**FINANCIAL STATEMENTS**
**DECEMBER 31, 2015 AND 2014**

**AND**

**STATEMENT OF APPROPRIATED EXPENDITURES**
**BIENNIUM ENDED JUNE 30, 2015**

Bank of North Dakota

**BANK OF NORTH DAKOTA**

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# Independent Auditor's Report

The Industrial Commission
Bank of North Dakota
Bismarck, North Dakota

**Report on the Financial Statements**
We have audited the accompanying financial statements of the Bank of North Dakota, an enterprise fund of the State of North Dakota, which comprise the statements of net positions as of December 31, 2015 and 2014, and the related statements of revenues, expenses and changes in fund net position and cash flows for the years then ended, and the related notes to the financial statements.

**Management's Responsibility for the Financial Statements**
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.


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**Opinion**
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank of North Dakota as of December 31, 2015 and 2014, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**Emphasis of Matters**

**Adoption of New Accounting Standard**
As described in Notes 1 and 17 to the financial statements, the Bank of North Dakota early adopted the provisions of GASB Statement No. 72, *Fair Value Measurement and Application.* Our opinion is not modified with respect to this matter.

**Reporting Entity**
As discussed in Note 1, the financial statements of the Bank of North Dakota are intended to present the financial position, the changes in financial position and cash flows of only that portion of the State of North Dakota that is attributable to the transactions of the Bank of North Dakota. They do not purport to, and do not, present fairly the financial position of the State of North Dakota as of December 31, 2015 and 2014 and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

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

**Other Matters**

**Required Supplementary Information**
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 to 11, the schedule of bank's share of net pension liability on page 52, and the schedule of bank contributions on page 52 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Information**
Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The schedule of appropriated expenditures shown on pages 66 to 67 is presented for purposes of additional analysis and is not a required part of the financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by Title 2 U.S. Code of Federal Regulation (CFR) Part 200, *Uniform Administrative Requirements, Costs Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), and is also not a required part of the financial statements.

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

**Other Reporting Required by Government Auditing Standards**
In accordance with *Government Auditing Standards*, we have also issued a report dated April 19, 2016 on our consideration of the Bank of North Dakota's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Bank of North Dakota's internal control over financial reporting and compliance.

Eide Bailly LLP

Aberdeen, South Dakota
April 19, 2016

The discussion and analysis which follows provides an overview of the Bank of North Dakota's (Bank) financial performance for the calendar years ended December 31, 2015 and 2014 and certain comparative data for 2013. The management's discussion and analysis does not present comparative information in all areas for 2013 due to the adoption of GASB Statement No. 68 during 2014 as the restatement of all prior periods was not practical and the information necessary to provide comparative information was not available prior to 2014. Please read it in conjunction with the financial statements of the Bank.

FINANCIAL HIGHLIGHTS:

On an aggregate basis, the loan portfolio grew by $472,000 or 12.5% to $4,255,000 at December 31, 2015. In 2014, the loan portfolio grew by $366,000 or 10.7%. In 2013, the loan portfolio grew by $199,000 or 6.2%.

Total assets grew by $188,000 or 2.6% to $7,393,000 at December 31, 2015. The increase was largely attributable to increased loan demand, coupled with a decrease in the securities portfolio. In 2014, total assets grew by $340,000 or 4.9% to $7,205,000. The increase was attributable to increased loan demand. In 2013, total assets grew by $720,000 or 11.7% to $6,865,000. The increase was attributable to continued growth in state deposits and liquidity of banks investing at the Bank.

The tier one leverage ratio is 10.02% compared to 8.77% and 8.42% in the prior two years. The leverage ratio is a measure of strength. Well capitalized per federal regulations requires this percentage to be a minimum of 5%.

REQUIRED FINANCIAL STATEMENTS:

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

(continued on next page) 

**(In Thousands)**

**CONDENSED STATEMENTS OF NET POSITION**

| | **2015** | 2014 |
|---|---|---|
| ASSETS | | |
| Cash and cash equivalents | **$ 396,259** | $ 405,090 |
| Interest receivable | **44,635** | 41,843 |
| Securities | **2,615,296** | 2,895,441 |
| FHLB Stock | **37,758** | 34,027 |
| Loans, net | **4,255,279** | 3,782,849 |
| Other assets | **32,104** | 33,799 |
| Capital assets, net | **11,566** | 11,678 |
| Total assets | **7,392,897** | 7,204,727 |
| DEFERRED OUTFLOWS OF RESOURCES | **6,695** | 5,281 |
| TOTAL ASSETS AND DEFERRED OUTFLOWS | **$ 7,399,592** | $ 7,210,008 |
| LIABILITIES | | |
| Federal funds purchased | **$ 119,500** | $ 178,455 |
| Non-interest bearing deposits | **641,264** | 700,446 |
| Interest bearing deposits | **5,160,878** | 5,030,165 |
| Interest payable | **966** | 1,103 |
| Transfer payable | **-** | 45 |
| Other liabilities | **14,674** | 13,753 |
| Short and long-term debt | **727,322** | 645,126 |
| Total liabilities | **6,664,604** | 6,569,093 |
| DEFERRED INFLOWS OF RESOURCES | **2,402** | 1,524 |
| NET POSITION | | |
| Invested in capital assets | **11,566** | 11,678 |
| Restricted for pledging purposes | **170,684** | 48,235 |
| Unrestricted | **550,336** | 579,478 |
| Total net position | **732,586** | 639,391 |
| TOTAL LIABILITIES, DEFERRED INFLOWS AND NET POSITION | **$ 7,399,592** | $ 7,210,008 |

*Securities*

Securities totaled $2,615,000 at December 31, 2015 compared to $2,895,000 at December 31, 2014 and $2,554,000 at December 31, 2013. The decrease in 2015 is a result of investments maturing with the proceeds used to fund loans. The majority of the securities portfolio consists of AAA rated U.S. government/agency securities. The primary objective of the securities portfolio is to provide liquidity.

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**(In Thousands)**

*Loans*

On an aggregate basis, the loan portfolio increased by $472,000, or 12.5%, to $4,255,000 at year-end 2015 from $3,783,000 at year-end 2014 and $3,417,000 at year-end 2013. There are four major categories of loans at the Bank.

Student loans increased by $112,800 in 2015 compared to an increase of $104,200 in 2014 and $34,500 in 2013. In 2015, new student loans totaled $86,200 and new consolidation loans were $198,800. Decreases were from $172,200 in loan payments including loans paid in full through consolidation. In 2014, new student loans totaled $98,300 and new consolidation loans were $156,100. Decreases were from $150,200 in loan payments including loans paid in full through consolidation. In 2013, new student loans totaled $113,400 and new consolidation loans were $35,400. Decreases were from $114,300 in loan payments including loans paid in full through consolidation.

Residential loans increased by $41,600 in 2015, $22,100 in 2014, and $35,400 in 2013. New and refinanced loans made in 2015, 2014, and 2013 totaled $158,400, $117,500, and $165,200, respectively, while normal loan payments and refinancing payoffs were $116,800, $95,400, and $129,800 respectively.

Commercial loans increased by $252,000 in 2015 compared to increasing by $171,000 in 2014 and by $109,700 in 2013.

Farm loans increased by $76,900 in 2015 compared to an increase of $75,200 in 2014 and $18,900 in 2013.

*Loan Delinquencies and Allowance for Credit Losses*

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

The allowance for credit losses are established by charges to income and are decreased by loans charged off, net of recoveries. Adequacy of the allowance is determined by the credit quality of outstanding loans, which are assigned specific ratings commensurate with risk on a case-by-case basis. Management currently reviews the allowance for credit losses for adequacy on a monthly basis. As of December 31, 2015, 44% of the overall loan portfolio is federally or state guaranteed compared to 45% at December 31, 2014 and 47% at December 31, 2013.

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

| | **2015** | 2014 |
|---|---|---|
| Gross loans at end of year | **$ 4,324,573** | $ 3,841,195 |
| Allowance for loan losses | | |
| Balance, beginning of year | **$ 58,346** | $ 51,770 |
| Provision charged to operations | **12,500** | 8,000 |
| Loans charged off | **(6,888)** | (2,134) |
| Recoveries | **5,336** | 710 |
| Balance, end of year | **$ 69,294** | $ 58,346 |

(continued on next page)

**(In Thousands)**

| | **2015** | 2014 |
|---|---|---|
| Net loan charge-offs to total loans at the end of period | **0.04%** | 0.04% |
| Net loan charge-offs to non-guaranteed loans at the end of period | **0.06%** | 0.07% |
| Allowance at end of period to total loans at end of period | **1.60%** | 1.69% |
| Allowance at end of period to non-guaranteed loans at the end of period | **2.85%** | 3.08% |

*Capital Assets*

Bank of North Dakota had $11,600 in bank premises, equipment, and software at year-end 2015, $11,700 at year-end 2014, and $11,200 at year-end 2013. Capital expenditures totaled $630 in 2015 compared to $491 in 2014 and $322 in 2013. This year's expenditures were mainly related to software purchases. (See Note 7 to the financial statements.)

*Deposits*

Noninterest bearing deposits are $641,300 at December 31, 2015 compared to $700,400 at December 31, 2014 and $798,600 at December 31, 2013. Noninterest bearing deposits are primarily related to the amount of check clearing activities of respondent banks. Interest-bearing deposits totaled $5,160,900 at December 31, 2015 compared to $5,030,200 at December 31, 2014 and $4,802,600 at December 31, 2013. This increase is from state deposits related to the current economic base of the state.

*Short-Term Borrowings*

Short-term borrowings are from North Dakota financial institutions investing in overnight federal funds at the Bank, customer investments in repurchase agreements with the Bank and overnight borrowings from the Federal Home Loan Bank (FHLB). Short-term borrowings were $319,500 at December 31, 2015 comprised of $200,000 in FHLB borrowings and $119,500 in federal funds. Borrowings were $278,500 at December 31, 2014 comprised of $100,000 in FHLB borrowings and $178,500 in federal funds. Borrowings were $245,100 at December 31, 2013 made up entirely of overnight federal funds.

*Long-Term Debt*

FHLB long-term debt is $526,942 at December 31, 2015 compared to $544,574 at December 31, 2014 and $465,228 at December 31, 2013. FHLB long-term debt is one funding source utilized to fund long-term fixed rate loans. (See Note 10 to the financial statements.)

