FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011

AND

STATEMENT OF APPROPRIATED EXPENDITURES
YEAR ENDED JUNE 30, 2012

BND

Bank of North Dakota

BANK OF NORTH DAKOTA

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Independent Auditor's Report

The Industrial Commission
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, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Bank of North Dakota's basic financial statements as listed in the table of contents.

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 audit. We conducted our audit 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, 2012, and the changes in financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters
The consolidated financial statements of the Bank of North Dakota as of and for the year ended December 31, 2011, were audited by other auditors whose report dated March 13, 2012, expressed an unqualified opinion on those statements.

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

As discussed in Note 1, the financial statements of the Bank of North Dakota are intended to present the financial position, changes in financial position and the 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, 2012 and 2011, and the changes in its financial position and cash flows, where applicable, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Required Supplementary Information
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 11 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 American, 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 that collectively compromise the Bank of North Dakota's financial statements. The schedules of appropriated expenditures are presented for purposes of additional analysis and are 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 U.S. Office of Management and Budget Circular *A-133, Audits of States, Local Governments, and Non-Profit Organization,* and is also not a required part of the financial statements.

The schedules 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 schedules 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 our report dated April 9, 2013, 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, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 9, 2013

The discussion and analysis which follows provides an overview of the Bank of North Dakota's (Bank) financial performance for the calendar year ended December 31, 2012 and comparative data for 2011 and 2010. Please read it in conjunction with the financial statements of the Bank.

FINANCIAL HIGHLIGHTS:

On an aggregate basis, the loan portfolio grew by $285,000 or 9.7% to $3,227,000 at December 31, 2012. In 2011 and 2010, the loan portfolio grew by $174,000 or 6.3% and $97,000 or 3.6%, respectively.

Total assets grew by $780,000 or 14.5% to $6,155,000. The increase was attributable to continued growth in state deposits and liquidity of banks investing at the Bank.

The tier one leverage ratio is 7.59% compared to 7.70% and 7.95% 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 balance sheets, statements of revenues, expenses and changes in fund net position, and statements of cash flows. The balance sheet 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.

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CONDENSED BALANCE SHEETS
DECEMBER 31, 2012, 2011 AND 2010

	2012	2011	2010
ASSETS			
Cash and cash equivalents	**$ 697,620**	$ 1,369,370	$ 671,200
Interest receivable	**40,102**	39,479	39,146
Securities	**2,171,546**	1,008,051	537,157
Loans, net	**3,227,498**	2,942,271	2,767,935
Other assets	**6,798**	3,736	2,195
Capital assets, net	**11,637**	12,166	12,294
Total assets	**$ 6,155,201**	$ 5,375,073	$ 4,029,927
LIABILITIES			
Federal funds purchased and repurchase agreements	**$ 275,960**	$ 318,325	$ 240,725
Non-interest bearing deposits	**891,197**	649,922	387,040
Interest bearing deposits	**4,112,365**	3,529,915	2,671,686
Interest payable	**1,156**	1,840	2,419
Transfers payable	**43**	86	44
Other liabilities	**4,566**	3,660	3,351
Short and long-term debt	**406,252**	471,422	397,365
Total liabilities	**5,691,539**	4,975,170	3,702,630
NET POSITION			
Invested in capital assets	**11,637**	12,166	12,294
Restricted for pledging purposes	**227,652**	183,430	116,344
Unrestricted	**224,373**	204,307	198,659
Total net position	**463,662**	399,903	327,297
Total liabilities and net position	**$ 6,155,201**	$ 5,375,073	$ 4,029,927

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Securities

Securities totaled $2,172,000 at December 31, 2012 compared to $1,008,000 at December 31, 2011 and $537,000 at December 31, 2010. The increase is related to the bank's overall growth. 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.

Loans

On an aggregate basis, the loan portfolio increased by $285,000, or 9.7%, to $3,227,000 at year-end 2012 from $2,942,000 at year-end 2011. There are four major categories of loans at the Bank.

Student loans increased by $1,500 in 2012 compared to increases of $18,100 in 2011 and $112,100 in 2010. In 2012, new student loans totaled $100,200 and new consolidation loans were $17,400. Decreases were from $116,100 in loan payments including loans paid in full through consolidation. In 2011, new student loans totaled $92,500 and new consolidation loans were $11,200. Decreases were from $85,600 in loan payments including loans paid in full through consolidation. In 2010, new student loans totaled $180,000 and new consolidation loans were $8,800. Decreases were from $33,600 in loan payments including loans paid in full through consolidation. Starting July 1, 2010 the Bank no longer made loans through the Federal Family Education Loan Program.

Residential loans increased by $19,500 in 2012 and $104,000 in 2011 and decreased by $4,000 in 2010. New and refinanced loans made in 2012, 2011 and 2010 totaled $147,300, $193,900 and $93,400, respectively, while normal loan payments and refinancing payoffs were $127,800, $89,900 and $97,400, respectively.

Commercial loans increased by $209,800 in 2012 compared to increasing by $47,000 in 2011 and decreasing by $17,000 in 2010.

Farm loans increased by $53,800 in 2012 compared to an increase of $12,000 in 2011 and $9,000 in 2010.

Loan Delinquencies and Allowance for Loans 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.

Delinquent and nonaccrual loans for the periods indicated were as follows:

	2012	2011	2010
Accruing loans 90 days or more past due	**$ 52,130**	$ 40,252	$ 47,254
Nonaccrual loans	**8,644**	12,900	12,161

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Accruing loans 90 days or more past due include guaranteed student loans of $45,400, $32,900 and $37,600 as of December 31, 2012, 2011 and 2010, respectively. The Bank is entitled to reimbursement from the guarantor 270 days after default in the case of a student loan payable in monthly installments and 330 days in the case of a student loan payable in less frequent installments.

Residential loans of $4,700, $5,500 and $4,400 as of December 31, 2012, 2011 and 2010, respectively, are also included in accruing loans 90 days or more past due. In the event of a foreclosure a residential loan guaranteed by the Federal Housing Administration will be paid in full and the property title is transferred to them with the exception of flooded properties. The Department of Veterans Affairs has the option of paying their guaranty percentage and the Bank keeps the foreclosed property as well as any gain or loss from the sale or they can pay the loan in full and title is transferred to them.

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, 2012, 48% of the overall loan portfolio is federally guaranteed compared to 52% at December 31, 2011 and 53% at December 31, 2010. The following sets forth certain information with respect to the Bank's loan loss experience:

	2012	2011	2010
Gross loans at end of year	**$ 3,279,778**	$ 2,995,154	$ 2,814,548
Allowance for loan losses			
Balance, beginning of year	**$ 52,883**	$ 46,613	$ 42,468
Provision charged to operations	**2,000**	11,000	12,100
Loans charged off	**(2,980)**	(4,805)	(8,166)
Recoveries	**377**	75	211
Balance, end of year	**$ 52,280**	$ 52,883	$ 46,613
Net loan charge-offs to total loans at the end of period	**0.08%**	0.16%	0.28%
Net loan charge-offs to non-guaranteed loans at the end of period	**0.15%**	0.33%	0.60%
Allowance at end of period to total loans at end of period	**1.59%**	1.77%	1.66%
Allowance at end of period to non-guaranteed loans at the end of period	**3.08%**	3.69%	3.49%

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Federal Funds Purchased and Repurchase Agreements

Short-term borrowings were $276,000 at December 31, 2012 compared to $318,300 at December 31, 2011 and $240,700 at December 31, 2010. Short-term borrowings are from North Dakota financial institutions investing in overnight federal funds at the Bank and customer investments in repurchase agreements with the Bank.

Deposits

Noninterest bearing deposits are $891,200 at December 31, 2012 compared to $649,900 at December 31, 2011 and $387,000 at December 31, 2010. Noninterest bearing deposits are primarily related to the amount of check clearing activities of respondent banks. Interest-bearing deposits totaled $4,112,400 at December 31, 2012 compared to $3,529,900 at December 31, 2011 and $2,671,700 at December 31, 2010. This increase is from state deposits related to the growing economic base of the state.

Net Position

At December 31, 2012, tier one capital was $446,800, which provides a tier one leverage ratio of 7.59%. At December 31, 2011, tier one capital was $394,200, which provides a tier one leverage ratio of 7.70%. At December 31, 2010, tier one capital was $326,700, which provides a tier one leverage ratio of 7.95%. 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 balance sheet 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 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.

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CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

	2012	2011	2010
INTEREST INCOME	**$ 153,148**	$ 138,386	$ 133,930
INTEREST EXPENSE	**44,311**	39,541	45,188
NET INTEREST INCOME	**108,837**	98,845	88,742
Provision for loan losses	**2,000**	11,000	12,100
NET INTEREST INCOME AFTER PROVISION	**106,837**	87,845	76,642
Noninterest income	**8,543**	9,070	4,468
Noninterest expense	**22,624**	21,494	20,374
INCOME BEFORE TRANSFERS	**92,756**	75,421	60,736
TRANSFERS OUT	**(28,997)**	(2,815)	(5,088)
CHANGE IN NET POSITION	**63,759**	72,606	55,648
TOTAL NET POSITION - BEGINNING	**399,903**	327,297	271,649
POSITION ASSETS - ENDING	**$ 463,662**	$ 399,903	$ 327,297

Earnings Summary

The Bank’s income before transfers was $92,800 in 2012 compared to $75,400 in 2011, an increase of 23.0%. This was mainly attributable to an increase in net interest income and a net increase in the fair value of securities.

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. Average earning assets grew from $4,572,700 to $5,405,000 at December 31, 2012 with a decrease in interest margin**.**

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The following table shows the average rates earned and paid for 2012, 2011 and 2010:

	2012	2011	2010
Annualized average interest rate earned			
Federal funds sold	**0.29%**	0.25%	0.26%
Securities	**0.87%**	1.81%	2.11%
Loans	**4.16%**	4.23%	4.34%
Weighted average interest rates earned	**2.70%**	3.01%	3.35%
Annualized average interest rate paid			
Deposits	**0.42%**	0.63%	0.93%
Federal funds purchased and repurchase agreements	**0.13%**	0.13%	0.22%
Short and long-term debt	**6.23%**	4.66%	4.76%
Weighted average interest rates paid	**0.97%**	1.03%	1.31%
Net interest spread	**1.73%**	1.98%	2.04%
Net interest margin	**1.88%**	2.14%	2.21%

Provision for Loan Losses

The provision for loan losses was $2,000 in 2012, $11,000 in 2011 and $12,100 in 2010. During 2012 BND made revisions to its allowance for credit loss methodology that recognized an overall lower allowance need requirement primarily in the commercial and farm loan portfolios. As a result, the Bank's overall loan loss provision was reduced during 2012 from higher amounts recorded during 2011 and 2010.

Noninterest Income

Overall, noninterest income decreased by $527 in 2012. This decrease was entirely a result in the increase in the fair value of securities not being as significant as it was in 2011.

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Noninterest Expense

Noninterest expense increased by $1,100, or 5.3%. The increase in noninterest expense is primarily related to two noninterest expense categories. Salaries and benefits were increased for approved legislative increases and other needed increases. Increases in other operating expenses related to marketing expenses for the North Dakota College Access Network.

