance for these purposes and not to provide any assurance on the effectiveness of the Bank of North Dakota's internal control over compliance.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

We have provided our comments regarding internal controls during our audit in our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* dated April 6, 2020 . We have also provided our comments regarding compliance with the types of compliance requirements referred to above and internal controls over compliance during our audit in our Independent Auditor's Report on Compliance with Each Major Federal Program and Report on Internal Control Over Compliance Required by the Uniform Guidance dated April 6, 2020.

**Planned Scope and Timing of the Audit**

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

**Compliance with All Ethics Requirements Regarding Independence**

The engagement team, others in our firm, as appropriate, our firm, and other firms utilized in the engagement, if applicable, have complied with all relevant ethical requirements regarding independence.

**Qualitative Aspects of the Entity's Significant Accounting Practices**

*Significant Accounting Policies*

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Bank of North Dakota is included in Note 1 to the financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during 2019. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

*Significant Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements were:

Management's estimate of the allowance for credit losses is based on management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. We evaluated the key factors and assumptions used to develop the allowance for credit losses in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of the net pension liability is based on an actuary's calculation in accordance with the plan provisions and census data for plan participants. We evaluated the key factors and assumptions used to develop the net pension liability in determining that it is reasonable in relation to the financial statements taken as a whole.

*Financial Statement Disclosures*

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the Bank of North Dakota's financial statements relate to Note 5 – Loans and Note 12 – Pension Plan.

**Significant Difficulties Encountered during the Audit**

We encountered no significant difficulties in dealing with management relating to the performance of the audit

**Uncorrected and Corrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of the uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or dislcosures, and the financial statements as a whole. There were no corrected or uncorrected misstatements to the financial statements identified as a result of the audit procedures performed.

**Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the financial statements or the auditor's report. No such disagreements arose during the course of the audit.

**Representations Requested from Management**

We have requested certain written representations from management that are included in the management representation letter dated April 6, 2020.

**Management's Consultations with Other Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

**Other Significant Matters, Findings, or Issues**

In the normal course of our professional association with the Bank of North Dakota, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the Bank of North Dakota's auditors.

**Modification of the Auditor's Report**

We have made the following modifications to our auditor's report to add Emphasis of Matter paragraphs:

*Reporting Entity*
As discussed in Note 1, the financial statements of the Bank of North Dakota are intended to present the financial position, the changes in financial position and cash flows of only that portion of the State of North Dakota that is attributable to the transactions of the Bank of North Dakota. They do not purport to, and do not, present fairly the financial position of the State of North Dakota as of December 31, 2019 and 2018 and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

*Financial Statement Presentation*
As discussed in Note 1 to the financial statements, the Bank of North Dakota elected to present an unclassified statement of net position because current assets are not matched with current liabilities. Presentation of a classified statement of net position would give the false impression that there is a liquidity problem at the bank. Presentation of a classified statement of net position for the Bank of North Dakota would be misleading to the extent that the financial statements may be materially misstated.

This report is intended solely for the information and use of the Governor of North Dakota, Legislative Assembly, Industrial Commission, Advisory Board of the Bank of North Dakota, and management of the Bank and is not intended to be and should not be used by anyone other than these specified parties.

Eide Bailly LLP

Bismarck, North Dakota