(continued on next page)

*Net Position*

The Bank has a tier one capital leverage ratio of 10.02%, 8.77%, and 8.42% as of December 31, 2015, 2014, and 2013, respectively. The leverage ratio is a measure of strength. Well capitalized per federal regulations requires this percentage to be a minimum of 5%. The total net position of the Bank is affected by several factors, some of which are external to the Bank's operations. The State Legislature, representing the ownership interest in the Bank, makes transfers to the State's General Fund or other programs. By statute, however, in no event is the Bank's net position to be reduced below $175,000.

*Asset/Liability Management - Interest Rate Risk*

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

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

*Liquidity Management*

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

(continued on next page)

**(In Thousands)**

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

| | **2015** | 2014 |
|---|---|---|
| INTEREST INCOME | **$ 200,188** | $ 167,562 |
| INTEREST EXPENSE | **32,164** | 31,455 |
| NET INTEREST INCOME | **168,024** | 136,107 |
| Provision for loan losses | **12,500** | 8,000 |
| NET INTEREST INCOME AFTER PROVISION | **155,524** | 128,107 |
| Noninterest income | **(7,315)** | 23,463 |
| Noninterest expense | **26,414** | 31,565 |
| INCOME BEFORE TRANSFERS | **121,795** | 120,005 |
| TRANSFERS IN | **-** | - |
| TRANSFERS OUT | **(28,600)** | (17,388) |
| NET TRANSFERS | **(28,600)** | (17,388) |
| CHANGE IN NET POSITION | **93,195** | 102,617 |
| NET POSITION - BEGINNING | **639,391** | 536,774 |
| NET POSITION - ENDING | **$ 732,586** | $ 639,391 |

*Earnings Summary*

The Bank's income before transfers was $121,800 in 2015 compared to $120,000 in 2014, an increase of 1.5%. This was mainly attributable to an increase in net interest income.

*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 $7,020,600 at December 31, 2014 to $7,566,500 at December 31, 2015 with an increase in interest margin.

(continued on next page)

**(In Thousands)**

The following table shows the average rates earned and paid for 2015 and 2014:

| | Year Ended December 31, **2015** | 2014 |
|---|---|---|
| Annualized average interest rate earned | | |
| Federal funds sold | **0.30%** | 0.29% |
| Securities | **1.30%** | 0.92% |
| Loans | **3.85%** | 3.83% |
| Weighted average interest rates earned | **2.61%** | 2.39% |
| Annualized average interest rate paid | | |
| Deposits | **0.22%** | 0.25% |
| Federal funds purchased and repurchase agreements | **0.13%** | 0.13% |
| Short and long-term debt | **3.32%** | 3.37% |
| Weighted average interest rates paid | **0.50%** | 0.53% |
| Net interest spread | **2.12%** | 1.86% |
| Net interest margin | **2.18%** | 1.94% |

*Provision for Credit Losses*

The provision for credit losses was $12,500 in 2015, $8,000 in 2014, and $0 in 2013. The Bank continually evaluates its allowance for credit loss position and any additional provision that would be needed.

*Noninterest Income*

Overall, noninterest income decreased by $30,800 in 2015 and increased by $25,900 in 2014. The main drivers in the fluctuation of noninterest income are changes in the fair value of securities as well as amortization and accretion of securities.

*Noninterest Expense*

Noninterest expense decreased by $5,200 in 2015. The decrease in noninterest expense is primarily due to a decrease in prepayments of long-term debt. Noninterest expense decreased by $4,000 in 2014. This decrease in noninterest expense was primarily related to a decrease in prepayments of long-term debt as well as a decrease in other operating expenses.

(continued on next page)

ECONOMIC CONDITION AND OUTLOOK

Standard & Poor's recently published its updated ratings report for the State of North Dakota. This report discusses the overall economic conditions of the State as well as impacts of these changing conditions on the State's budgetary performance.

The report focuses much attention on the energy market segment within the State, and how its change impacts the State's fiscal position. According to the report, the recent decline in oil prices throughout 2015 did not have an immediate effect on state economic indicators, but as oil process have stayed low, and production has slowed, deceleration in North Dakota's economy became increasingly apparent. The report goes on to say that the State's reserve position remains strong; however, recent updated revenue projections forecast a budget shortfall of $1.074 billion for the 2015-2017 biennium. This shortfall will be covered by accessing certain reserve funds, and also the implementation of budget cuts equal to 4.05%. Despite this shift in energy production, the State's income and wealth factors are stronger than national average, and its per capita gross state production have also outpaced the national rates. The State's per capita personal income has increased steadily since 2006 and was over 120% of the nation's level.

During 2015, the Bank continued with its mission of "delivering quality, sound financial services that promote agriculture, commerce and industry in North Dakota." While the downturn in the State's energy sector will have an impact on the Bank, the Bank is well diversified in its asset mix. In addition, prudent management tools are in place to proactively mitigate risk. As reported on previous pages, the Bank's capital position is as strong as it has ever been with a tier one capital leverage ratio of 10.02%, much higher than the "well capitalized" threshold of 5% as defined by federal banking regulations.

CONTACTING BANK OF NORTH DAKOTA'S FINANCIAL MANAGEMENT

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

# BANK OF NORTH DAKOTA
## STATEMENTS OF NET POSITION
## DECEMBER 31, 2015 AND 2014
## (In Thousands)

| | 2015 | 2014 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | | |
| Restricted | **$ 53,368** | $ 86,868 |
| Unrestricted | **264,986** | 276,117 |
| Federal funds sold | **77,905** | 42,105 |
| Cash and cash equivalents | **396,259** | 405,090 |
| Interest receivable | | |
| Due from other funds | **371** | 117 |
| Other | **44,264** | 41,726 |
| | **44,635** | 41,843 |
| Securities | **2,615,296** | 2,895,441 |
| Federal Home Loan Bank restricted stock | **37,758** | 34,027 |
| Loans | | |
| Restricted | **806,500** | 571,914 |
| Unrestricted | **3,518,073** | 3,269,281 |
| Less allowance for loan losses | **(69,294)** | (58,346) |
| | **4,255,279** | 3,782,849 |
| Other assets | | |
| Due from other funds | **21,789** | 25,999 |
| Other | **10,315** | 7,800 |
| | **32,104** | 33,799 |
| Capital assets | | |
| Land | **2,449** | 2,449 |
| Building and equipment, net | **8,480** | 8,753 |
| Intangibles, net | **637** | 476 |
| | **11,566** | 11,678 |
| Total assets | **7,392,897** | 7,204,727 |
| DEFERRED OUTFLOWS OF RESOURCES | **6,695** | 5,281 |
| TOTAL ASSETS AND DEFERRED OUTFLOWS | **$ 7,399,592** | $ 7,210,008 |

See Notes to Financial Statements

## STATEMENTS OF NET POSITION – PAGE 2

| | 2015 | 2014 |
|---|---|---|
| LIABILITIES | | |
| Federal funds purchased | **$ 119,500** | $ 178,455 |
| | | |
| Deposits | | |
| Non-interest bearing | **543,454** | 653,482 |
| Non-interest bearing - of other funds | **97,810** | 46,964 |
| Interest bearing | **273,686** | 253,513 |
| Interest bearing - of other funds | **4,887,192** | 4,776,652 |
| | **5,802,142** | 5,730,611 |
| | | |
| Interest payable | | |
| Due to other funds | **700** | 934 |
| Other | **266** | 169 |
| | **966** | 1,103 |
| | | |
| Transfer payable | **-** | 45 |
| | | |
| Other liabilities | | |
| Due to other funds | **180** | 197 |
| Net pension liability | **6,769** | 6,245 |
| Other | **7,725** | 7,311 |
| | **14,674** | 13,753 |
| | | |
| Short and long-term debt | | |
| Current portion | **206,669** | 107,502 |
| Long-term portion | **520,653** | 537,624 |
| | **727,322** | 645,126 |
| | | |
| Total liabilities | **6,664,604** | 6,569,093 |
| | | |
| DEFERRED INFLOWS OF RESOURCES | **2,402** | 1,524 |
| | | |
| NET POSITION | | |
| Invested in capital assets | **11,566** | 11,678 |
| Restricted for pledging purposes | **170,684** | 48,235 |
| Unrestricted | **550,336** | 579,478 |
| | | |
| Total net position | **732,586** | 639,391 |
| | | |
| TOTAL LIABILITIES, DEFERRED INFLOWS AND NET POSITION | **$ 7,399,592** | $ 7,210,008 |

## BANK OF NORTH DAKOTA
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION**
**YEARS ENDED DECEMBER 31, 2015 AND 2014**
**(In Thousands)**

| | **2015** | 2014 |
|---|---|---|
| INTEREST INCOME | | |
| Federal funds sold | **$ 380** | $ 214 |
| Securities | **48,092** | 28,411 |
| Loans | **151,716** | 138,937 |
| Total interest income | **200,188** | 167,562 |
| INTEREST EXPENSE | | |
| Deposits | **12,814** | 13,210 |
| Federal funds purchased and repurchase agreements | **223** | 269 |
| Short and long-term debt | **19,127** | 17,976 |
| Total interest expense | **32,164** | 31,455 |
| NET INTEREST INCOME | **168,024** | 136,107 |
| PROVISION FOR LOAN LOSSES | **12,500** | 8,000 |
| NET INTEREST AFTER PROVISION FOR LOAN LOSSES | **155,524** | 128,107 |
| NONINTEREST INCOME | | |
| Service fees and other | **7,648** | 7,555 |
| Net (decrease) increase in the fair value of securities | **(14,963)** | 15,908 |
| Total noninterest income | **(7,315)** | 23,463 |
| NONINTEREST EXPENSE | | |
| Salaries and benefits | **14,563** | 13,159 |
| Data processing | **4,838** | 4,636 |
| Occupancy and equipment | **726** | 795 |
| Long-term debt prepayment fee | **-** | 6,819 |
| Other operating expenses | **6,287** | 6,156 |
| Total noninterest expense | **26,414** | 31,565 |
| INCOME BEFORE TRANSFERS | **121,795** | 120,005 |
| TRANSFERS | | |
| Transfers out | **(28,600)** | (17,388) |
| Net transfers | **(28,600)** | (17,388) |
| CHANGE IN NET POSITION | **93,195** | 102,617 |
| TOTAL NET POSITION - BEGINNING OF YEAR | **639,391** | 536,774 |
| TOTAL NET POSITION - END OF YEAR | **$ 732,586** | $ 639,391 |