SHORT AND LONG-TERM DEBT

There was no short-term Federal Home Loan Bank (FHLB) debt as of December 31, 2012, 2011 or 2010. FHLB long-term debt is $405,300 at December 31, 2012 compared to $470,300 at December 31, 2011 and $396,200 at December 31, 2010. FHLB long-term debt is one funding source utilized to fund long-term fixed rate loans.

CAPITAL ASSETS

Bank of North Dakota has $11,600 in bank premises, equipment, and software. Capital expenditures totaled $368 in 2012 compared to $780 in 2011 and $507 in 2010. This year's expenditures were related to software purchases as well as the purchase of an adjacent property.

ECONOMIC CONDITION AND OUTLOOK

Moody's Analytics recently completed an analysis of the North Dakota economy for its *Précis U.S. State* October 2012 publication. The report depicts a strong, growing economy, leading the nation in several areas. North Dakota's state gross domestic product (GDP), the value of goods and services produced in the state, has grown by 30 percent from 2007 through 2011. In sharp contrast, GDP nationally has grown by less than 1 percent during that time.

The high level of economic activity, combined with an extremely low unemployment rate, has led to growth in the state's population. As the number of jobs has increased, so has the labor force as potential workers migrate from states with much weaker labor markets. From 2007 through 2011, employment in North Dakota grew by over 10 percent; nationally, it has declined by nearly 5 percent during that time.

Moody's concludes that "The North Dakota economy will outpace that of the U.S. over the next several years. High prices and new technologies will support energy production, accompanied by growth in auxiliary industries throughout the State."

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
BALANCE SHEETS
DECEMBER 31, 2012 AND 2011
(In Thousands)

	2012	2011
ASSETS		
Cash and due from banks		
Restricted	**$ 71,472**	$ 64,512
Unrestricted	**602,098**	1,286,543
Federal funds sold	**24,050**	18,315
Cash and cash equivalents	**697,620**	1,369,370
Interest receivable		
Due from other funds	**477**	70
Other	**39,625**	39,409
	40,102	39,479
Securities		
Restricted	**24,488**	29,735
Unrestricted	**2,147,058**	978,316
	2,171,546	1,008,051
Loans		
Restricted	**537,031**	559,510
Unrestricted	**2,742,747**	2,435,644
Less allowance for loan losses	**(52,280)**	(52,883)
	3,227,498	2,942,271
Other assets		
Due from other funds	**598**	636
Other	**6,200**	3,100
	6,798	3,736
Capital assets		
Land	**1,688**	1,445
Building and equipment, net	**9,218**	9,697
Intangibles, net	**731**	1,024
	11,637	12,166
Total assets	**$ 6,155,201**	$ 5,375,073

	2012	2011
LIABILITIES		
Federal funds purchased	**$ 275,960**	$ 318,325
Deposits		
Non-interest bearing	**840,382**	619,521
Non-interest bearing - of other funds	**50,815**	30,401
Interest bearing	**108,638**	170,671
Interest bearing - of other funds	**4,003,727**	3,359,244
	5,003,562	4,179,837
Interest payable		
Due to other funds	**1,063**	1,739
Other	**93**	101
	1,156	1,840
Transfers payable	**43**	86
Other liabilities		
Due to other funds	**369**	142
Other	**4,197**	3,518
	4,566	3,660
Short and long-term debt		
Current portion	**3,291**	3,170
Long-term portion	**402,961**	468,252
	406,252	471,422
Total liabilities	**5,691,539**	4,975,170
NET POSITION		
Invested in capital assets	**11,637**	12,166
Restricted for pledging purposes	**227,652**	183,430
Unrestricted	**224,373**	204,307
Total net position	**463,662**	399,903
Total liabilities and net position	**$ 6,155,201**	$ 5,375,073

BANK OF NORTH DAKOTA
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
YEARS ENDED DECEMBER 31, 2012 AND 2011
(In Thousands)

	2012	2011
INTEREST INCOME		
Federal funds sold	$ 178	$ 65
Securities	24,013	15,262
Loans	128,957	123,059
Total interest income	153,148	138,386
INTEREST EXPENSE		
Deposits	16,572	19,857
Federal funds purchased and repurchase agreements	287	337
Short and long-term debt	27,452	19,347
Total interest expense	44,311	39,541
NET INTEREST INCOME	108,837	98,845
PROVISION FOR LOAN LOSSES	2,000	11,000
NET INTEREST AFTER PROVISION FOR LOAN LOSSES	106,837	87,845
NONINTEREST INCOME		
Service fees and other	7,932	6,652
Net increase/(decrease) in the fair value of securities	611	2,418
Total noninterest income	8,543	9,070
NONINTEREST EXPENSE		
Salaries and benefits	12,060	11,693
Data processing	4,001	3,952
Occupancy and equipment	874	906
Other operating expenses	5,689	4,943
Total noninterest expenses	22,624	21,494
INCOME BEFORE TRANSFERS	92,756	75,421
TRANSFERS OUT	(28,997)	(2,815)
CHANGE IN NET POSITION	63,759	72,606
TOTAL NET POSITION - BEGINNING OF YEAR	399,903	327,297
TOTAL NET POSITION - END OF YEAR	$ 463,662	$ 399,903

BANK OF NORTH DAKOTA
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2012 AND 2011
(In Thousands)

	2012	2011
OPERATING ACTIVITIES		
Receipt of service fees and other income from other funds	$ 4,485	$ 4,120
Receipt of service fees and other income from other entities	3,314	2,515
Payment of salaries and benefits	(12,001)	(11,662)
Payment of data processing expenses	(2,831)	(3,015)
Payment of occupancy and equipment	(392)	(414)
Payment of other operating expenses	(7,049)	(5,905)
NET CASH USED FOR OPERATING ACTIVITIES	(14,474)	(14,361)
NON-CAPITAL FINANCING ACTIVITIES		
Net increase in non-interest bearing deposits	241,275	262,882
Net increase in interest bearing deposits	582,449	858,229
Interest payments on deposits	(17,253)	(20,436)
Net increase (decrease) in federal fund purchased and repurchase agreements	(42,365)	77,600
Interest payments on federal funds purchased and repurchase agreements	(288)	(336)
Proceeds from issuance of short and long-term debt	53,000	90,100
Payment of short and long-term debt	(118,170)	(16,043)
Interest payments on short and long-term debt	(27,454)	(19,348)
Payment of transfers	(29,040)	(2,773)
NET CASH FROM NON-CAPITAL FINANCING ACTIVITIES	642,154	1,229,875
CAPITAL AND RELATED FINANCING ACTIVITY		
Purchases of capital assets	(368)	(780)
INVESTING ACTIVITIES		
Purchase of securities	(1,557,662)	(593,502)
Proceeds from sales, maturities, and principal repayments of securities	394,779	125,026
Investment income received	22,429	14,551
Proceeds from sales of loans	17,311	1,995
Net increase in loans	(306,447)	(188,641)
Loan income received	130,096	123,503
Proceeds from sale of other real estate and property owned	432	504
NET CASH USED FOR INVESTING ACTIVITIES	(1,299,062)	(516,564)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(671,750)	698,170
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,369,370	671,200
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 697,620	$ 1,369,370

	2012	2011
RECONCILIATION OF INCOME BEFORE OPERATING TRANSFERS TO NET CASH USED FOR OPERATING ACTIVITIES		
Income before operating transfers	**$ 92,756**	$ 75,421
Adjustments to reconcile income before operating transfers to net cash used for operating activities		
Depreciation and amortization	**883**	899
Provision for loan losses	**2,000**	11,000
Gain on sale of loans	**(214)**	(43)
Gain on sale of other real estate and property owned	**(35)**	(7)
Loss on retirement of fixed assets	**14**	8
Net (increase)/decrease in the fair value of securities	**(611)**	(2,418)
Reclassification of interest income and expense to other activities	**(108,837)**	(98,845)
(Increase)/decrease in other assets	**(1,373)**	(688)
(Increase)/decrease in due from other funds	**37**	3
Increase (decrease) in due to other funds	**227**	(67)
Increase/(decrease) in other liabilities	**679**	376
NET CASH USED FOR OPERATING ACTIVITIES	**$ (14,474)**	$ (14,361)
SUPPLEMENTAL SCHEDULE OF NON-CASH TRANSACTIONS		
Transfers from net position to transfers payable	**$ 28,997**	$ 2,815

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Bank of North Dakota (Bank) 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. The Bank 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. The Bank is a participation lender; the vast majority of its loans are made in tandem with financial institutions throughout the State of North Dakota. The Bank's primary deposit products are interest-bearing accounts for state and political subdivisions.

Reporting Entity

In accordance with Governmental Accounting Standards Board (GASB) Statements No. 14, *The Financial Reporting Entity*, as amended by GASB No. 39, 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 balance sheet because current assets are not matched with current liabilities. Presentation of a classified balance sheet would give the false impression that there is a liquidity problem at the Bank. Presentation of a classified balance sheet for the Bank of North Dakota would be misleading to the extent that the financial statements may be materially misstated. Therefore, the balance sheet 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 in the statement of 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.

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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 balance sheet. 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 presents 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 accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses.

Significant Group Concentrations of Credit Risk

Most of the Bank's lending activities are with customers within the state of North Dakota. Due to the pervasive nature of agriculture in the economy of the state, all loans, regardless of type, are impacted by agriculture. The Bank's loan portfolio is comprised of the following concentrations as of December 31, 2012 and 2011:

	2012	2011
Commercial loans, of which 4% and 4% are federally guaranteed	**40%**	36%
Student loans, of which 97% and 97% are guaranteed	**32%**	35%
Residential loans, of which 83% and 83% are federally guaranteed	**18%**	19%
Agricultural loans, of which 5% and 5% are federally guaranteed	**10%**	10%
	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 with readily determinable fair values are carried at market value in accordance with Governmental Accounting Standards Board (GASB) Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Unrealized gains and losses due to fluctuations in market value are included in noninterest income. Investments in other equity securities that do not have readily determinable market values are reported at cost, provided there has not been an other than temporary impairment in that value.

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Declines in the fair value of securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issue for a period of time sufficient to allow for any anticipated recovery in fair value. 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.

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 4.45% of total FHLB advances. Since ownership of this stock is restricted, these securities are carried at cost and evaluated periodically for impairment.

Nonmarketable equity securities represent venture capital equity securities that are not publicly traded. The Bank reviews these assets at least annually for possible other-than-temporary impairment. These securities do not have a readily determinable fair value and are stated at cost. The Bank reduces the asset value when it considers declines in value to be other than temporary. We recognize any estimated loss as a loss from equity securities in noninterest income.

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

Loans are reported at the outstanding unpaid principal balances, adjusted for charge-offs, unamortized deferred fees and costs on originated loans and premiums or discounts on purchased loans. Interest income on loans is accrued at the specific rate on the unpaid principal balance. Unearned income, deferred fees and costs, and discounts and premiums are amortized to income over the estimated life of the loan using the interest or straight line method.

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 uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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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.

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 Banking and 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.

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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.

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 loan 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 $2,582 and $981 as of December 31, 2012 and 2011, 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 December 31 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.

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.