See Notes to Financial Statements

# BANK OF NORTH DAKOTA
## STATEMENTS OF CASH FLOWS
## YEARS ENDED DECEMBER 31, 2015 AND 2014
## (In Thousands)

| | 2015 | 2014 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Receipt of service fees and other income from other funds | $ 3,903 | $ 4,411 |
| Receipt of service fees and other income from other entities | 6,490 | 5,228 |
| Payment of salaries and benefits | (14,759) | (13,732) |
| Payment of data processing expenses | (4,486) | (4,198) |
| Payment of occupancy and equipment | (311) | (374) |
| Payment of other operating expenses | (10,803) | (13,823) |
| NET CASH USED FOR OPERATING ACTIVITIES | (19,966) | (22,488) |
| NON-CAPITAL FINANCING ACTIVITIES | | |
| Net decrease in non-interest bearing deposits | (59,182) | (98,113) |
| Net increase in interest bearing deposits | 130,713 | 227,597 |
| Interest payments on deposits | (13,033) | (13,230) |
| Net decrease in federal fund purchased and repurchase agreements | (58,955) | (66,655) |
| Interest payments on federal funds purchased and repurchase agreements | (222) | (269) |
| Proceeds from issuance of short and long-term debt | 615,000 | 600,000 |
| Payment of short and long-term debt | (532,804) | (420,835) |
| Interest payments on short and long-term debt | (19,047) | (24,675) |
| Payment of transfers | (28,645) | (17,345) |
| NET CASH FROM NON-CAPITAL FINANCING ACTIVITIES | 33,825 | 186,475 |
| CAPITAL AND RELATED FINANCING ACTIVITY | | |
| Purchases of capital assets | (630) | (491) |
| INVESTING ACTIVITIES | | |
| Purchase of securities | (475,155) | (1,234,928) |
| Proceeds from security sales, maturities, and principal repayments | 740,336 | 909,559 |
| Purchase of Federal Home Loan Bank stock | (25,015) | (24,857) |
| Sale of Federal Home Loan Bank stock | 21,283 | 16,826 |
| Purchase of other assets | (397) | (700) |
| Sale of other assets | 28 | 608 |
| Investment income received | 48,736 | 26,720 |
| Proceeds from sales of loans | 14,332 | 8,352 |
| Net increase in loans | (503,146) | (384,886) |
| Loan income received | 152,835 | 141,354 |
| Payments from rebuilders loan program | 4,103 | 6,783 |
| Proceeds from sale of other real estate and property owned | - | 319 |
| NET CASH USED FOR INVESTING ACTIVITIES | (22,060) | (534,850) |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | (8,831) | (371,354) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 405,090 | 776,444 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 396,259 | $ 405,090 |

See Notes to Financial Statements

| | 2015 | 2014 |
|---|---|---|
| RECONCILIATION OF INCOME BEFORE OPERATING TRANSFERS TO NET CASH USED FOR OPERATING ACTIVITIES | | |
| Income before operating transfers | **$ 121,795** | $ 120,005 |
| Adjustments to reconcile income before operating transfers to net cash used for operating activities | | |
| Depreciation and amortization | **742** | 771 |
| Provision for loan losses | **12,500** | 8,000 |
| Gain on sale of loans | **(201)** | (99) |
| Loss on sale of other real estate and property owned | **-** | 105 |
| Net increase/(decrease) in the fair value of securities | **14,963** | (15,908) |
| Reclassification of interest income and expense to other activities | **(168,024)** | (136,107) |
| Increase in other assets | **(5,473)** | (854) |
| Decrease in due from other funds | **4,210** | 6,750 |
| Decrease in due to other funds | **(17)** | (3,807) |
| Decrease in other liabilities | **(461)** | (1,344) |
| NET CASH USED FOR OPERATING ACTIVITIES | **$ (19,966)** | $ (22,488) |

| | 2015 | 2014 |
|---|---|---|
| SUPPLEMENTAL SCHEDULE OF NON-CASH TRANSACTIONS | | |
| Transfers from net position to transfers payable | **$ 28,645** | $ 17,388 |

## NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

*Nature of Operations*

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

*Reporting Entity*

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

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

*Accounting Standards*

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

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

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

*Fund Accounting*

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

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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 statement of net position. Net position is segregated into (1) net invested in capital assets, (2) restricted (distinguishing between major categories of restrictions) and (3) unrestricted. The statements of revenues, expenses and changes in fund net position present increases (e.g., revenues) and decreases (e.g., expenses) in total net position. The statements of cash flows 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 generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of net position and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses.

*Significant Group Concentrations of Credit Risk*

Most of the Bank’s lending activities are with customers within the state of North Dakota. The Bank’s loan portfolio is comprised of the following concentrations as of December 31, 2015 and 2014:

| | **2015** | 2014 |
|---|---|---|
| Commercial loans, of which 4% and 3% are federally guaranteed | **42%** | 41% |
| Student loans, of which 99% and 99% are guaranteed | **30%** | 31% |
| Residential loans, of which 73% and 77% are federally guaranteed | **16%** | 17% |
| Agricultural loans, of which 4% and 4% are federally guaranteed | **12%** | 11% |
| | **100%** | 100% |

*Cash and Cash Equivalents*

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

*Securities*

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

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*Federal Home Loan Bank Restricted Stock*

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

*Loans Held For Sale*

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

*Loans*

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

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

*Allowance for Credit Losses*

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

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

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The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and amount of the shortfall in relation to the principal and interest owed.

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

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

*Loan Charge-Offs*

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

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

*Credit Related Financial Instruments*

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

*Transfers of Financial Assets*

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

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*Deferred Outflows/Inflows of Resources*

In addition to assets, the statement of net position will sometimes report a separate section of deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. See Note 12 for additional information.

*Capital Assets*

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

*Foreclosed Assets*

Foreclosed assets, which are included in other assets, represent assets acquired through loan foreclosure or other proceedings. Foreclosed assets are recorded at the lower of the amount of the loan or fair market value of the assets. Any write-down to fair market value at the time of the transfer to foreclosed assets is charged to the allowance for 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 $508 and $400 as of December 31, 2015 and 2014, 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.

*Pensions*

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

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*Restricted Assets and Restricted Net Position*

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

*Interest Rate Swaps*

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

*Income Taxes*

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

*New GAAP Implementation*

In fiscal year 2015, the Bank early implemented GASB Statement No. 72 – *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements. This statement provides guidance for determining fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The Bank's implementation of this statement required no adjustment to prior periods presented, however did include certain reclassifications for certain cost-basis assets, primarily FHLB stock, not meeting the definition of an investment per GASB 72. Such reclassifications had no effect on previously reported net position or change in net position.

## 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 $65,079 in 2015 and $67,693 in 2014.

## 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.

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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, 2015 and 2014:

| | **2015** | 2014 |
|---|---|---|
| Covered by depository insurance | | |
| Due from banks | **$ 881** | $ 1,050 |
| Uncollateralized | | |
| Due from banks | **73,691** | 102,321 |
| Federal funds sold | **77,905** | 42,105 |
| Total bank balances | **$ 152,477** | $ 145,476 |

*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.

The composition of the investment portfolio, related credit quality rating, custody, and duration as of December 31, 2015 is provided below:

| | Rating * | Custody | Duration (In Years) | **2015** |
|---|---|---|---|---|
| U.S. Treasury | **Aaa** | **(1)** | **2.24** | **$ 39,796** |
| Mortgage-backed | **Aaa** | **(1) & (2)** | **2.99** | **975,743** |
| Federal agency | **Aaa** | **(1) & (2)** | **2.96** | **1,592,117** |
| State and municipal | **Not rated** | **(2) & (3)** | **0.86** | **7,640** |
| | | | | **$ 2,615,296** |

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

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The composition of the investment portfolio, related credit quality rating, custody, and duration as of December 31, 2014 is provided below:

| | Rating * | Custody | Duration (In Years) | 2014 |
|---|---|---|---|---|
| U.S. Treasury | Aaa | (1) | 3.21 | $ 39,592 |
| Mortgage-backed | Aaa | (1) & (2) | 3.56 | 1,033,195 |
| Federal agency | Aaa | (1) & (2) | 2.36 | 1,808,652 |
| State and municipal | Not rated | (2) & (3) | 2.24 | 14,002 |
| | | | | $ 2,895,441 |

* 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.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Bank's investment policy provides for a duration range of one to four years which will serve to decrease interest rate risk. The duration for the Bank's investments is provided in the table provided above using the modified duration method. The average duration for the Bank's entire investment portfolio was 2.9 years and 2.7 years as of December 31, 2015 and 2014, respectively.

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

Investments in any one issuer that represent 5% or more of total investments as of December 31, 2015 and 2014, are as follows:

| | **2015** | | 2014 | |
|---|---|---|---|---|
| | **Amount** | **Percent** | Amount | Percent |
| Federal agency | | | | |
| Federal Home Loan Bank | **$ 437,395** | **16.7%** | $ 615,305 | 21.3% |
| Fannie Mae | **400,578** | **15.3%** | 520,552 | 18.0% |
| Freddie Mac | **313,795** | **12.0%** | 373,909 | 12.9% |
| Farm Credit | **197,645** | **7.6%** | 152,063 | 5.3% |
| Small Business Administration | **203,218** | **7.8%** | 108,022 | 3.7% |
| Mortgage-backed | | | | |
| Fannie Mae | **650,093** | **24.9%** | 673,746 | 23.3% |
| Freddie Mac | **302,329** | **11.6%** | 314,673 | 10.9% |
| Others less than 5% | **110,243** | **4.2%** | 137,171 | 4.7% |
| | **$ 2,615,296** | **100.0%** | $ 2,895,441 | 100.0% |

There were no securities pledged as of December 31, 2015 and 2014 for repurchase agreements or for other required pledging purposes.

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The maturity distribution of debt securities at December 31, 2015, is shown below. The distribution of mortgage-backed securities is based on average expected maturities. Actual maturities may differ because issuers may have the right to call or prepay obligations.

| | |
|---|---|
| Within one year | $ 369,210 |
| Over one year through five years | 2,147,251 |
| Over five years through ten years | 85,047 |
| Over ten years | 13,788 |
| | $ 2,615,296 |

For the years ended December 31, 2015 and 2014, proceeds from the sales of securities amounted to $9,552 and $59,299, respectively.

## NOTE 4 - INTERFUND TRANSACTIONS

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

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

Dakota Education Alternative Loans are fully guaranteed by the North Dakota Guaranteed Student Loan Program, which is administered by the Bank. The outstanding principal balance of these loans was $934,666 and $739,851 at December 31 2015 and 2014, respectively. Administrative fees paid by the Bank to the North Dakota Guaranteed Student Loan Program were $6,556 and $4,538 for the years ended December 31, 2015 and 2014.

In the ordinary course of business, the Bank holds loans and deposits of principal officers and directors and their affiliates. Outstanding principal balances of these loans held by the Bank at December 31, 2015 and 2014 amounted to $14,738 and $18,501, respectively. Deposits and short term borrowings held by the Bank were $13,212 and $44,174.

The Bank also made transfers to the Rebuilders Loan Program to fund loans to owners of homes damaged in the 2011 floods. These funds will be repaid to the Bank as payments are received from the borrowers. At year end December 31, 2015 and 2014, the Bank had a receivable resulting from these transfers for $21,369 and $25,472, respectively. The Bank had no administrative fees receivable from this program at year end December 31, 2015 and $78 in administrative fees receivable from this program at year end December 31, 2014.

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

| | 2015 | 2014 |
|---|---|---|
| OTHER ASSETS - Due from other funds (accounts receivable - current, unless noted otherwise) | | |
| Rebuilders Loan Program ($19,225 and $23,382 non-current in 2015 and 2014) | **$ 21,369** | $ 25,550 |
| North Dakota Guaranteed Student Loan Program | **210** | 223 |
| North Dakota Student Loan Trust | **92** | 111 |
| Community Water Facility Loan Fund | **24** | 20 |
| Department of Human Services | **7** | 8 |
| Information Technology Department | **10** | 11 |
| Board of University and School Lands | **61** | 76 |
| Medical Facility Infrastructure Loan Program | **14** | - |
| State Water Commission | **2** | - |
| | **$ 21,789** | $ 25,999 |
| OTHER LIABILITIES - Due to other funds (trade accounts payable - all current) | | |
| Information Technology Department | **$ 165** | $ 183 |
| Attorney General | **8** | 14 |
| Guaranteed Student Loan Program | **7** | - |
| | **$ 180** | $ 197 |
| OPERATING TRANSFERS - Out | | |
| PACE Fund | **$ 20,100** | $ 12,900 |
| Ag PACE Fund | **700** | 1,200 |
| Beginning Farmer Revolving Loan Fund | **2,800** | 3,200 |
| Industrial Commission | **-** | 88 |
| Housing Incentive Fund | **5,000** | - |
| | **$ 28,600** | $ 17,388 |

COMPONENT UNITS OF THE STATE OF NORTH DAKOTA

| | 2015 | 2014 |
|---|---|---|
| LONG TERM DEBT | | |
| NDPFA (to fund irrigation and waste management loans - $30 and $172 current in 2015 and 2014) | **$ 380** | $ 552 |
| INTEREST PAYABLE (NDPFA - all current) | **$ 4** | $ 6 |

(continued on next page)

## NOTE 5 - LOANS

The composition of the loan portfolio at December 31, 2015 and 2014 is as follows:

| | **2015** | 2014 |
|---|---|---|
| Commercial | **$ 1,811,751** | $ 1,559,733 |
| Student | **1,305,177** | 1,192,386 |
| Residential loans | **693,712** | 652,076 |
| Agricultural | **513,933** | 437,000 |
| | **4,324,573** | 3,841,195 |
| Allowance for loan losses | **69,294** | 58,346 |
| | **$ 4,255,279** | $ 3,782,849 |
| Current portion | **$ 854,319** | $ 929,633 |

Net unamortized loan premiums and discounts on residential loans totaled $6,195 and $7,382 as of December 31, 2015 and 2014, respectively.

In the normal course of business, overdrafts of deposit accounts are reclassified as loans. There were no overdrafts of deposit accounts at December 31, 2015 and 2014.

The composition of State Institutions loans at December 31, 2015 and 2014 is as follows:

| | **2015** | | 2014 | |
|---|---|---|---|---|
| | **Principal** | **Interest** | Principal | Interest |
| Mill and Elevator (annual operating) | **$ 15,000** | **$ 2** | $ 14,000 | $ 3 |
| Western Area Water Supply | **67,449** | **14** | 77,086 | 20 |
| Housing Finance Agency | **-** | **-** | 21,134 | 39 |
| Office of the Adjutant General | **78** | **1** | 1,468 | 24 |
| Dept of Corrections | **-** | **-** | 1,100 | 29 |
| Rough Rider Industries | **-** | **-** | 9 | - |
| Williston State College | **2,412** | **5** | - | - |
| State Water Commission | **45,840** | **349** | - | - |
| | **$ 130,779** | **$ 371** | $ 114,797 | $ 115 |
| Current portion | **$ 17,490** | **$ 371** | $ 37,711 | $ 115 |

(continued on next page)

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

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

The total allowance reflects management's estimate of credit losses inherent in the loan portfolio at the statement of net position date. The Bank considers the allowance for credit losses of $69,294 and $58,346 adequate to cover loan losses inherent in the loan portfolio, at December 31, 2015 and 2014. The following tables represent, by portfolio segment, the changes in the allowance for credit losses and the recorded investment in loans.

| | **2015** | | | | |
|---|---|---|---|---|---|
| | **Commercial** | **Agricultural** | **Residential** | **Student** | **TOTAL** |
| Beginning Balance: | **$ 46,298** | **$ 9,552** | **$ 710** | **$ 1,786** | **$ 58,346** |
| Charge-offs | **(6,632)** | **-** | **-** | **(256)** | **(6,888)** |
| Recoveries | **5,319** | **11** | **-** | **6** | **5,336** |
| Provision | **7,946** | **4,376** | **205** | **(27)** | **12,500** |
| Ending Balance | **$ 52,931** | **$ 13,939** | **$ 915** | **$ 1,509** | **$ 69,294** |

| | 2014 | | | | |
|---|---|---|---|---|---|
| | Commercial | Agricultural | Residential | Student | TOTAL |
| Beginning Balance: | $ 43,059 | $ 6,486 | $ 655 | $ 1,570 | $ 51,770 |
| Charge-offs | (1,962) | - | - | (172) | (2,134) |
| Recoveries | 693 | 13 | - | 4 | 710 |
| Provision | 4,508 | 3,053 | 55 | 384 | 8,000 |
| Ending Balance | $ 46,298 | $ 9,552 | $ 710 | $ 1,786 | $ 58,346 |

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

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

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

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

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

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

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

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

## NOTE 6 - LOAN SALES AND LOAN SERVICING

A summary of the Bank's loan sales during 2015 and 2014 follows:

| | **2015** | 2014 |
|---|---|---|
| Residential loans sold on the secondary market | **$ 14,131** | $ 8,253 |

BND recognized gains on sale of loans of $201 and $99 in 2015 and 2014 which are included in noninterest income on the Statements of Revenues, Expenses and Changes in Fund Net Position.

The Bank has contracts to provide servicing of loans for others. These loans are not included in the accompanying statement of net position. The unpaid principal balances of loans serviced for others as of December 31, 2015 and 2014 were as follows:

| | **2015** | 2014 |
|---|---|---|
| Student loans | | |
| North Dakota Student Loan Trust | **$ 20,915** | $ 25,110 |
| Residential loans | | |
| Fannie Mae | **36,856** | 28,078 |
| Other state fund loans | | |
| Western Area Water | **99,500** | 73,022 |
| Rebuilders Loan Program | **40,230** | 44,838 |
| Board of University and School Lands | **13,238** | 15,882 |
| Community Water Facility Loan Fund | **19,204** | 15,564 |
| Information Technology Department | **8,144** | 8,787 |
| Department of Human Services | **6,018** | 6,414 |
| State Water Commission | **689** | 706 |
| Workforce Safety | **139** | 161 |
| | **$ 244,933** | $ 218,562 |

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

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## NOTE 7 - CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2015 is as follows:

| | Balance 2014 | Additions | Retirements | Balance 2015 |
|---|---|---|---|---|
| Capital assets not being depreciated: | | | | |
| Land | **$ 2,449** | **$ -** | **$ -** | **$ 2,449** |
| Capital assets being depreciated: | | | | |
| Building | **$ 10,212** | **$ 105** | **$ -** | **$ 10,317** |
| Equipment | **678** | **72** | **121** | **629** |
| Furniture | **698** | **-** | **1** | **697** |
| Hardware | **233** | **-** | **50** | **183** |
| Intangibles - software | **5,045** | **453** | **34** | **5,464** |
| | **16,866** | **630** | **206** | **17,290** |
| Less accumulated depreciation for | | | | |
| Building | **2,013** | **276** | **-** | **2,289** |
| Equipment | **513** | **72** | **121** | **464** |
| Furniture | **452** | **68** | **1** | **519** |
| Hardware | **89** | **34** | **50** | **73** |
| Intangibles - software | **4,570** | **292** | **34** | **4,828** |
| Total accumulated depreciation | **7,637** | **742** | **206** | **8,173** |
| Capital assets being depreciated, net | **$ 9,229** | **$ (112)** | **$ -** | **$ 9,117** |

Depreciation and amortization expense on the above assets amounted to $742 in 2015.

Capital asset activity for the year ended December 31, 2014 is as follows:

| | Balance 2013 | Additions | Retirements | Balance 2014 |
|---|---|---|---|---|
| Capital assets not being depreciated: | | | | |
| Land | $ 1,688 | $ 761 | $ - | $ 2,449 |
| Capital assets being depreciated: | | | | |
| Building | $ 10,212 | $ - | $ - | $ 10,212 |
| Equipment | 783 | 68 | 173 | 678 |
| Furniture | 691 | 7 | - | 698 |
| Hardware | 203 | 158 | 128 | 233 |
| Intangibles - software | 4,787 | 258 | - | 5,045 |
| | 16,676 | 491 | 301 | 16,866 |
| Less accumulated depreciation for | | | | |
| Building | 1,742 | 271 | - | 2,013 |
| Equipment | 603 | 83 | 173 | 513 |
| Furniture | 385 | 67 | - | 452 |
| Hardware | 194 | 23 | 128 | 89 |
| Intangibles - software | 4,243 | 327 | - | 4,570 |
| Total accumulated depreciation | 7,167 | 771 | 301 | 7,637 |
| Capital assets, net | $ 9,509 | $ (280) | $ - | $ 9,229 |

Depreciation and amortization expense on the above assets amounted to $771 in 2014.