Defined Benefit Plan

The Bank funds amounts equal to pension costs accrued.

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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.

Recent Accounting Pronouncements

In March 2012, the GASB issued Statement No. 65 *Items Previously Reported as Assets and Liabilities* will result in a reclassification of some financial statement line items on the balance sheet of governments. The objective of this Statement is to either (a) properly classify certain items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources or (b) recognize certain items that were previously reported as assets and liabilities as expenses or revenues, such as debt issuance costs, fees and costs associated with mortgage banking activities, lending activities and loan purchases. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2012. Accounting changes adopted to conform to the provisions of this Statement will be applied retroactively by restating financial statements for all periods presented. The Bank is currently evaluating the impact this statement will have on financial reporting

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27.* The statement amends the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* and Statement No. 50, *Pension Disclosures,* as they relate to government employers that account for pensions provided through trusts, or equivalent arrangements, that meet certain criteria. The statement includes accounting guidance for employers participating in single-employer and multiple-employer defined benefit pension plans, cost-sharing plans and defined contribution plans. The statement also addresses note disclosure and required supplementary information for employers whose employees are provided with defined benefit pensions through trusts. GASB 27 and 50 will remain applicable to employers whose pensions are not covered by the scope of this new statement.

Under the new statements, a cost-sharing employer whose employees receive pensions through a trust will report a net pension asset or liability, deferred outflows or inflows of resources related to pensions and pension expense based on its proportionate share of the collective net pension liability of all employers in the plan. The share of collective net pension liability recognized by an individual employer should be based on the employer’s relationship to all employers and non-employer contributing entities in the plan. The employer’s proportion should be consistent with how contributions are determined; the use of the long-term contribution effort of the employer is encouraged. The measurement of collective net pension liability, pension expense and other key information will follow the same standards that apply to single and agent employers. The effects of changes to an employer’s expected proportion of total employer-related contributions—as well as the effects of differences between the expected and actual proportionate share of total employer-related contributions each period—will be reported as a deferred outflow or inflow of resources and recognized in the employer’s pension expense in a systematic and rational manner over a closed period representative of the average expected remaining service lives of employees, beginning with the period of adoption. Under the current standards, governments recognize only the portion of cost-sharing pension obligations related to their annual required contributions.

GASB 68 will be effective for fiscal years beginning after June 15, 2014, with earlier application is encouraged. The Bank is currently evaluating the impact this statement will have on financial reporting.

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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 $62,835 in 2012 and $56,628 in 2011, respectively.

NOTE 3 - DEPOSITS AND INVESTMENTS

Deposits

The Bank has depository relationships where it is a requirement of the other institution in order 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, 2012 and 2011:

	2012	2011
Covered by depository insurance		
Due from banks	**$ 957**	$ 851
Uncollateralized		
Due from banks	**304,798**	1,072,703
Federal funds sold	**24,050**	18,315
Total bank balances	**$ 329,805**	$ 1,091,869

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, capital stock of government sponsored agencies, and venture capital.

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The composition of the investment portfolio, related credit quality rating, custody, and duration as of December 31, 2012 and 2011, is provided below:

	Rating *	Custody	Duration (In Years)	**2012**	2011
Mortgage-backed	Aaa	(1) & (2)	5.40	**$ 599,375**	$ 367,094
Federal agency	Aaa	(1) & (2)	1.82	**1,519,887**	479,972
Corporate bonds	Aaa	(1)	-	**-**	114,605
State and municipal	Not rated	(2) & (3)	4.57	**23,637**	16,161
Federal Home Loan Bank	Not rated	(4)	N/A	**24,488**	25,776
Other equity securities	Not rated	(3)	N/A	**4,159**	4,443
				$ 2,171,546	$ 1,008,051

* The credit quality rating indicated above is based on Moody's Investors Service.

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.
(4) Not registered and held at FHLB.

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 five 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 as of December 31, 2012.

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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 (1)	S & P (2)	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%

Investments in any one issuer that represent 5% or more of total investments as of December 31, 2012, are as follows:

	Amount	Percent
Federal agency		
Freddie Mac	$ 532,516	24.4%
Federal Home Loan Bank	455,855	21.0%
Fannie Mae	414,130	19.1%
Mortgage-backed		
Fannie Mae	327,064	15.1%
Freddie Mac	169,853	7.8%
Federal Home Loan Bank stock	24,488	1.1%
Others less than 5%	247,640	11.4%
	$ 2,171,546	100.0%

Securities with a fair value of $3,758 at December 31, 2011, were used to secure repurchase agreements and for other required pledging purposes. There were no securities pledged as of December 31, 2012 for these purposes. FHLB stock totaling $24,488 at December 31, 2012 and $25,776 at December 31, 2011 is pledged on the FHLB advances (Note 10).

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The maturity distribution of debt securities at December 31, 2012, 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. Federal Home Loan Bank stock and other equity securities are not included in the following maturity distribution.

Within one year	$ 107,452
Over one year through five years	1,886,499
Over five years through ten years	129,224
Over ten years	19,725
	$ 2,142,900

For the year ended December 31, 2012, proceeds from the sales of securities amounted to $7,678. For the year ended December 31, 2011, proceeds from the sales of securities amounted to $4,093.

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 $443,413 and $355,316 at December 31 2012 and 2011, respectively.

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 were held by the Bank at December 31, 2012 and 2011 amounted to $7,994 and 7,739, respectively. Deposits and short term borrowings held by the Bank were $52,860 and $42,115, respectively.

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	2012	2011
LOANS AND INTEREST RECEIVABLE – DUE FROM OTHER FUNDS – See NOTE 5		
OTHER ASSETS - Due from other funds (trade accounts receivable - all current)		
North Dakota Guaranteed Student Loan Program	$ 250	$ 225
North Dakota Student Loan Trust	158	190
Community Water Facility Loan Fund	21	21
Department of Human Services	9	10
Information Technology Department	6	6
Board of University and School Lands	154	184
	$ 598	$ 636
OTHER LIABILITIES - Due to other funds (trade accounts payable - all current)		
Information Technology Department	$ 361	$ 135
Attorney General	8	7
	$ 369	$ 142
OPERATING TRANSFERS - Out		
Rebuilders Loan Program	$ 27,771	$ 2,229
Information Technology Department	1,226	500
Industrial Commission	-	86
	$ 28,997	$ 2,815
COMPONENT UNITS OF THE STATE OF NORTH DAKOTA		
SECURITIES		
ND Public Finance Authority (to fund required reserves established by various series resolutions - all noncurrent)	$ 2,435	$ 2,819
LONG TERM DEBT		
NDPFA (to fund irrigation and waste mangement loans - $181 current in 2012 and $181 current in 2011)	$ 914	$ 1,095
INTEREST PAYABLE (NDPFA - all current)	$ 9	$ 11

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NOTE 5 - LOANS

The composition of the loan portfolio at December 31, 2012 and 2011 is as follows:

	2012	2011
Student	$ 1,278,405	$ 1,068,598
Commercial	1,064,041	1,062,534
Residential loans	594,508	575,020
Agricultural	342,824	289,002
	3,279,778	2,995,154
Allowance for loan losses	52,280	52,883
	$ 3,227,498	$ 2,942,271
Current portion	$ 773,155	$ 518,700

Unamortized deferred student loan costs totaled $10,368 and $11,414 as of December 31, 2012 and 2011, respectively. Net unamortized loan premiums and discounts on residential loans totaled $8,145 and $4,658 as of December 31, 2012 and 2011, respectively.

Overdrafts of deposit accounts at December 31, 2012 and 2011 in the amounts of $1,217 and $22, respectively, have been reclassified as loans.

The composition of State Institutions loans at December 31, 2012 and 2011 is as follows:

	2012		2011	
	Principal	Interest	Principal	Interest
Mill and Elevator (annual operating)	$ 38,000	$ -	$ 35,000	$ 64
Dept of Transportation	33,000	162	-	-
Western Area Water Supply	50,000	261	-	-
Rough Rider Industries	213	-	311	-
ND State Fair Association	965	42	2,601	1
Job Service	-	5	301	4
Highway Patrol	266	3	-	-
Housing Finance Agency	7,245	4	-	-
	$ 129,689	$ 477	$ 38,213	$ 69
Current portion	$ 79,210	$ 216	$ 35,301	$ 69

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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 and 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 loss 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.

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The total allowance reflects management's estimate of credit losses inherent in the loan portfolio at the balance sheet date. The Bank considers the allowance for credit losses of $52,280 adequate to cover loan losses inherent in the loan portfolio, at December 31, 2012. The following tables represent, by portfolio segment, the changes in the allowance for credit losses and the recorded investment in loans.

	2012				
	Commercial	**Agricultural**	**Residential**	**Student**	**TOTAL**
Beginning Balance:	**$ 40,118**	**$ 9,478**	**$ 2,000**	**$ 1,287**	**$ 52,883**
Charge-offs	**(2,418)**	**(12)**	**(362)**	**(188)**	**(2,980)**
Recoveries	**253**	**24**	**98**	**2**	**377**
Provision	**4,159**	**(2,388)**	**(289)**	**518**	**2,000**
Ending Balance	**$ 42,112**	**$ 7,102**	**$ 1,447**	**$ 1,619**	**$ 52,280**

	2011				
	Commercial	Agricultural	Residential	Student	TOTAL
Beginning Balance:	$ 36,210	$ 8,803	$ 483	$ 1,117	$ 46,613
Charge-offs	(4,613)	(63)	-	(129)	(4,805)
Recoveries	42	26	-	7	75
Provision	8,479	712	1,517	292	11,000
Ending Balance	$ 40,118	$ 9,478	$ 2,000	$ 1,287	$ 52,883

The following tables disaggregate our allowance for credit losses by impairment methodology.

	2012				
	Commercial	**Agricultural**	**Residential**	**Student**	**TOTAL**
Collectively evaluated	**$ 33,866**	**$ 6,817**	**$ 1,277**	**$ 1,619**	**$ 43,579**
Individually evaluated	**8,246**	**285**	**170**	**-**	**8,701**
Total	**$ 42,112**	**$ 7,102**	**$ 1,447**	**$ 1,619**	**$ 52,280**

	2011				
	Commercial	Agricultural	Residential	Student	TOTAL
Collectively evaluated	$ 30,770	$ 9,081	$ 2,000	$ 1,287	$ 43,138
Individually evaluated	9,348	397	-	-	9,745
Total	$ 40,118	$ 9,478	$ 2,000	$ 1,287	$ 52,883

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The following tables disaggregate our loan portfolio by impairment methodology.

	2012				
	Commercial	**Agricultural**	**Residential**	**Student**	**TOTAL**
Collectively evaluated	**$1,092,501**	**$ 325,140**	**$ 593,853**	**$ 617,665**	**$2,629,159**
Individually evaluated	**39,471**	**1,068**	**538**	**-**	**41,077**
Loan types excluded from allowance	**146,431**	**16,618**	**117**	**446,376**	**609,542**
Total	**$1,278,403**	**$ 342,826**	**$ 594,508**	**$1,064,041**	**$3,279,778**

	2011				
	Commercial	Agricultural	Residential	Student	TOTAL
Collectively evaluated	$ 1,012,566	$ 272,882	$ 573,640	$ 707,218	$ 2,566,306
Individually evaluated	44,978	2,006	1,242	-	48,226
Loan types excluded from allowance	11,053	14,115	138	355,316	380,622
Total	$ 1,068,597	$ 289,003	$ 575,020	$ 1,062,534	$ 2,995,154

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The Bank's internally assigned ratings are as follows:

	Risk Code	Description
Exceptional	1	Loan considered prime on the basis of very substantial financial capacity with minimal risk of non payment.
Excellent	2	Loan considered sound on the basis of strong financial capacity with little or no apparent weakness and very limited risk of non payment. The probability of serious financial deterioration is highly unlikely.
Good	3	Loan may reveal weaknesses in some areas, however, not of a serious nature and the debt remains collectible in its entirety. The collateral may be characterized as being less marketable than that of a higher rated borrower.
Acceptable	4	Bank feels that the credit risk is acceptable, but may require above average officer attention. Credit in this class exhibit the earliest signs of potential problems. A greater reliance will be placed on the quality and marketability of the underlying collateral as the cash flow may be unproven or somewhat erratic.
Special Mention	5	May be bankable based on certain types of loan programs which fall within the Bank's mission. This type of loan may be currently protected, but has potential unrealized weaknesses. The loan will require close monitoring as deterioration remains a strong possibility. The potential problems must remain manageable and must not pose a serious threat to repayment.
Substandard	6	Well defined weaknesses jeopardize orderly repayment. The loan is no longer protected by sound net worth or repayment capacity of the borrower. Even though elements of loss are present, the borrower can potentially repay if deficiencies are corrected. Close monitoring of this type of loan is extremely important to prevent loss to the Bank.
Doubtful	7	Loan had deteriorated to the point where collection or liquidation in full on the basis of current information, conditions and values is highly questionable and improbable. A doubtful classification is warranted during this period of quantifying/defining the amount of exposure or loss. A well defined corrective action or liquidation plan should be developed and implemented as soon as possible to limit further loss potential for the bank.
Loss	8	Loan is considered uncollectible and of such value that it should be charged-off. This classification does not mean that the asset has no recovery or salvage value.

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The following table represents credit exposures by internally assigned risk ratings for the years ended December 31, 2012 and 2011. The rating analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Bank's internal credit risk rating is based on experiences with similarly rated loans. Credit risk ratings are refreshed periodically as they become available, at which time management analyzes the resulting scores, as well as other external statistics and factors, to track loan performance.

2012

Risk Rating	Commercial Participations	Bank Stock	All Other Business Loans (Including PACE)	Farm & Ranch	Farm Real Estate
No assigned risk rating	$ -	$ -	$ -	$ -	$ -
1	2,685	-	-	-	-
2	11,389	-	83,812	6,425	104
3	318,585	79,087	35,531	73,373	42,675
4	365,187	54,493	71,340	67,239	70,750
5	35,585	2,028	5,749	3,136	28,142
6	45,825	12,339	834	873	80
7	5,885	-	1,621	-	-
8	-	-	-	-	-
Loan types excluded from allowance	-	-	146,431	-	-
Total	$ 785,141	$ 147,947	$ 345,318	$ 151,046	$ 141,751

Risk Rating	All Other Farm Loans	Residential Real Estate	Student Loans	Total
No assigned risk rating	$ -	$ 594,391	$ 617,665	$ 1,212,056
1	-	-	-	2,685
2	404	-	-	102,134
3	5,429	-	-	554,680
4	19,084	-	-	648,093
5	8,491	-	-	83,131
6	-	-	-	59,951
7	-	-	-	7,506
8	-	-	-	-
Loan types excluded from allowance	16,618	117	446,376	609,542
Total	$ 50,026	$ 594,508	$ 1,064,041	$ 3,279,778

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	2011				
Risk Rating	Commercial Participations	Bank Stock	All Other Business Loans (Including PACE)	Farm & Ranch	Farm Real Estate
No assigned risk rating	$ -	$ -	$ -	$ -	$ -
1	-	-	39,747	-	-
2	25,591	-	78,006	2,929	-
3	251,004	53,704	26,105	55,996	43,018
4	304,385	84,326	71,809	59,944	53,167
5	51,066	649	6,242	703	23,662
6	39,850	15,298	1,602	4,902	279
7	7,517	-	643	-	-
8	-	-	-	-	-
Loan types excluded from allowance	-	-	11,053	-	-
Total	$ 679,413	$ 153,977	$ 235,207	$ 124,474	$ 120,126

Risk Rating	All Other Farm Loans	Residential Real Estate	Student Loans	Total
No assigned risk rating	$ -	$ 574,882	$ 707,218	$ 1,282,100
1	-	-	-	39,747
2	66	-	-	106,592
3	3,208	-	-	433,035
4	20,536	-	-	594,167
5	6,478	-	-	88,800
6	-	-	-	61,931
7	-	-	-	8,160
8	-	-	-	-
Loan types excluded from allowance	14,115	138	355,316	380,622
Total	$ 44,403	$ 575,020	$ 1,062,534	$ 2,995,154

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Following are tables which include an aging analysis of the recorded investment of past due financing receivables as of December 31, 2012 and 2011. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (1) well-secured and in the process of collection, (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual or (3) student loans where accrued interest is guaranteed.

	2012						
Loan Class	**31-60 days past due**	**61 - 90 days past due**	**Greater than 90 days**	**Total Past Due**	**Current**	**Total Loans**	**Investment >90 days and accruing**
Commercial Participations	**$ 349**	**$ 4,202**	**$ 3,577**	**$ 8,128**	**$ 777,013**	**$ 785,141**	**$ 1,753**
Bank Stock	**-**	**-**	**-**	**-**	**147,947**	**147,947**	**-**
All other Business Loans (Including PACE)	**335**	**887**	**1,386**	**2,608**	**342,709**	**345,317**	**15**
Farm & Ranch	**873**	**-**	**253**	**1,126**	**149,920**	**151,046**	**253**
Farm Real Estate	**454**	**-**	**-**	**454**	**141,297**	**141,751**	**-**
All other Farm loans	**389**	**-**	**-**	**389**	**49,638**	**50,027**	**-**
Residential Real Estate	**11,358**	**1,706**	**4,825**	**17,889**	**576,619**	**594,508**	**4,664**
Student Loans	**22,169**	**8,519**	**45,676**	**76,364**	**987,677**	**1,064,041**	**45,445**
Totals	**$ 35,927**	**$ 15,314**	**$ 55,717**	**$ 106,958**	**$3,172,820**	**$3,279,778**	**$ 52,130**

	2011						
Loan Class	31-60 days past due	61 - 90 days past due	Greater than 90 days	Total Past Due	Current	Total Loans	Investment >90 days and accruing
Commercial Participations	$ 142	$ 178	$ 6,442	$ 6,762	$ 672,651	$ 679,413	$ 562
Bank Stock	-	-	-	-	153,977	153,977	-
All other Business Loans (Including PACE)	708	958	1,044	2,710	232,498	235,208	122
Farm & Ranch	1,077	1,851	952	3,880	120,594	124,474	952
Farm Real Estate	823	-	243	1,066	119,061	120,127	243
All other Farm loans	427	-	-	427	43,974	44,401	-
Residential Real Estate	10,829	2,456	5,963	19,248	555,772	575,020	5,511
Student Loans	16,648	10,835	33,076	60,559	1,001,975	1,062,534	32,861
Totals	$ 30,654	$ 16,278	$ 47,720	$ 94,652	$ 2,900,502	$ 2,995,154	$ 40,251

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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.

The following tables include the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable. Management determined the specific allowance based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the remaining source of repayment for the loan is the operation or liquidation of the collateral. In those cases, the current fair value of the collateral, less selling costs was used to determine the specific allowance recorded.

Also presented are the average recorded investments in the impaired loans during the time within the period that the impaired loans were impaired. 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.

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	2012									
Loan Class		Recorded Investment		Unpaid Principal Balance (1)		Associated Allowance		Average Recorded Investment		Interest Income Recognized
With No Specific Allowance Recorded:										
Commercial Participations	$	-	$	-	$	-	$	-	$	-
Bank Stock		-		-		-		-		-
All other Business Loans (Including PACE)		2		2		-		2		-
Farm & Ranch		-		-		-		-		-
Farm Real Estate		-		-		-		-		-
All other Farm loans		-		-		-		-		-
Residential Real Estate		300		300		-		302		15
With an Allowance Recorded:										
Commercial Participations	$	35,527	$	35,527	$	7,106	$	39,034	$	1,337
Bank Stock		1,929		1,929		290		2,006		80
All other Business Loans (Including PACE)		2,013		2,113		850		2,148		21
Farm & Ranch		873		873		265		928		66
Farm Real Estate		178		178		19		241		8
All other Farm loans		17		17		1		17		-
Residential Real Estate		238		238		170		238		5
Totals:										
Commercial Participations	$	35,527	$	35,527	$	7,106	$	39,034	$	1,337
Bank Stock		1,929		1,929		290		2,006		80
All other Business Loans (Including PACE)		2,015		2,115		850		2,150		21
Farm & Ranch		873		873		265		928		66
Farm Real Estate		178		178		19		241		8
All other Farm loans		17		17		1		17		-
Residential Real Estate		538		538		170		540		20

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Loan Class	2011 Recorded Investment	2011 Unpaid Principal Balance (1)	2011 Associated Allowance	2011 Average Recorded Investment	2011 Interest Income Recognized
With No Specific Allowance Recorded:					
Commercial Participations	$ -	$ -	$ -	$ -	$ -
Bank Stock	-	-	-	-	-
All other Business Loans (Including PACE)	3	3	-	25	-
Farm & Ranch	10	10	-	11	-
Farm Real Estate	-	-	-	-	-
All other Farm loans	-	-	-	-	-
Residential Real Estate	1,242	1,242	-	1,451	64
With an Allowance Recorded:					
Commercial Participations	$ 41,287	$ 41,287	$ 8,432	$ 42,715	$ 1,258
Bank Stock	1,115	1,115	167	1,145	51
All other Business Loans (Including PACE)	2,573	2,673	749	2,842	122
Farm & Ranch	1,077	1,077	342	1,282	91
Farm Real Estate	838	838	49	389	13
All other Farm loans	81	81	6	89	2
Residential Real Estate	-	-	-	-	-
Totals:					
Commercial Participations	$ 41,287	$ 41,287	$ 8,432	$ 42,715	$ 1,258
Bank Stock	1,115	1,115	167	1,145	51
All other Business Loans (Including PACE)	2,576	2,676	749	2,867	122
Farm & Ranch	1,087	1,087	342	1,293	91
Farm Real Estate	838	838	49	389	13
All other Farm loans	81	81	6	89	2
Residential Real Estate	1,242	1,242	-	1,451	64

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

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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.

On the following table are the financing receivables on nonaccrual status as of December 31, 2012 and 2011. The balances are presented by class of financing receivable.