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## NOTE 8 - DEPOSITS

At December 31, 2015, the scheduled maturities of certificates of deposits are as follows:

| | | |
|---|---|---|
| One year or less | $ | 3,544,985 |
| One to three years | | 264,161 |
| Over three years | | 92,230 |
| | $ | 3,901,376 |

## NOTE 9 - FEDERAL FUNDS PURCHASED AND REPURCHASE AGREEMENTS

| | **December 31, 2015** | | | |
|---|---|---|---|---|
| | Federal Funds Purchased | | Repurchase Agreements | |
| Ending balance | **$** | **119,500** | **$** | **-** |
| Highest month-end balance | | **367,195** | | **-** |
| Average daily balance | | **164,318** | | **-** |
| Interest rate as of year-end | | **0.375%** | | **0.00%** |
| Weighted average interest rate paid during year | | **0.130%** | | **0.00%** |

| | December 31, 2014 | | | |
|---|---|---|---|---|
| | Federal Funds Purchased | | Repurchase Agreements | |
| Ending balance | $ | 178,455 | $ | - |
| Highest month-end balance | | 471,840 | | - |
| Average daily balance | | 212,324 | | - |
| Interest rate as of year-end | | 0.125% | | 0.00% |
| Weighted average interest rate paid during year | | 0.127% | | 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 has not been provided since this information would not provide any useful information to the users of the financial statements.

Federal funds purchased generally mature the day following the date of purchase. The Bank enters into repurchase agreements, which are a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying agreements to repurchase normally exceeds the cash received, providing the dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the Bank or provide securities or cash of equal value, the Bank would suffer an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. There was no credit exposure as of December 31, 2015 and 2014 because the dealer did not take control of the securities. The Bank had not incurred any losses on these agreements in 2015 and 2014. All sales of investments under agreements to repurchase are for fixed terms. In investing the proceeds of agreements to repurchase, the Bank policy is for the term to maturity of the investment to be the same as the term of the agreement to repurchase. Such matching existed at year-end.

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## NOTE 10 - SHORT AND LONG-TERM LIBILITIES

Activity for short and long-term liabilities for the year ended December 31, 2015 was as follows:

| | Balance 2014 | Additions | Reductions | Balance 2015 | Amounts Due Within One Year |
|---|---|---|---|---|---|
| SHORT AND LONG-TERM LIABILITIES | | | | | |
| Federal Home Loan Bank advances | **$ 644,574** | **$ 615,000** | **$ 532,632** | **$ 726,942** | **$ 206,639** |
| ND Public Finance Authority | **552** | **-** | **172** | **380** | **30** |
| Compensated absences | **1,066** | **972** | **914** | **1,124** | **955** |
| Total long-term liabilities | **$ 646,192** | **$ 615,972** | **$ 533,718** | **$ 728,446** | **$ 207,624** |

Activity for short and long-term liabilities for the year ended December 31, 2014 was as follows:

| | Balance 2013 | Additions | Reductions | Balance 2014 | Amounts Due Within One Year |
|---|---|---|---|---|---|
| SHORT AND LONG-TERM LIABILITIES | | | | | |
| Federal Home Loan Bank advances | $ 465,228 | $ 600,000 | $ 420,654 | $ 644,574 | $ 107,330 |
| ND Public Finance Authority | 733 | - | 181 | 552 | 172 |
| Compensated absences | 1,021 | 1,031 | 986 | 1,066 | 906 |
| Total long-term liabilities | $ 466,982 | $ 601,031 | $ 421,821 | $ 646,192 | $ 108,408 |

As of December 31, 2015, a summary, by years, of future minimum payments required to amortize the outstanding short and long-term debt is as follows:

| | Principal | Interest | Total |
|---|---|---|---|
| 2016 | $ 206,669 | $ 16,650 | $ 223,319 |
| 2017 | 6,966 | 16,434 | 23,400 |
| 2018 | 87,158 | 14,234 | 101,392 |
| 2019 | 47,348 | 13,388 | 60,736 |
| 2020 | 27,590 | 11,319 | 38,909 |
| 2021-2025 | 317,576 | 24,410 | 341,986 |
| 2026-2030 | 34,015 | 2,015 | 36,030 |
| Totals | $ 727,322 | $ 98,450 | $ 825,772 |

The FHLB long-term advances outstanding at December 31, 2015, mature from January 2018 through October 2029. The FHLB long-term advances have fixed rate interest, ranging from 1.12% to 5.56%. The advances must be secured by minimum qualifying collateral maintenance levels by pledging residential loans and student loans. Loans totaling $806,500 and $719,914 at December 31, 2015 and 2014, respectively, are currently being used as security to meet these minimum levels.

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

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## NOTE 11 - TRANSFER PAYABLE

Transfers have been made out of unrestricted net position to transfer payable. The Bank has the following transfer payable as of December 31, 2015 and 2014:

| | 2015 | 2014 |
|---|---|---|
| Industrial Commission | $ - | $ 45 |

## NOTE 12 - DEFERRED OUTFLOWS AND INFLOWS OF RESOURCES

Deferred Outflows of Resources and Deferred Inflows of Resources are grouped into one line item on the face of the financial statements. Details as of December 31, 2015 and 2014 are provided as follows:

| | 2015 | 2014 |
|---|---|---|
| Deferred Outflows of Resources | | |
| Unrealized loss on interest rate swap | **$ 5,064** | $ 4,443 |
| Derived from pension | **1,631** | 838 |
| | **$ 6,695** | $ 5,281 |
| Deferred Inflows of Resources | | |
| Unrealized gain on interest rate swap | **$ 863** | $ - |
| Derived from pension | **1,539** | 1,524 |
| | **$ 2,402** | $ 1,524 |

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

## NOTE 13 - PENSION PLAN

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

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

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

Responsibility for administration of the NDPERS defined benefit pension plan is assigned to a Board comprised of seven members. The Board consists of a Chairman, who is appointed by the Governor; one member appointed by the Attorney General; one member appointed by the State Health Officer; three members elected by the active membership of the NDPERS system; and one member elected by the retired public employees. Effective July 1, 2015, the board was expanded to include two members of the legislative assembly appointed by the chairman of the legislative management.

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*Pension Benefits*

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

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

*Death and Disability Benefits*

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

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

*Refunds of Member Account Balance*

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

*Member and Employer Contributions*

Member and employer contributions paid to NDPERS are set by statute and are established as a percent of covered compensation. Member contribution rates are 7% and employer contribution rates are 7.12% of covered compensation. The Bank also contributes 4% of the member contributions in addition to the employer contribution rate of 7.12%.

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

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

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

At December 31, 2015 and 2014, the Bank reported a liability of $6,769 and $6,245, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of July 1, 2015 and 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Bank's proportion of the net pension liability was based on the Bank's share of covered payroll in the Main System pension plan relative to the covered payroll of all participating Main System employers. At July 1, 2015, the Bank's portion was 0.995461 percent. At July 1, 2014, the Bank's portion was 0.983912 percent.

For the years ended December 31, 2015 and 2014 the Bank recognized pension expense of $973 and $1,168, respectively. At December 31, 2015 and 2014, the Bank reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | **2015** | |
|---|---|---|
| | **Deferred Outflows of Resources** | **Deferred Inflows of Resources** |
| Differences between expected and actual experience | **$ 183** | **$ -** |
| Changes of assumptions | **-** | **603** |
| Net difference between projected and actual earnings on pension plan investments | **782** | **925** |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | **51** | **11** |
| Employer contributions subsequent to the measurement date (see below) | **615** | **-** |
| | **$ 1,631** | **$ 1,539** |

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The employer contributions subsequent to the measurement date of $615 reported as deferred outflows of resources relate to Bank contributions subsequent to the measurement date and will be recognized as a reduction of the net pension liability in the year ended December 31, 2016.

| | 2014 | |
|---|---|---|
| | Deferred Outflows of Resources | Deferred Inflows of Resources |
| Differences between expected and actual experience | $ 246 | $ - |
| Changes of assumptions | - | - |
| Net difference between projected and actual earnings on pension plan investments | - | 1,524 |
| Changes in proportion and differences between employer contributions and proportionate share of contributions | - | - |
| Employer contributions subsequent to the measurement date (see below) | 592 | - |
| | $ 838 | $ 1,524 |

The employer contributions subsequent to the measurement date of $592 reported as deferred outflows of resources relate to Bank contributions subsequent to the measurement date and were recognized as a reduction of the net pension liability in the year ended December 31, 2015.

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

| | |
|---|---|
| Year Ended December 31: | |
| 2016 | $ (178) |
| 2017 | (178) |
| 2018 | (178) |
| 2019 | 117 |
| 2020 | (107) |
| Thereafter | - |

*Actuarial Assumptions*

The total pension liability in the July 1, 2015 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

| | |
|---|---|
| Inflation | 3.50% |
| Salary increases | 4.50% per annum |
| Investment rate of return | 8.00%, net of investment expenses |
| Cost-of-living adjustments | None |

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For active members, inactive members and healthy retirees, mortality rates were based on the RP-2000 Combined Healthy Mortality Table set back two years for males and three years for females, projected generationally using the SSA 2014 Intermediate Cost scale from 2014. For disabled retirees, mortality rates were based on the RP-2000 Disabled Retiree Mortality Table with ages set back one year for males (not set back for females) multiplied by 125%.

The actuarial assumptions used were based on the results of an actuarial experience study completed in 2015. They are the same as the assumptions used in the July 1, 2015, funding actuarial valuation for NDPERS.

As a result of the 2015 actuarial experience study, the NDPERS Board adopted several changes to the actuarial assumptions effective July 1, 2015. This includes changes to the mortality tables, disability incidence rates, retirement rates, administrative expenses, salary scale, and percent married assumption.

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

| Asset Class | Target Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Domestic Equity | 31% | 6.90% |
| International Equity | 21% | 7.55% |
| Private Equity | 5% | 11.30% |
| Domestic Fixed Income | 17% | 1.52% |
| International Fixed Income | 5% | 0.45% |
| Global Real Assets | 20% | 5.38% |
| Cash Equivalents | 1% | 0.00% |

*Discount Rate*

The discount rate used to measure the total pension liability was 8 percent as of June 30, 2015. The projection of cash flows used to determine the discount rate assumes that member and employer contributions will be made at rates equal to those based on the July 1, 2015, Actuarial Valuation Report. For this purpose, only employer contributions that are intended to fund benefits of current plan members and their beneficiaries are included. Projected employer contributions that are intended to fund the service costs of future plan members and their beneficiaries, as well as projected contributions from future plan members, are not included. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments for current plan members as of June 30, 2015. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability as of June 30, 2015.