	2012	2011
Commercial Participations	**$ 6,329**	$ 10,996
Bank Stock	**-**	-
All Other Business Loans (Including PACE)	**1,923**	1,100
Farm & Ranch	**-**	-
Farm Real Estate	**-**	-
All Other Farm Loans	**-**	-
Residential Real Estate	**161**	589
Student	**231**	215
TOTAL	**$ 8,644**	$ 12,900

Accruing loans 90 days or more past due include guaranteed student loans of $45,445 and $32,861 as of December 31, 2012 and 2011, respectively. The Bank is entitled to reimbursement from the guarantor 270 days after default in the case of a student loan payable in monthly installments and 330 days in the case of a student loan payable in less frequent installments.

Residential loans of $4,664 and $5,511 as of December 31, 2012 and 2011, respectively, are also included in accruing loans 90 days or more past due. In the event of a foreclosure a residential loan guaranteed by the Federal Housing Administration will be paid in full and the property title is transferred to them with the exception of flooded properties. The Department of Veterans Affairs has the option of paying their guaranty percentage and the Bank keeps the foreclosed property as well as any gain or loss from the sale or they can pay the loan in full and title is transferred to them.

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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.

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.

The following table presents information related to loans modified in a troubled debt restructuring during the year ended December 31, 2012. None of these loans subsequently defaulted after modification.

	Number of Modifications	Recorded Investment
Commercial Participations	7	$ 3,708
Bank Stock	-	-
All Other Business Loans (Including PACE)	1	352
Farm & Ranch	-	-
Farm Real Estate	-	-
All Other Farm Loans	-	-
Residential Real Estate	-	-
Student Loans	-	-
TOTAL	8	$ 4,060

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The following table presents the unpaid principal of loans modified in a troubled debt restructuring during the year ended December 31, 2012, by type of modification.

	To Interest Only	Below Market Rate	Other (1)	Total
Commercial Participations	$ 867	$ 2,312	$ 529	$ 3,708
Bank Stock	-	-	-	-
All Other Business Loans (Including PACE)	-	-	352	352
Farm & Ranch	-	-	-	-
Farm Real Estate	-	-	-	-
All Other Farm Loans	-	-	-	-
Residential Real Estate	-	-	-	-
Student Loans	-	-	-	-
TOTAL	$ 867	$ 2,312	$ 881	$ 4,060

(1) Other modifications include reamortization of payments, extended maturity and reduction of interest rate.

There were no material commitments to lend additional funds to customers whose loans were classified as impaired or restructured at December 31, 2012 and 2011.

NOTE 6 - LOAN SALES AND LOAN SERVICING

A summary of the Bank’s loan sales during 2012 and 2011 follows:

	2012	2011
Residential loans sold on the secondary market	**$ 17,097**	$ 1,952

BND recognized gains on sale of loans of $214 in 2012 and $43 in 2011 which are included in noninterest income on the Statements of Revenue, Expenses and Changes in Fund Net Position.

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The Bank has contracts to provide servicing of loans for others. These loans are not included in the accompanying balance sheets. The unpaid principal balances of loans serviced for others as of December 31, 2012 and 2011 were as follows:

	2012	2011
	(Unaudited)	
Student loans		
North Dakota Student Loan Trust	**$ 35,339**	$ 41,233
Residential loans	**13,655**	10,250
Other state fund loans		
Rebuilders Loan Program	**36,616**	2,206
Western Area Water	**32,390**	-
Board of University and School Lands	**30,751**	55,806
Community Water Facility Loan Fund	**16,048**	16,143
Department of Human Services	**7,433**	7,860
Information Technology Department	**6,268**	4,404
Workforce Safety	**162**	152
	$ 178,662	$ 138,054

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 years ended December 31, 2012 and 2011 is as follows:

	Balance 2011	Additions	Retirements	Balance 2012
Capital assets not being depreciated:				
Land	$ 1,445	$ 243	$ -	$ 1,688
Capital assets being depreciated:				
Building	$ 10,212	$ -	$ -	$ 10,212
Equipment	663	27	8	682
Furniture	679	-	1	678
Hardware	574	-	322	252
Intangibles - software	4,913	98	176	4,835
	17,041	125	507	16,659
Less accumulated depreciation for				
Building	1,168	300	-	1,468
Equipment	471	115	8	578
Furniture	251	67	-	318
Hardware	537	24	321	240
Intangibles - software	3,893	377	164	4,106
Total accumulated depreciation	6,320	883	493	6,710
Capital assets, net	$ 10,721	$ (758)	$ 14	$ 9,949

	Balance 2010	Additions	Retirements	Balance 2011
Capital assets not being depreciated:				
Land	$ 1,171	$ 274	$ -	$ 1,445
Capital assets being depreciated:				
Building	$ 10,212	$ -	$ -	$ 10,212
Equipment	756	76	169	663
Furniture	679	-	-	679
Hardware	627	11	64	574
Intangibles - software	5,513	419	1,019	4,913
	17,787	506	1,252	17,041
Less accumulated depreciation for				
Building	868	300	-	1,168
Equipment	510	126	165	471
Furniture	184	67	-	251
Hardware	509	92	64	537
Intangibles - software	4,593	315	1,015	3,893
Total accumulated depreciation	6,664	900	1,244	6,320
Capital assets, net	$ 11,123	$ (394)	$ 8	$ 10,721

Depreciation and amortization expense on the above assets amounted to $883 and $900 in 2012 and 2011, respectively.

NOTE 8 - DEPOSITS

The aggregate amount of locally sold certificates of deposit larger than $100,000 was $3,136,633 and $2,526,984 as of December 31, 2012 and 2011, respectively.

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At December 31, 2012, the scheduled maturities of certificates of deposits are as follows:

One year or less	$ 2,847,596
One to three years	232,368
Over three years	83,570
	$ 3,163,534

NOTE 9 - FEDERAL FUNDS PURCHASED AND REPURCHASE AGREEMENTS

	Federal Funds Purchased	Repurchase Agreements
2012		
Ending balance	**$ 275,960**	**$ -**
Highest month-end balance	**511,915**	**-**
Average daily balance	**225,769**	**-**
Weighted average interest rate		
As of year-end	**0.13%**	**0.00%**
Paid during year	**0.13%**	**0.00%**
2011		
Ending balance	$ 318,325	$ -
Highest month-end balance	426,160	-
Average daily balance	305,372	-
Weighted average interest rate		
As of year-end	0.13%	0.00%
Paid during year	0.11%	0.00%

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 have 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, 2012 and 2011, because the dealer did not take control of the securities. The Bank had not incurred any losses on these agreements in 2012 and 2011. 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 years ended December 31, 2012 and 2011 was as follows:

	Balance 2011	Additions	Reductions	Balance 2012	Amounts Due Within One Year
SHORT AND LONG-TERM LIABILITIES					
Federal Home Loan Bank advances	$ 470,327	$ 53,000	$ 117,989	$ 405,338	$ 3,110
ND Public Finance Authority	1,095	-	181	914	181
Compensated absences	966	824	770	1,020	816
Total long-term liabilities	$ 472,388	$ 53,824	$ 118,940	$ 407,272	$ 4,107

	Balance 2010	Additions	Reductions	Balance 2011	Amounts Due Within One Year
SHORT AND LONG-TERM LIABILITIES					
Federal Home Loan Bank advances	$ 396,199	$ 90,000	$ 15,872	$ 470,327	$ 2,989
ND Public Finance Authority	1,165	100	170	1,095	181
Compensated absences	930	796	760	966	821
Total long-term liabilities	$ 398,294	$ 90,896	$ 16,802	$ 472,388	$ 3,991

A summary, by years, of future minimum payments required to amortize the outstanding long-term debt is as follows:

	Principal	Interest	Total
2013	$ 3,291	$ 16,296	$ 19,587
2014	3,417	16,163	19,580
2015	3,540	16,024	19,564
2016	10,650	15,633	26,283
2017	3,763	15,320	19,083
2018-2022	373,304	32,251	405,555
2023-2025	8,287	1,027	9,314
Totals	$ 406,252	$ 112,714	$ 518,966

The FHLB long-term advances outstanding at December 31, 2012, mature from August 2016 through March 2025. The FHLB long-term advances have fixed rate interest, ranging from 2.20% to 7.35%. The advances must be secured by minimum qualifying collateral maintenance levels by pledging residential loans and student loans totaling $537,031 and $559,510 at December 31, 2012 and 2011, 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.

(continued on next page)

NOTE 11 - TRANSFERS PAYABLE

Transfers have been made out of unrestricted net assets to transfers payable. The Bank has the following transfers payable as of December 31, 2012 and 2011:

	2012	2011
Industrial Commission	**$ 43**	$ 86

NOTE 12 - PENSION PLAN

Bank of North Dakota participates in the North Dakota Public Employees' Retirement System (NDPERS) administered by the State of North Dakota. Following is a brief description of the plan.

NDPERS is a cost-sharing multiple-employer defined benefit pension plan covering substantially all classified employees of Bank of North Dakota. The plan provides retirement, disability, and death benefits. If an active employee dies with less than three years of credited service, a death benefit equal to the value of the employee's accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than three years of credited service, the surviving spouse will be entitled to a single payment refund, lifetime monthly payments in an amount equal to 50% of the employee's accrued normal retirement benefit, 60 monthly payments equal to the employee's accrued normal retirement benefit calculated as if the employee were age 65 the day before death occurred, or monthly payments in an amount equal to the employee'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 employee's accumulated pension benefits are paid, the balance will be payable to the surviving spouse's designated beneficiary.

Eligible employees who become totally disabled after a minimum of 180 days of service receive monthly disability benefits that are equal to 25% of their final average salary with a minimum benefit of $100. To qualify under this section, the employee must meet the criteria established by the Retirement Board for being considered totally disabled.

Employees are entitled to unreduced monthly pension benefits equal to 2.0% of their final average salary for each year of service beginning when the sum of age and years of credited service equal or exceed 85, or at normal retirement age (65). The plan permits early retirement at ages 55-64, with five or more years of service.

Benefit and contribution provisions are administered in accordance with chapter 54-52 of the North Dakota Century Code. This state statute requires that 5% of the participant's salary be contributed to the plan by either the employee or by the employer under a "salary reduction" agreement. Bank of North Dakota has implemented a salary reduction agreement and is currently contributing the employees share. Bank of North Dakota is required to contribute 5.12% of each participant's salary as the employer's share. In addition to the 5.12% employer contribution, the employer is required to contribute 1% of each participating employee's gross wage to a prefunded retiree health insurance program. The required contributions are determined using an entry age normal actuarial funding method. The North Dakota Retirement Board was created by the State Legislature and is the governing authority of NDPERS. Bank of North Dakota's required and actual contributions to NDPERS for the fiscal years ending December 31, 2012, 2011 and 2010 were approximately $868, $754 and $710, respectively.

NDPERS issues a publicly available financial report 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 - 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, 2011 and ending June 30, 2013 and in one case create a loan fund to provide low cost loans to individuals to repair their flood damaged homes. Following is a summary of legislative action and/or North Dakota Statute in effect:

H.B. 1003, Section 4 – Williston State College may borrow up to $1,725 for the workforce training building project.

H.B. 1004, Section 5 – The Department of Health, contingent on litigation and administrative proceedings, may borrow up to $500, the proceeds of which is appropriated for the purpose of defraying the expenses associated with possible litigation and other administrative proceedings involving the United States Environmental Protection Agency.

H.B. 1012, Section 4 – The Department of Transportation may borrow up to $200,000 for the purpose of providing funding for emergency relief projects on the state highway system. Any federal funding received for projects receiving funding under this section must be used to repay the loan.

H.B. 1015, Section 3 – The Department of Corrections and Rehabilitation may borrow up to $1,100 for the purpose of defraying the expenses of the penitentiary expansion project.

H.B. 1021, Sections 4 & 6 – The Health Information Technology Office Director may request the Bank of North Dakota to transfer up to $8,000 to the Health Information Technology Loan Fund to meet any required match for federal funds or to the Electronic Health Information Exchange Fund to meet any required match for federal funds or for ongoing operating expenditures of the Health Information Exchange or as directed, a portion to both funds to meet any required match for federal funds. The Health Information Technology Office Director shall request fund transfers from the Bank only as necessary to comply with federal requirements and to meet cash flow needs of the funds. The Health Information Technology Office Director may request the Bank of North Dakota to transfer up to $5,000 to the Health Information Technology Planning Loan Fund. The Health Information Technology Office Director shall request transfers from the Bank only as necessary to meet cash flow needs of the fund. For the years ended December 31, 2012 and 2011, the Bank had transferred $1,224 and $500, respectively, to these funds.

H.B. 1206, Section 2 – The Bank shall provide a loan of $50,000 to the Western Area Water Supply Authority for construction of a large water project in the western part of the state. The terms and conditions of the loan must be negotiated between the Bank and the Western Area Water Supply Authority, however, the term of the loan may not exceed seven years after June 30, 2014.

S.B. 2150, Section1 – The Department of Public Instruction may borrow the necessary funds to reimburse school districts for the excess cost of serving the one percent of special education students statewide who require the greatest school district expenditures in order to be provided with special education and related services. No borrowing limit was established. The Superintendent of Public Instruction shall file for introduction legislation requesting the ensuing legislative assembly to return any amount transferred under this bill.

S.B. 2308, Section 3 – A line of credit not exceeding $2,560 shall be extended to the Highway Patrol to establish an online electronic permit system.

S.B. 2371, Section 7 – The Bank shall transfer up to $30,000 from its current earnings and undivided profits to the Rebuilders Loan Program. As of December 30, 2012, the Bank had transferred the entire $30,000 to this fund.

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.

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, 2012 and 2011, the Bank has guarantees outstanding totaling $106 and $273, respectively. The Bank had no guarantee commitments outstanding as of December 31, 2012 and 2011 included in commitments to extend credit.

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 $200. The term of the guarantee may not exceed five years. As of December 31, 2012 and 2011, the Bank has guarantees outstanding totaling $4,516 and $4,963, respectively, and had guarantee commitments outstanding of $558 and $248, respectively, included in commitments to extend credit.

Livestock Loan Guarantee Program

Chapter 6-09-41 of the North Dakota Century Code provides that the Bank of North Dakota establish and administer a loan guarantee program that is designed to expand livestock feeding and dairy farming in this state. This program was effective through June 30, 2009.

The Bank may guarantee loans made by a bank, credit union, a savings and loan association, or any other lending institution in this state to the owner of a commercial livestock feeding operation or to the owner of a new or expanding dairy operation. In the event of a default, the Bank shall pay to the lender the amount agreed upon, provided that the amount may not exceed 85% of the principal due the lender at the time the claim is approved.

As of December 31, 2011, the Bank had guarantees outstanding totaling $743. As of December 31, 2012, there were no guarantees outstanding. The Bank had no guarantee commitments outstanding as of December 31, 2012 and 2011 included in commitments to extend credit.

NOTE 14 - 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 and financial standby letters of credit. 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, 2012 and 2011, the following financial instruments were outstanding where contract amounts represent credit risk:

	Contract Amount	
	2012	2011
Commitments to extend credit	**$ 780,001**	$ 708,282
Financial standby letters of credit	**260,731**	323,703
Guarantees provided	**5,180**	6,227

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 likelihood of funding any of these letters of credit is considered to be remote. The Bank holds collateral supporting those commitments.

Financial standby letters of credit include letters of credit pledged for public deposits by North Dakota banks for $191,935 and $212,286 at December 31, 2012 and 2011, respectively. These letters of credit are an authorized form of collateral for public deposits per North Dakota Century Code 21-04-09.

NOTE 15 - FAIR VALUE OF FINANCIAL INSTRUMENTS

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Investment securities are recorded at fair value on a recurring basis.

Effective January 1, 2008, the Bank adopted Statement of Financial Accounting Standards Accounting Standards Codification (ASC) 820-10, *Fair Value Measurements*. ASC 820-10 defines fair value and establishes a consistent framework for measuring fair value under generally accepted accounting principles and expands disclosure requirements for fair value measurements.

Fair Value Hierarchy

Under ASC 820-10, we group our assets and liabilities 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 for identical instruments traded in active markets.
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments 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 ASC 820-10, we base our fair values 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 our 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 of ASC 820-10.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value and for estimating fair value for financial instruments not recorded at fair value (ASC 825-10 disclosures).

Cash and Cash Equivalents

Cash and cash equivalents**,** include cash and due from banks, items out for collection, and federal funds sold. These assets are carried at historical cost. The carrying amounts of cash and cash equivalents approximate fair value due to the relatively short period of time between the origination of the instruments and their expected realization.

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 on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury, other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include private collateralized mortgage obligations and state and political securities. FHLB stock and nonmarketable securities are not publically traded and management has determined fair value approximate cost.

Loans

The carrying value of loans is described in note 1, "Summary of Significant Accounting Policies". We do not record loans at fair value on a recurring basis. As such, valuation techniques discussed herein for loans are primarily for estimating fair value for ASC 825-10 disclosure purposes. However, from time to time, we record nonrecurring fair value adjustments to loans to reflect (1) partial write-downs that are based on the observable market price or current appraised value of the collateral, or (2) the full charge-off of the loan carrying value.

The fair value estimates for ASC 825-10 purposes differentiates loans based on their financial characteristics, such as product classification, loan category, pricing features and remaining maturity. Prepayment and credit loss estimates are evaluated by product and loan rate.

- The fair value of student loans is based on market values as established by the secondary market.
- For real estate 1-4 family first and junior lien mortgages, fair value is based on market values as established by the secondary market.
- The fair value of all other loans is calculated by discounting contractual cash flows using discount rates that reflect our current pricing for loans with similar characteristics and remaining maturity.
- Off-Balance Sheet Credit-Related Instruments include loans commitments, standby letters of credit, and guarantees. These instruments generate ongoing fees at our current pricing levels, which are recognized over the term of the commitment period. The fair value of these instruments is estimated based upon fees charged for similar agreements. The carrying value of the deferred fees is a reasonable estimate of the fair value of the commitments.

Interest Receivable

The carrying amount of interest receivable approximates fair value due to the relatively short period of time between accrual and expected realization.

Non-Maturity Deposits

The fair value for deposits with no stated maturity, such as demand deposits, savings, NOW, and money market accounts, are disclosed as the amount payable upon demand.

Deposits with Stated Maturities

The fair value for interest bearing certificates of deposit has been estimated by discounted future cash flows using rates currently offered for deposits of similar remaining maturities.

Federal Funds Purchased and Repurchase Agreements

The carrying amount of federal funds purchased and repurchase agreements approximates fair value due to the relatively short period of time between the origination of the instruments and their expected payments.

Interest payable

The carrying amount of interest payable approximates fair value due to the relatively short period of time between accrual and expected payment.

Short and Long-Term Debt

Current market prices were used to estimate the fair value of short and long-term debt using current market rates of similar maturity debt.

Other Liabilities

The carrying amount of other liabilities approximates fair value due to the short period of time until expected payment.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below presents the balances of assets and liabilities measured at fair value on a recurring basis at December 31, 2012 and 2011.

	2012			
	Total	**Quoted Prices in Active Markets Level 1**	**Significant Other Observable Inputs Level 2**	**Significant Unobservable Inputs Level 3**
Debt securities				
Mortgage-backed securities				
Agency	**$ 277,762**	**$ 277,762**	**$ -**	**$ -**
Collateralized mortgage obligations				
Agency	**320,914**	**320,914**	**-**	**-**
Non-agency	**701**	**-**	**701**	**-**
Agency bonds	**1,519,885**	**1,519,885**	**-**	**-**
Municipal bonds	**23,637**	**-**	**23,637**	**-**
Totals	**$ 2,142,899**	**$2,118,561**	**$ 24,338**	**$ -**

	2011			
	Total	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Debt securities				
Mortgage-backed securities				
Agency	$ 124,189	$ 124,189	$ -	$ -
Collateralized mortgage obligations				
Agency	235,014	235,014	-	-
Non-agency	7,891	-	7,891	-
Agency bonds	479,973	479,973	-	-
Corporate bonds	114,605	114,605	-	-
Municipal bonds	16,161	-	16,161	-
Totals	$ 977,833	$ 953,781	$ 24,052	$ -

Assets Measured at Fair Value on a Nonrecurring Basis

The tables below presents the Bank's balances of financial instruments measured at fair value on a nonrecurring basis at December 31, 2012 and 2011.

	2012		
	Quoted Prices in Active Markets Level 1	**Significant Other Observable Inputs Level 2**	**Significant Unobservable Inputs Level 3**
Impaired loans	**$ -**	**$ -**	**$ 32,376**
Totals	**$ -**	**$ -**	**$ 32,376**

	2011		
	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Impaired loans	$ -	$ -	$ 38,481
Totals	$ -	$ -	$ 38,481

The significant unobservable inputs used in the fair value measurement of collateral for collateral-dependent impaired loans primarily relate to customized discounting criteria applied to the customer's reported amount of collateral. The amount of the collateral discount depends upon the marketability of the underlying collateral. The Bank's primary objective in the event of default would be to monetize the collateral to settle the outstanding balance of the loan, in which collateral with lesser marketability characteristics would receive a larger discount.

The valuations are reviewed at least quarterly by the internal Problem Loan Committee and are considered in the overall calculation of the allowance for credit losses. Unobservable inputs are monitored and adjusted if market conditions change.

ASC 825-10, Disclosures about Fair Value of Financial Instruments

The table on the next page is a summary of fair value estimates as of December 31, 2012 and 2011, for financial instruments, as defined by ASC 825-10. The carrying amounts in the following table are recorded in the balance sheet under the indicated captions. In accordance with ASC 825-10, we have not included assets and liabilities that are not financial instruments in our disclosure, such as our premises and equipment and other assets. Additionally, the amounts in the table have not been updated since year end; therefore the valuations may have changed significantly since that point in time. For these reasons, the total of the fair value calculations presented does not represent, and should not be construed to represent, the underlying value of the Bank.