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

The following presents the Bank's proportionate share of the net pension liability calculated using the discount rate of 8 percent, as well as what the Bank's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7 percent) or 1-percentage-point higher (9 percent) than the current rate:

| | 1% Decrease (7%) | Current Discount Rate (8%) | 1% Increase (9%) |
|---|---|---|---|
| Bank's proportionate share of the net pension liability | $ 10,380 | $ 6,769 | $ 3,815 |

*Pension Plan Fiduciary Net Position*

Detailed information about the pension plan's fiduciary net position is available in the separately issued NDPERS financial report.

NDPERS issues a publicly available financial statement that includes financial statements and the required supplementary information for NDPERS. That report may be obtained by writing to NDPERS; 400 East Broadway, Suite 505; PO Box 1657; Bismarck, ND 58502-1657

**NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES**

*Legislative Action* – Various legislative bills provide state agencies the authority to borrow money from the Bank of North Dakota during the biennium beginning July 1, 2015 and ending June 30, 2017. Following is a summary of legislative action and/or North Dakota Statute in effect:

H.B. 1014, Section 7 – The Bank shall transfer the sum of $5,000 from the Bank's current earnings and undivided profits to the Housing Incentive Fund. As of December 31, 2015, the Bank had transferred $5,000.

H.B. 1014, Section 8 – The Bank of North Dakota shall transfer the sum of $5,000 from the Bank's current earnings and undivided profits to the Housing Incentive Fund for the period beginning July 1, 2015, and ending June 30, 2017, if the Bank's net income, reported in accordance with Financial Accounting Standards Board accounting standards, for the calendar year 2015 exceeds $130,000. The Bank transferred $5,000 in January 2016.

H.B. 1014, Section 9 – The Bank shall transfer up to $28,000 from its current earnings and undivided profits to the Partnership in Assisting Community Expansion Fund. As of December 31, 2015, the Bank had transferred $8,300.

H.B. 1014, Section 10 – The Bank shall transfer up to $3,000 from its current earnings and undivided profits to the Agriculture Partnership in Assisting Community Expansion Fund. As of December 31, 2015, the Bank had transferred $600.

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H.B. 1014, Section 11 – The Bank shall transfer up to $2,000 from its current earnings and undivided profits to the Biofuels Partnership in Assisting Community Expansion Fund. As of December 31, 2015, the Bank had transferred $800.

H.B. 1014, Section 12 – The Bank shall transfer up to $7,000 from its current earnings and undivided profits to the Beginning Farmer Revolving Loan Fund. As of December 31, 2015, the Bank had transferred $2,000.

H.B. 1014, Section 13 – The Bank of North Dakota shall develop a Medical Partnership in Assisting Community Expansion Program to assist in the financing of critical access hospital medical infrastructure projects. The Bank shall adopt policies and procedures to implement this program, and transfer interest rate buy-down funds from existing Partnership in Assisting Community Expansion Program eligible funds, with a total approximating $10,250. As of December 31, 2015, the Bank had transferred $0.

H.B. 1014, Section 26 – The Bank of North Dakota approved budget includes $17,000 from the assets of the Bank of North Dakota for the purpose of constructing a North Dakota Financial Center on a site adjacent to the existing building in which the Bank is located. The Bank may spend the funding only if the Bank's net income, reported in accordance with Financial Accounting Standards Board accounting standards, for calendar year 2015 exceeds $125,000. The Bank's net income exceeded this threshold as of December 31, 2015. As a result, the Bank has engaged an architect, and is pursuing the selection of a construction manager-at-risk, to assist in the Financial Center project.

H.B. 1049, Section 2 – The Bank of North Dakota shall develop and implement a program under which loans may be provided to qualified individuals participating in a paid or unpaid internship at a licensed substance abuse treatment facility in this state, in order to obtain licensure as an addiction counselor. Interest on outstanding loans under this section must accrue at the Bank of North Dakota's current base rate, but may not exceed six percent per annum. The maximum loan for which an applicant may qualify under this section is seven thousand five hundred dollars. The Bank of North Dakota shall maintain a revolving loan fund for the purpose of making loans under this section. All moneys transferred into the fund, interest upon moneys in the fund, and payments to the fund of principal and interest on loans under this section are appropriated to the Bank on a continuing basis. There is appropriated out of any moneys in the Student Loan Trust Fund in the State Treasury, not otherwise appropriated, the sum of $200, or so much of the sum as may be necessary, which the Director of the Office of Management and Budget shall transfer to the Bank of North Dakota, for purposes of the Addiction Counselor Internship Loan Program Revolving Fund. As of December 31, 2015, outstanding loans totaled $37.

H.B. 1112, Section 2 – When approved by the Emergency Commission, the Office of the Adjutant General is authorized to borrow from the Bank of North Dakota, to respond and recover from state disasters if the event has met the Stafford Act minimum for a presidential disaster declaration for which the request is denied, and to match federal funds under the Robert T. Stafford Disaster Emergency Assistance Act [Public Law 93-288, as amended]. In addition to the principal repayment, the Bank of North Dakota shall receive interest on the loan at a rate equal to other state agency borrowings. On behalf of the State, the Office of the Adjutant General shall administer the Disaster or Emergency Recovery Program according to State procedures based on federal laws or regulations. As of December 31, 2015, the outstanding loan totaled $78.

H.B. 1373, Section 1 – The Bank of North Dakota shall adopt rules to administer, manage, promote, and market the North Dakota Achieving a Better Life Experience Plan. The Bank shall ensure that the North Dakota Achieving a Better Life Experience Plan is maintained in compliance with internal revenue service standards for qualified state disability expense programs. The Bank, as trustee of the North Dakota Achieving a Better Life Experience Plan, may impose an annual administrative fee to recover expenses incurred in connection with operation of the plan. Administrative fees received by the Bank are appropriated to the Bank on a continuing basis to be used as provided under this section.

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H.B. 1443, Section 3 – Provides for the creation of the Infrastructure Revolving Loan Fund. The Infrastructure Revolving Loan Fund is a special loan fund in the State Treasury from which the Bank of North Dakota shall provide loans to political subdivisions for essential infrastructure projects. The Bank shall administer the Infrastructure Loan Fund. The maximum term of a loan made under this section is thirty years. A loan made from this Fund under this section must have an interest rate that does not exceed two percent per year. Loan funds must be used to address the needs of the community by providing critical infrastructure funding. In processing political subdivision loan applications under this section, the Bank shall calculate the maximum loan amount for which a qualified applicant may qualify, not to exceed fifteen million dollars per loan. The Bank shall deposit in the Infrastructure Revolving Loan Fund all payments of interest and principal paid under loans made from the Infrastructure Revolving Loan Fund. The Bank may use a portion of the interest paid on the outstanding loans as a servicing fee to pay for administrative costs which may not exceed one - half of one percent of the amount of the interest payment. All moneys transferred to the Fund, interest upon moneys in the Fund, and payments to the Fund of principal and interest are appropriated to the Bank on a continuing basis for administrative costs and for loan disbursement according to this section. If a political subdivision receives funds distributed by the State Treasurer under subsection 1 or 4 of section 1 or by the Department of Transportation under subsection 1 of section 2 of Senate Bill No. 2103, as approved by the sixty-fourth legislative assembly, it is the intent of the legislative assembly that political subdivision be ineligible to receive a loan under the Infrastructure Revolving Loan Fund until July 1, 2017.

During the biennium beginning July 1, 2015, and ending June 30, 2017, the Office of Management and Budget shall transfer the sum of $50,000 from the Strategic Investment and Improvements Fund to the Infrastructure Revolving Loan Fund. The Office of Management and Budget shall transfer the funds provided under this section to the Infrastructure Revolving Loan Fund as requested by the Bank of North Dakota. As of December 31, 2015, the Bank had not requested transfer of such funds.

During the biennium beginning July 1, 2015, and ending June 30, 2017, the Bank of North Dakota shall transfer the sum of $100,000, or so much of the sum as may be necessary, from the Bank's current earnings and undivided profits to the Infrastructure Revolving Loan Fund. As of December 31, 2015, the Bank had transferred $0.

S.B. 2008, Section 6 – The Bank of North Dakota shall transfer from the Beginning Farmer Revolving Loan Fund to the Public Service Commission the sum of $900, or so much of the sum as may be necessary, included in the estimated income line item in section 1 of this Act to pay for costs associated with a rail rate complaint case. Transfers must be made during the biennium beginning July 1, 2015, and ending June 30, 2017, upon order of the Commission. If any amounts are spent pursuant to this section, the Public Service Commission shall reimburse the Beginning Farmer Revolving Loan Fund using amounts available from damages or proceeds received, net of legal fees, from a successful outcome of a rail complaint case. As of December 31, 2015, the Bank had transferred $0.

S.B. 2018, Section 6 – The State Historical Society may obtain a loan from the Bank of North Dakota in an amount not to exceed $1,250, the sum of which is appropriated to the State Historical Society for the purpose of defraying the expenses of repairs to the Double Ditch historic site, for the biennium beginning July 1, 2015, and ending June 30, 2017. The loan authorization and appropriation in this section is contingent on the State Historical Society being unable to obtain assistance to contract with the Adjutant General for the Double Ditch historic site repairs. As of December 31, 2015, there was no outstanding loan balance.

S.B. 2020, Section 7 – The State Water Commission shall obtain a loan from the Bank of North Dakota in an amount that may not exceed $56,000 for the purpose of paying off or defeasing outstanding bond issues, for the period ending June 30, 2017. As of December 31, 2015, the outstanding loan totaled $45,840.

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S.B. 2020, Section 32 – The Bank of North Dakota shall extend a line of credit not to exceed two hundred million dollars at a rate that may not exceed one and three-quarters percent to the State Water Commission. The State Water Commission shall repay the line of credit from funds available in the Resources Trust Fund, Water Development Trust Fund, or other funds, as appropriated by the legislative assembly. The State Water Commission may access the line of credit, as necessary, to provide funding as authorized by the legislative assembly for water supply projects in suspense, water supply projects identified in section 19 of this Act and water supply projects approved before June 30, 2017, and flood control projects that have approval for funding before June 30, 2017. As of December 31, 2015, there was no outstanding loan balance.