The carrying amounts and estimated fair values of the Bank's financial instruments as of December 31, 2012 and 2011 were as follows:

	2012		2011	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	**$ 725,231**	**$ 725,231**	$ 1,369,370	$ 1,369,370
Securities	**2,171,546**	**2,171,546**	1,008,051	1,008,051
Interest receivable	**40,102**	**40,102**	39,479	39,479
Loans, net	**3,227,498**	**3,311,568**	2,942,271	3,021,256
Financial liabilities				
Non-maturity deposits	**$ 1,840,028**	**$1,840,028**	$ 1,539,270	$ 1,539,270
Deposits with stated maturities	**3,163,534**	**3,189,792**	2,640,567	2,564,873
Federal funds purchased and repurchase agreements	**275,960**	**275,960**	318,325	318,325
Short and long-term debt	**406,252**	**461,798**	471,422	526,017
Other liabilities	**5,765**	**5,765**	5,586	5,586
Unrecognized financial instruments				
Commitments to extend credit	**$ 780,001**	**$ 780,001**	$ 708,282	$ 708,282
Financial standby letters of credit	**260,731**	**260,731**	323,703	323,703
Guarantees provided	**5,180**	**5,180**	6,227	6,227

NOTE 16 - 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 17 - CONTINGENCY

The Bank manages a portion of the investment portfolio for the State Investment Board (SIB). During 2012, SIB requested that the Bank transition a portion of that investment portfolio. SIB contends it provided instructions to the Bank regarding the transition, to include the date upon which the transition was to have been completed by the Bank. SIB contends that because the Bank did not complete the transition by the requested date, SIB suffered investment losses for which the Bank is responsible. The Bank's management acknowledges that the Bank did not complete the transition by the requested date and anticipates correcting any underperformance in SIB's investment portfolio that may have occurred between the date SIB requested the transition be completed and the date the Bank actually completed the transition. Because the Bank has not yet determined the amount of any resulting underperformance experienced by SIB, it has not recorded such an amount in the Bank's financial statements.

NOTE 18 - SUBSEQUENT EVENTS

In January 2013, the Bank transferred $7,500 from Undivided Profits to the Health Information Exchange in accordance with H.B. 1021.

BANK OF NORTH DAKOTA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS **EXHIBIT A-1**
YEAR ENDED DECEMBER 31, 2012

Federal Grantor/Program Title	Federal CFDA Number	Expenditures
DEPARTMENT OF EDUCATION		
Direct Program:		
Federal Family Education Loan Program	84.032	
Interest subsidy		$ 4,540,953
Special allowance		137,677
Excess interest		(17,622,808)
Net special allowance received/(paid)		(17,485,131)
Guaranteed Student Loans:		
Previous year balance of loans on which there are continuing compliance requirements		695,748,378
Total guaranteed student loans (Note 2)		695,748,378
Total Department of Education		682,804,200
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		424,025,406
FHA loan principal disbursed during the fiscal year		96,209,542
Total guaranteed loans (Note 3)		520,234,948
Total Department of Housing and Urban Development		520,234,948
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		124,386,582
VA loan principal disbursed during the fiscal year		34,510,983
Total guaranteed loans (Note 4)		158,897,565
Total Department of Defense		158,897,565
DEPARTMENT OF JUSTICE		
Direct Program:		
John R. Justice Prosecutors and Defenders Incetive Act	16.816	
Grant for loan forgiveness		105,164
Department of Juctice		105,164
TOTAL FEDERAL AWARDS		$ 1,362,041,877

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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE 2 - The outstanding balance of guaranteed student loans on which there are continuing compliance requirements under the student loan program totaled $610,207,495 as of December 31, 2012.

NOTE 3 - The outstanding balance of guaranteed FHA residential loans on which there are continuing compliance requirements totaled $426,088,009 as of December 31, 2012.

NOTE 4 - The outstanding balance of guaranteed VA residential loans on which there are continuing compliance requirements totaled $124,540,901 as of December 31, 2012.

None

EideBailly
CPAs & BUSINESS ADVISORS

EXHIBIT A-3

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*

The Industrial Commission
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, 2012, 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 9, 2013.

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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified a certain deficiency in internal control that we consider to be a material weakness.

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 Bank of North Dakota's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompany schedule of findings and questioned costs as item 2012-01 to be a material weakness.

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(continued on next page)

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 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*.

Bank of North Dakota's Response to Finding

The Bank of North Dakota's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The Bank of North Dakota's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 result of that testing, and not to provide an opinion on the effectiveness of the entity'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 9, 2013

Report on Compliance for Each Major Federal Program and Report on Internal Control over Compliance Required by OMB Circular A-133

The Industrial Commission
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 Circular A-133 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, 2012. 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 the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of 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, 2012.

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(continued on next page)

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 2012-02. Our opinion on each major federal program is not modified with response to this matter.

The Bank of North Dakota's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The Bank of North Dakota's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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 OMB Circular A-133, 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 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2012-02, 2012-03, 2012-04 and 2012-05 that we consider to be significant deficiencies.

The Bank of North Dakota's responses to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The Bank of North Dakota's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

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 OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Eide Bailly LLP

Bismarck, North Dakota
April 9, 2013

BANK OF NORTH DAKOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS **EXHIBIT A-5**
YEAR ENDED DECEMBER 31, 2012

A. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued	Unqualified
Internal control over financial reporting:	
Material weakness identified	Yes
Significant deficiency	None reported
Noncompliance material to financial statements noted	No

Federal Awards

Internal control over federal programs:	
Material weakness identified	No
Significant deficiency	Yes
Type of auditor's report issued on compliance with major programs	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)	Yes

Identification of major programs:

Name of Federal Program	CFDA number
Federal Family Education Loans Program	84.032
Mortgage Insurance – Homes	14.117
Veterans Housing – Guaranteed and Insured Loans	64.114

Dollar threshold used to distinguish between Type A and Type B programs	$300,000
Auditee qualified as low-risk auditee	Yes

B. Findings - Financial Statement Audit

2012-01 – Financial Statement Audit Adjustment – Material Weakness

Condition – The Bank accounted for the purchase and sale of investment securities on a settlement date basis as opposed to trade date basis. Accounting principles generally accepted in the United States of America requires the accounting for the purchase and sale of investment securities on a trade date basis.

Criteria – The implementation guide to GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, requires purchases and sales of securities shall be recorded on the trade date.

Context – Six investment security purchases with a trade date prior to December 31, 2012 and settlement date subsequent to December 31, 2012, were not included in the security line item within the balance sheet and the related security footnote disclosures.

Cause – The Bank accounted for their security purchases and sales on a settlement date basis, which conflicts with the requirements to record security purchases and sales on a trade date basis.

Effect – The Bank's financial statement line item for investment securities was understated by $27,611,497, and the financial statement line item for cash and due from banks was over stated by $27,611,497.

Recommendation – The Bank should revise their accounting policy for the purchase and sale of investment securities to conform to the requirements of GASB, whereby investments security purchases and sales are accounted for on a trade date basis.

Management's Response/Proposed Action Item(s): Effective March 31, 2013, the Investment Department's investment portfolio software, SunGard/InTrader, which records all investment portfolio activity for the bank, will be programmed to automatically run the "Pending Trades by Security" report. This report will indicate all trades that have been entered into, but not yet settled. This report will automatically be run along with the Quarter-End RCB Call Report information and with the Quarter-End Risk-Based Capital Report which is given directly to Accounting Services.

Any pending trades at quarter end will be processed on trade date. We will continue this procedure until our software vendor develops an enhancement to process all trades on trade date in compliance with ASC 942-325-25-2. This procedure was updated as of Friday, February 8, 2013.

Action Item Owner: Accounting & Treasury
Action Item Target Date: Manual process completed as of February 8, 2013. Automated process will take effect March 31, 2013.

C. Findings - Major Federal Award Programs Audit

2012-02 - Special Tests and Provisions – Interest Subsidies related to Loan Purchases, Department of Education, Federal Family Education Loans Program, CFDA 84.032, 2012 Award Year – Significant Deficiency

Condition – The Bank billed the Department of Education for interest benefits on ineligible FFEL rehabilitation loans that were purchased during 2012.

Criteria – 34 CFR 682.300 states that loans eligible for interest benefits are Stafford loans during all periods prior to the beginning of the repayment period, during any period when the borrower has an authorized deferment and during a period that does not exceed three consecutive years from the established repayment period start date on each loan under an income-based repayment plan.

Context – Nine of twenty-five purchased rehabilitation loans tested were incorrectly reported in the Interest Benefits section of the Lender's Interest and Special Allowance Request and Report (LaRS). There were 836 rehabilitated loans purchased during 2012.

Questioned costs - $2,179

Cause – The Bank had errors in data entered in the loan system when the rehabilitation loans were purchased that caused the loans to be incorrectly identified as being eligible for interest benefits in prior periods and resulted in an adjustment on the LaRS related to the prior periods.

Effect – Errors in data input can result in errors in the information reported on the quarterly LaRS that are not easily detected as most of the LaRS information reported is based on system generated reports based on the data inputs.

Recommendation – We recommend the Bank review the internal controls related to data input to ensure all loan information is accurately entered.

Management's Response/Proposed Action Item(s): Student Loan Services reviewed every loan that was purchased since conversion to Helms. We identified 560 loans that were billed incorrectly totaling approximately $152,000. An adjustment to correct the overbilling will be performed on the next LaRs filing (April 2013).

Student Loan Services has also provided 5280 with copies of our loan input procedures for review. We are requesting 5280 to identify data entry steps that SLS may be performing incorrectly. We expect a response by March 31, 2013. If 5280 determines that the procedures are incorrect, SLS will provide additional training to employees and will make the necessary adjustments immediately. If 5280 determines a system flaw exists, updated system code is expected by June 30, 2013.

To prevent further errors from reporting incorrectly on the LaRs, SLS will manually remove each purchased loan from the LaRs report that incorrectly bills interest against prior quarters.

Action Item Owner: Lending/Student Loans
Action Item Target Date: June 30, 2013.

2012-03 - Special Tests and Provisions – LaRS Reporting for Cured Loans, Department of Education, Federal Family Education Loans Program, CFDA 84.032, 2012 Award Year – Significant Deficiency

Condition – The Bank did not accurately report information related to loan cures on the LaRS during 2012. Specifically, the average daily balance calculations reported in the special allowance payment section of the LaRS were not adjusted when the loans became ineligible for special allowance payments at the time the loans ceased to be eligible for insurance and again at the time when the loans became eligible for special allowance payments after being cured.

Criteria – 34 CFR 682.302(d) states that the obligation to pay special allowance on a loan terminates the date a loan ceases to be guaranteed or ceases to be eligible for reinsurance under this part, with respect to that portion of the loan that ceases to be guaranteed or reinsured, regardless of whether the lender has filed a claim for loss on the loan with the guarantor. 34 CFR 682, Appendix D states that for any loans on which a cure is required, in order to receive any reinsurance payments, the lender may resume billing for interest and special allowance on the loan only for periods following its completion of the required cure procedure.

Context – Two of two cured loans tested were incorrectly reported in the special allowance section of the LaRS. There were eight loans reported as cured on the 2012 LaRS.

Cause – The Bank did not identify the due-diligence and timely filing violations in the loan system at the time the violations occurred and did not enter the cure procedures to remedy the violations in the loan system when the necessary cures were taken. This caused the average daily balances reported in the special allowance section of the LaRS to be calculated incorrectly and resulted in ineligible loans reported in the special allowance section.