S.B. 2039, Section 5 – The Bank of North Dakota may provide up to two hundred million dollars from the School Construction Assistance Loan Fund to eligible school districts for school construction loans, except that the total of all loans provided under this section prior to July 1, 2018, may not exceed fifty percent of the total amount authorized under this subsection. With the advice and consent of the Superintendent of Public Instruction, the Bank of North Dakota shall award the loans in accordance with a prioritization system that is based on a review of all applications filed during the twelve-month period preceding April 1st. The term of a loan under this section is twenty years, unless a shorter term is requested by the board of a school district in its application. The interest rate on a loan under this section may not exceed two percent. The legislative assembly shall, however, conduct a biennial review of interest rates applicable to new loans. The maximum loan amount to which a school district is entitled under this section is twenty million dollars. Bank may charge a school district a fee for managing and servicing the loan. The Bank shall receive payments of principal and interest from school districts and shall deposit such payments in the School Construction Assistance Loan Fund. As of December 31, 2015, there were no outstanding loan balances.

S.B. 2178, Section 2 – In addition to any construction loans made available under North Dakota Century Code Section 15.1-36-02, the Bank of North Dakota may provide up to two hundred fifty million dollars to eligible school districts for school construction loans, except that the total of all loans provided under this section during the first year of the 2015-17 biennium may not exceed fifty percent of the total amount authorized under this subsection. With the advice and consent of the Superintendent of Public Instruction, the Bank of North Dakota shall award the loans in accordance with a prioritization system set out in this Section. The term of a loan under this section is twenty years, unless a shorter term is requested by the board of a school district in its application. The interest rate on a loan under this section may not exceed two percent, until July 1, 2025. Thereafter, the interest rate on the remainder of a loan under this section may not exceed the Bank of North Dakota’s base rate, or may be fixed. The maximum loan amount to which a school district is entitled under this section is twenty million dollars. As of December 31, 2015, outstanding loans totaled $29,492.

S.B. 2178, Section 5 – There is transferred from the Bank of North Dakota's current earnings and undivided profits the sum of $7,875,000, or so much of the sum as may be necessary, to the Bank of North Dakota for the purpose of providing interest rate buy-downs on construction loans awarded to school districts under section 2 of this Act, for the biennium beginning July 1, 2015, and ending June 30, 2017. As of December 31, 2015, the Bank had transferred $0.

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*State Water Commission*

Under chapter 61-02.1-04 of North Dakota Century Code, principal and interest on bonds issued are payable from transfers to be made and appropriated by the legislative assembly from the Water Development Trust Fund as provided in section 61-02.1-05, then from transfers to be made and appropriated by the legislative assembly from revenues in the Resources Trust Fund other than revenues from state taxes, then from appropriations of other available revenues in the then current biennium, and then from any other revenues the State Water Commission makes available during the then current biennium for that purpose, including any federal moneys received by the state for the construction of flood control or reduction projects to pay bonds issued for that project. If sufficient funds from these sources are not available, then from transfers to be made and appropriated by the legislative assembly from the first available current biennial earnings of the Bank of North Dakota not to exceed $6,500 per biennium prorated with any other bonds payable from transfers to be made and appropriated by the legislative assembly from the available current biennial earnings of the Bank of North Dakota, to be credited by the Trustee to the Fund established for paying principal and interest on the bonds under a trust indenture. If the Bank has to provide a transfer to the State Water Commission to make principal and interest payments on these bonds, the State Water Commission would then have to request from the next legislative assembly funding to repay the transfer made by the bank. As of December 31, 2015, the Bank has provided no such transfers.

*Farm Real Estate Loan Guarantee Program*

Chapter 6-09.7-09 provides that the Bank of North Dakota may guarantee the loan of money by banks, credit unions, lending institutions that are part of the farm credit system, and savings and loan associations in this state to eligible persons for the purchase of agricultural real estate or the restructuring of agricultural real estate loans, provided the transactions do not exceed a loan to value ratio of 80% and further provided that no single loan exceeds $400. The Bank may have no more than $8,000 in outstanding loan guarantees under this Program. The Bank may guarantee up to 75% of the amount of principal due the lender. The guarantee term may not exceed 5 years. As of December 31, 2015 and 2014, the Bank has guarantees outstanding totaling $296 and $0, respectively, and had no guarantee commitments outstanding, respectively, included in commitments to extend credit. The Bank has not recorded a contingent liability related to the guarantee loan program as of December 31, 2015 and 2014.

*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, 2015 and 2014, the Bank has guarantees outstanding totaling $5,035 and $5,200, respectively, and had guarantee commitments outstanding of $379 and $394, respectively, included in commitments to extend credit. The Bank has not recorded a contingent liability related to the guarantee loan program as of December 31, 2015 and 2014.

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## NOTE 15 - OFF-BALANCE-SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, financial standby letters of credit, and guarantees related to loan programs as discussed in Note 15. 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, 2015 and 2014, the following financial instruments were outstanding where contract amounts represent credit risk:

| | Contract Amount | |
|---|---|---|
| | **2015** | 2014 |
| Commitments to extend credit | **$ 1,158,518** | $ 1,036,020 |
| Financial standby letters of credit | **379,528** | 353,296 |
| Guarantees provided | **5,710** | 5,594 |

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

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

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party which require this type of facility. The maturities for these letters of credit range from three months to ten years, and the likelihood of funding any of these letters of credit is considered to be remote. The Bank holds collateral supporting those commitments. The Bank also has letters of credit with the North Dakota Public Finance Authority (NDPFA) with maturities ranging from four years to 30 years. If the letters issued to the NDPFA were ever drawn upon, the NDPFA is legally obligated to reimburse the Bank from funds legally available, or from any appropriation made available from the Legislative Assembly after certification by the Industrial Commission. The likelihood of funding any of these letters of credit is also considered to be remote. Outstanding issued letters of credit as of December 31, 2015 and 2014 were $84,806 and $80,428, respectively.

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Confirming letters of credit are issued to North Dakota financial institutions to support letters of credit they have issued but are still in need of backing from an institution with a long-term, high quality bond rating. In the event these letters were to be drawn upon, based on the terms of the agreement, the Bank would immediately withdraw funds from the institution's correspondent bank account held at the Bank to cover the amount drawn. These agreements generally have terms of 12 months or less. The likelihood of funding any of these confirming letters of credit is also considered to be remote. Outstanding issued confirming letters of credit as of December 31, 2015 and 2014 were $6,532 and $6,043, respectively.

Letters of credit pledged for public deposits to North Dakota financial institutions are issued to support public borrowing arrangements. These letters are fully collateralized by a pool of loans pledged to the Bank. These agreements generally have terms of 12 months or less. Financial standby letters for public deposits by North Dakota banks totaled $288,190 and $266,825 at December 31, 2015 and 2014, respectively. The likelihood of funding any of these letters of credit is also considered to be remote. These letters of credit are an authorized form of collateral for public deposits per North Dakota Century Code 21-04-09.

The Bank has not recorded a contingent liability related to off-balance sheet activity as of December 31, 2015 and 2014.

## NOTE 16 - INTEREST RATE SWAP CONTRACTS

*Objective of the Interest Rate Swaps*

The Bank has outstanding interest rate swap agreements with a notional amount totaling $100,000 to convert variable rate federal funds into fixed-rate instruments over the term of the contracts.

*Terms*

On June 5, 2014 ("June Swap") the Bank entered into a swap agreement which matures on June 1, 2029, and the swap's notional amount is $50,000. Under the terms of the swap, the Bank pays the counterparty a fixed payment of 2.861% and receives a variable payment based on the USD-FEDERAL FUNDS-H.15 interest rate.

On April 14, 2015 ("April Swap") the Bank entered into a swap agreement which matures on May 1, 2030, and the swap's notional amount is $50,000. Under the terms of the swap, the Bank pays the counterparty a fixed payment of 1.920% and receives a variable payment based on the USD-FEDERAL FUNDS-H.15 interest rate.

*Fair Value*

At December 31, 2015, the swap June Swap has a negative fair value of $5,064 because interest rates have declined since the swap was executed. Also at December 31, 2015, the April Swap has a positive fair value of $863 because interest rates have increased since the swap was executed. Fair values for interest rate swap agreements are based upon the settlement value adjusted by estimated nonperformance risk.

At December 31, 2014, the June Swap had a negative fair value of $4,443 because interest rates had declined since the swap was executed. Fair values for interest rate swap agreements are based upon the settlement value adjusted by estimated nonperformance risk.

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*Credit Risk*

At December 31, 2015 and 2014, the Bank was not exposed to material credit risk because each counterparty is required to fully collateralize the fair value of the swaps within $250 of daily mark-to-market valuations by depositing funds with the other counterparty. As of December 31, 2015, the Bank pledged $4,750 in cash under collateral arrangements related to the June Swap contract, classified as “Other liabilities”, to satisfy the collateral requirement associated with this interest rate swap contract. The Bank holds $1,210 in cash pledged under collateral arrangements related to the interest rate swap classified as “Other assets” at December 31, 2015, to satisfy the collateral requirement associated with the April Swap contract.

As of December 31, 2014, the Bank pledged $4,010 in cash under collateral arrangements related to the June Swap contract, classified as “Other liabilities” at December 31, 2014, to satisfy the collateral requirement associated with this interest rate swap contract.

*Interest Rate Risk*

The Bank is exposed to interest rate risk on its swap agreement. On its pay-fixed, receive variable interest rate swap, the Bank’s net payment increases as the USD-FEDERAL FUNDS-H.15 interest rate decreases.

*Termination Risk*

Either the Bank or its counterparties may terminate the interest rate swap if the other party fails to perform under the terms of the contract. Termination could result in the Bank being required to make a payment of the fair value of the swap to counterparty.