Effect – Errors in data input can result in errors in the information reported on the quarterly LaRS that are not easily detected as most of the LaRS information reported is based on system generated reports based on the data inputs.

Recommendation – We recommend the Bank review the internal controls related to data input to ensure all loan information is accurately entered.

Management's Response/Proposed Action Item(s): Two borrowers had loans that became uninsured in January 2012. A CSR in the Processing area updated Helms to uninsured status on the first loan of a borrower, but did not perform those same updates on subsequent loans. The subsequent loans then reported on the LaRs in error. None of the loans were updated to uninsured status of the second borrower also causing incorrect reporting on the LaRs.

CSR's in the Processing area have been informed that each loan must be updated in Helms. Corrections to the LaRs report will be performed during the next LaRs filing (April 2013).

Action Item Owner: Lending/Student Loans
Action Item Target Date: April 30, 2013.

2012-04 - Special Tests and Provisions – Loan Servicing of Delinquent and Defaulted Loans, Department of Housing and Urban Development, Mortgage Insurance – Homes, CFDA 14.117, 2012 Award Year – Significant Deficiency

Condition – The Bank did not make telephone contact with delinquent borrowers between the 17th and 30th day of delinquency.

Criteria – 24 CFR 203.600 states that mortgagees shall take prompt action to collect amounts due from mortgagors to minimize the number of accounts in a delinquent or default status. HUD Handbook 4330.1, chapter 7 discusses collection techniques based on 24 CFR 203.600 and states that mortgagees must commence telephone contacts by the 17th day of delinquency and complete them by the end of the month. The Bank's collection procedures include contacting delinquent borrowers through telephone contacts between the 17th and 30th day of delinquency although the collection techniques are adapted to individual differences in mortgagors and takes account of the circumstances peculiar to each mortgagor as allowed by 24 CFR 203.600.

Context – The Bank did not make telephone contact between the 17th and 30th day of delinquency for three of forty delinquent loans tested. Later collection efforts were made for the three loans that did not have telephone contact in the first month of delinquency and the accounts were brought current during 2012.

Cause – The delinquent loans were inadvertently missed when the monthly telephone contacts were being made by the Bank's collections department.

Effect – 24 CFR 203.500 states that failure to comply with mortgage servicing requirements for mortgages insured by HUD will not be a basis for denial of insurance benefits, but can be cause for penalties. Failure to complete the necessary collection procedures can also affect timely remedy of delinquent loans to prevent them from reaching a default status.

Recommendation – We recommend the Bank review the internal controls related to telephone contacts made for delinquent loans to ensure all delinquent borrowers are contacted in the first month of delinquency.

Management's Response/Proposed Action Item(s): The 45 day delinquency letter and comment is generated by our collections system. If an account is current and then becomes delinquent as a result of an NSF check a letter is not generated after the check is returned.

Residential Lending staff has discussed this finding and staff is aware to research accounts when a check is returned to make sure that a 45 day letter is then sent manually if needed.

Action Item Owner: Lending/Residential Real Estate
Action Item Target Date: Training completed.

2012-05 - <u>Special Tests and Provisions – Loan Servicing of Delinquent and Defaulted Loans, Department of Veteran's Affairs, Veterans Housing – Guaranteed and Insured Loans, CFDA 64.114, 2012 Award Year</u> – Significant Deficiency

Condition – The Bank did not make telephone contact with a delinquent borrower during the first 30 days of delinquency and did not send a letter to another borrower within 45 calendar days after the payment was due.

Criteria – 38 CFR 36.4350(g) discusses the required collection actions for delinquent loans which include, at a minimum, the mortgagor making an effort to establish contact with the borrower by telephone within the first 30 days of delinquency and a letter to the borrower if payment has not been received within 45 calendar days after such payment was due.

Context – There were errors in the collection actions taken for two of thirty delinquent loans tested. The Bank did not make telephone contact during the first 30 days of delinquency for one of thirty delinquent loans tested. The Bank did not send the 45 day letter for one of thirty delinquent loans tested. Later collection efforts were made for the loans and the accounts were brought current.

Cause – The delinquent loan was inadvertently missed when the monthly telephone contacts were being made by the Bank's collections department. A payment was received on the 44th day of delinquency for the other loan causing the Bank's system to identify that the loan was current when the delinquency letters were system-generated on the 45th day of delinquency. The payment that had been received on the 44th day of delinquency was later rejected due to insufficient funds so the 45 day letter was missed.

Effect – Failure to comply with the required collection actions could result in penalties assessed by the Department of Veterans Affairs. Failure to complete the necessary collection procedures could also affect timely remedy of delinquent and defaulted loans to prevent them from reaching foreclosure.

Recommendation – We recommend the Bank review the internal controls related to collection efforts to ensure all necessary actions are taken for each delinquent borrower.

Management's Response/Proposed Action Item(s): Residential Lending has a process in place to contact borrowers in a timely manner that complies with agency guidelines. Our collections system has the ability to bring up only one account at a time. When the Collections Officer speaks with a borrower there are times that he is not able to complete his comment because another borrower calls him and he needs to bring up the new account. At times, due to the volume of calls, comments may be missed even though the call was made.

Residential Lending staff has discussed both of the findings and staff is aware to make a diligent effort to make sure that all comments are documented in the collections system.

Action Item Owner: Lending/Residential Real Estate
Action Item Target Date: Training completed.

CPAs & BUSINESS ADVISORS

EXHIBIT A-6

Independent Auditor's Comments Requested by the North Dakota Legislative Audit and Fiscal Review Committee

The Industrial Commission
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, 2012 audit of Bank of North Dakota are as follows:

Audit Report Communications:

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

   Unqualified

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?

   No. An internal control deficiency was identified. See schedule of findings and questioned costs.

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 were no prior year findings or recommendations.

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

   No.

Audit Committee Communications:

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

   There were no significant changes in accounting policies, management conflicts of interest, or any significant unusual transactions.

   BND does have a contingency which has been included in the notes to the financial statements as Note 17. The contingency is related to the matter involving the lack of timeliness in the transitioning of the portion of the State Investments Board's investment portfolio managed by Bank of North Dakota. As of the date that the financial statements were available to be issued, Bank of North Dakota was not able to reasonably determine an estimated liability relating to the matter.

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 loan losses. The allowance for loan losses is maintained at an amount considered by management to adequately provide for probable losses in the loan portfolio at the balance sheet date. The allowance for loan losses is based on periodic analysis of the loan portfolio by management. In this analysis, management considers factors including, but not limited to, current economic conditions, loan portfolio composition and historical loss experience. We have performed tests of the allowance for loan losses to satisfy ourselves as to its reasonableness in relation to the financial statements taken as a whole.

3. Identify any significant audit adjustments.

   There was one significant audit adjustment as a result of the audit procedures performed. The adjustment was to increase Securities and decrease Cash and Due From Bank by $27,611,497. The Bank had accounted for the purchase and sale of investment securities on the settlement date of the transaction. The implementation guide to GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, requires purchases and sales of securities to be recorded on a trade date basis.

   There was no income statement effect to the audit adjustment noted above.

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 North Dakota Industrial Commission, Legislative Audit and Fiscal Review Committee, Advisory Board, management, and the federal awarding agencies 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 9, 2013

BANK OF NORTH DAKOTA
SCHEDULE OF APPROPRIATED EXPENDITURES **EXHIBIT B-1**
BIENNIUM ENDED JUNE 30, 2012
(In Thousands)

	Biennium Appropriation July 1, 2011 to June 30, 2013	Expenditures for Year Ended June 30, 2012	Unexpended Appropriations
APPROPRIATED EXPENDITURES:			
Operating Expenses	$ 45,587	$ 20,012	$ 25,575
Capital Assets	1,266	124	1,142
	$ 46,853	$ 20,136	$ 26,717

* **Expenditures Reconciliation:**

Total expenses per financial statements-	
Interest expense	$ 44,311
Provision for loan losses	2,000
Operating expenses	22,624
	68,935
Non-appropriated expenditures:	
Interest expense	44,311
Provision for loan losses	2,000
Correspondent fees	818
Depreciation and amortization	913
Other real estate expense	-
Loan collection expenses	397
Loan servicing fee expense	399
Other expenses	15
Nonappropriated expenditures	48,853
Equipment capitalized	-
Land capitalized	517
Hardware capitalized	11
Software capitalized	67
Salaries capitalized	63
	658
Timing differences for appropriated expenditures:	
July 1, 2012 to December 31, 2012	(10,511)
July 1, 2011 to December 31, 2011	9,907
	(604)
Appropriated Expenditures for the fiscal year	$ 20,136

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

BANK OF NORTH DAKOTA
DETAILED SCHEDULE OF APPROPRIATED EXPENDITURES **EXHIBIT B-2**
YEARS ENDED JUNE 30, 2012

		2012
Operating		
Salaries and wages	$	8,598
Social security		656
Hospital insurance		1,727
State retirement contribution		809
Vacation and sick leave benefits		98
Unemployment insurance and worker's compensation premium		20
Building expenses		213
Furniture and equipment expenses		83
Processing and development expenses		1,241
Software/IT supplies		484
Contractual services/repairs		1,437
IT equipment < $5,000		42
Telephone		273
Marketing		1,509
Professional services		765
Travel		157
Dues and publications		181
Supplies		147
Postage		679
Other operating expenses		317
Contingency		576
		20,012
Capital assets		124
	$	20,136

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EXHIBIT C-1

Karlene Fine, Executive Director
The Industrial Commission
State of North Dakota
Bismarck, North Dakota

We have audited the financial statements of the business-type activities of the Bank of North Dakota for the year ended December 31, 2012. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards* and OMB Circular A-133 as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated October 9, 2012. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices
Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Bank of North Dakota are described in Note 1 to the financial statements. During 2012, the Bank of North Dakota implemented GASB Statement No. 62 - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* and GASB Statement No. 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which did not have a significant effect on financial reporting. No new accounting policies were adopted and the application of existing policies was not changed during 2012. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's 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 significantly from those expected. The most sensitive estimate affecting the financial statements was:

> The allowance for loan losses is maintained at an amount considered by management to adequately provide for probable losses in the loan portfolio as of the balance sheet date. The allowance for loan losses is based on periodic analysis of the loan portfolio by management. In this analysis, management considers factors including, but not limited to, current economic conditions, loan portfolio composition and historical loss experience. Loans are charged off to the extent they are deemed to be uncollectible. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. We have performed tests of the allowance for loan losses to satisfy ourselves as to its reasonableness in relation to the financial statements taken as a whole.

The financial statement disclosures are neutral, consistent, and clear.

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Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We noted the following uncorrected misstatement of the financial statements, which management has determined that the effect is immaterial to the financial statements taken as a whole:

Other operating expenses	$2,500,000	
Other liabilities		$2,500,000

To record the estimated contingent liability related to State Investment Board

The following material misstatement detected as a result of the audit procedures was corrected by management:

Securities	$27,611,497	
Cash and due from banks		$27,611,497

To record purchase of securities as of trade date as opposed to settlement date

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated April 9, 2013.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This information is intended solely for the use of the North Dakota Industrial Commission, Legislative Audit and Fiscal Review Committee, Advisory Board 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 9, 2013