The following table summarizes the derivative financial instrument utilized at December 31, 2015:

| | | Fair Value | | Changes in Fair Value | |
|---|---|---|---|---|---|
| | Notional amount | Classification | Amount | Classification | Amount |
| Pay-fixed June interest rate swap | **$ 50,000** | **Other liabilities** | **$ (5,064)** | **Deferred outflow** | **$ (621)** |
| Pay-fixed April interest rate swap | **$ 50,000** | **Other assets** | **$ 863** | **Deferred inflow** | **$ 863** |

The following table summarizes the derivative financial instrument utilized at December 31, 2014:

| | | Fair Value | | Changes in Fair Value | |
|---|---|---|---|---|---|
| | Notional amount | Classification | Amount | Classification | Amount |
| Pay-fixed June interest rate swap | $ 50,000 | Other liabilities | $ (4,443) | Deferred outflow | $ (4,443) |

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*Swap Payments and Hedged Debt*

Using rates as of December 31, 2015, the interest expense of the variable rate federal funds and the net swap payments are as follows. As rates vary, the federal fund interest expense and the net swap payments will vary.

| Year Ended December 31: | Federal Fund Interest | Interest Rate Swap, net | Total |
|---|---|---|---|
| 2016 | $ 376 | $ 2,296 | $ 2,672 |
| 2017 | 376 | 2,296 | 2,672 |
| 2018 | 376 | 2,296 | 2,672 |
| 2019 | 376 | 2,296 | 2,672 |
| 2020 | 376 | 2,296 | 2,672 |
| 2021-2025 | 1,880 | 11,480 | 13,360 |
| 2026-2029 | 1,457 | 8,665 | 10,122 |
| | $ 5,217 | $ 31,625 | $ 36,842 |

**NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

During the year ended December 31, 2015, the Bank early adopted GASB Statement No. 72 – *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements. This statement provides guidance for determining fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

*Fair Value Hierarchy*

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

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

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*Determination of Fair Value*

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

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

*Securities*

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

*Interest Rate Swap Agreements*

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

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

The tables below presents the balances of assets and liabilities measured at fair value on a recurring basis at December 31, 2015 and 2014.

(continued on next page)

**2015**

| | **Total** | **Quoted Prices in Active Markets Level 1** | **Significant Other Observable Inputs Level 2** | **Significant Unobservable Inputs Level 3** |
|---|---|---|---|---|
| ASSETS | | | | |
| Mortgage-backed securities | | | | |
| Agency | **$ 448,777** | **$ -** | **$ 448,777** | **$ -** |
| Collateralized mortgage obligations | | | | |
| Agency | **526,835** | **-** | **526,835** | **-** |
| Non-agency | **131** | **-** | **131** | **-** |
| Agency bonds | **1,592,117** | **1,592,117** | **-** | **-** |
| US treasuries | **39,796** | **39,796** | **-** | **-** |
| Municipal bonds | **7,640** | **-** | **7,640** | **-** |
| Interest rate swap | **863** | **-** | **863** | **-** |
| Totals | **$ 2,616,159** | **$ 1,631,913** | **$ 984,246** | **$ -** |
| LIABILITIES | | | | |
| Interest rate swap | **$ 5,064** | **$ -** | **$ 5,064** | **$ -** |
| Totals | **$ 5,064** | **$ -** | **$ 5,064** | **$ -** |

2014

| | Total | Quoted Prices in Active Markets Level 1 | Significant Other Observable Inputs Level 2 | Significant Unobservable Inputs Level 3 |
|---|---|---|---|---|
| ASSETS | | | | |
| Mortgage-backed securities | | | | |
| Agency | $ 507,691 | $ - | $ 507,691 | $ - |
| Collateralized mortgage obligations | | | | |
| Agency | 525,303 | - | 525,303 | - |
| Non-agency | 201 | - | 201 | - |
| Agency bonds | 1,808,652 | 1,808,652 | - | - |
| US Treasuries | 39,592 | 39,592 | - | - |
| Municipal bonds | 14,002 | - | 14,002 | - |
| Totals | $ 2,895,441 | $ 1,848,244 | $ 1,047,197 | $ - |
| LIABILITIES | | | | |
| Interest rate swap | $ 4,443 | $ - | $ 4,443 | $ - |
| Totals | $ 4,443 | $ - | $ 4,443 | $ - |

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## NOTE 18 - RISK MANAGEMENT

The Bank is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The following are funds/pools established by the state for risk management issues:

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

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

**(In Thousands)**

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

| | **2015** | 2014 |
|---|---|---|
| 1. Bank's proportion of the net pension liability (asset) | **0.995461%** | 0.983912% |
| 2. Bank's proportionate share of the net pension liability (asset) | **$6,769** | $6,245 |
| 3. Bank's covered-employee payroll | **$8,868** | $8,288 |
| 4. Bank's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll | **76.33%** | 75.35% |
| 5. Plan fiduciary net position as a percentage of the total pension liability | **77.15%** | 77.70% |

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

Data reported is measured as of 7/1/2015 and 7/1/2014.

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

| | **2015** | 2014 |
|---|---|---|
| 1. Statutorily required contribution | **$674** | $590 |
| 2. Contribution in relation to the statutorily required contribution | **$1,204** | $1,085 |
| 3. Contribution deficiency (excess) | **($530)** | ($495) |
| 4. Bank's covered-employee payroll | **$8,868** | $8,288 |
| 5. Contributions as a percentage of covered-employee payroll | **13.58%** | 13.09% |

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

Data reported is measured as of 7/1/2015 and 7/1/2014.

## NOTE 1 - CHANGES OF ASSUMPTIONS

Amounts reported in 2015 reflect actuarial assumption changes effective July 1, 2015 based on the results of an actuarial experience study completed in 2015. This includes changes to the mortality tables, disability incidence rates, retirement rates, administrative expenses, salary scale, and percent married assumption.

# BANK OF NORTH DAKOTA
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS** **EXHIBIT A-1**
**YEAR ENDED DECEMBER 31, 2015**

| Federal Grantor/Program Title | Federal CFDA Number | Expenditures |
|---|---|---|
| DEPARTMENT OF EDUCATION | | |
| Direct Program: | | |
| Federal Family Education Loan Program | 84.032 | |
| Interest subsidy | | $ 1,393,738 |
| Special allowance | | 142,640 |
| Excess interest | | (10,287,114) |
| Net special allowance received/(paid) | | (10,144,474) |
| Guaranteed Student Loans: | | |
| Previous year balance of loans on which there are continuing compliance requirements | | 452,490,552 |
| Total guaranteed student loans (Note 2) | | 452,490,552 |
| Total Department of Education | | 443,739,816 |
| 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 | | 412,310,451 |
| FHA loan principal disbursed during the fiscal year | | 78,136,108 |
| Total guaranteed loans (Note 3) | | 490,446,559 |
| Total Department of Housing and Urban Development | | 490,446,559 |
| 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 | | 151,380,637 |
| VA loan principal disbursed during the fiscal year | | 52,778,035 |
| Total guaranteed loans (Note 4) | | 204,158,672 |
| Total Department of Defense | | 204,158,672 |
| DEPARTMENT OF JUSTICE | | |
| Direct Program: | | |
| John R. Justice Prosecutors and Defenders Incentive Act | 16.816 | |
| Grant for loan forgiveness | | 30,633 |
| Department of Justice | | 30,633 |
| TOTAL FEDERAL AWARDS | | $ 1,138,375,680 |

**NOTE 1 -** The schedule of expenditures of federal awards includes the federal grant activity of the Bank of North Dakota and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

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

**NOTE 2 -** The outstanding balance of guaranteed student loans on which there are continuing compliance requirements under the student loan program totaled $370,468,235 as of December 31, 2015.

**NOTE 3 -** The outstanding balance of guaranteed FHA residential loans on which there are continuing compliance requirements totaled $409,351,689 as of December 31, 2015.

**NOTE 4 -** The outstanding balance of guaranteed VA residential loans on which there are continuing compliance requirements totaled $179,139,329 as of December 31, 2015.

No federal award findings were reported in the prior year.

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

The Industrial Commission
Bank 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, 2015, 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 19, 2016.

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

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

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

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

**Purpose of this Report**
The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the 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

Aberdeen, South Dakota
April 19, 2016

CPAs & BUSINESS ADVISORS

**Independent Auditor's Report on Compliance for the Major Federal Program; Report on Internal Control over Compliance required by the Uniform Guidance**

To the Industrial Commission
Bank of North Dakota
Bismarck, North Dakota

**Report on Compliance for the Major Federal Program**
We have audited the Bank of North Dakota's, an enterprise fund of the State of North Dakota, compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Bank of North Dakota's major federal program for the year ended December 31, 2015.The Bank of North Dakota's major federal program is 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 the compliance for the Bank of North Dakota's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Bank of North Dakota's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

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

**Opinion on the Major Federal Program**
In our opinion, the Bank of North Dakota complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major Federal program for the year ended December 31, 2015.

**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 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 the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Bank of North Dakota's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement 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 that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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

Eide Bailly LLP

Aberdeen, South Dakota
April 19, 2016

**Section I – Summary of Auditor's Results**

**Financial Statements**

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

**Federal Awards**

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

**Identification of major programs:**

| Name of Federal Program | CFDA number |
|---|---|
| Federal Family Education Loan Program | 84.032 |

| | |
|---|---|
| Dollar threshold used to distinguish between Type A and Type B programs | $750,000 |
| Auditee qualified as low-risk auditee | Yes |

## Section II – Financial Statement Findings

No financial statement findings reported in the current year.

## Section III – Federal Award Findings and Questioned Costs

No federal award findings reported in the current year.

CPAs & BUSINESS ADVISORS

**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, 2015 audit of Bank of North Dakota are as follows:

**Audit Report Communications:**

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

   Unmodified

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

   Yes

3. Was internal control adequate and functioning effectively?

   Yes.

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

   No

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

   There were no prior audit findings and 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.

   As described in Notes 1 and 17, the Bank of North Dakota changed accounting policies related to disclosures for the fair value of investments by early adopting GASB Statement No. 72 – *Fair Value Measurement and Application* in 2015. The statement provides guidance for determining a fair value measurement for financial reporting purposes and for applying fair value to certain investments and disclosures related to all fair value measurements.

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 statement of net position 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 evaluated the key factors and assumptions used to develop the allowance for loan losses in determining that it is reasonable in relation to the financial statements taken as a whole.

   The Bank of North Dakota also has a significant estimate in their determination of the fair value of their federal funds interest rate swaps. Management's specialist completes a quarterly pricing analysis, as well as tests the effectiveness of the hedge, which complies with appropriate GASB Accounting Standards for hedge accounting. We have evaluated the key factors and assumptions used to develop the fair value of the interest rate swaps in determining that it is reasonable in relation to the financial statements taken as a whole.

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

3. Identify any significant audit adjustments.

   None

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

   None

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

   None

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

   None

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

   None

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

   Based on the audit procedures performed, Bank of North Dakota's critical information technology system is the Fiserv system. There were no exceptions identified that were directly related to this application, except for the significant deficiency identified above that noted unlimited administrator access to Fiserv for certain users.

This report is intended solely for the information and use of the North Dakota Industrial Commission, Legislative Audit and Fiscal Review Committee, Bank of North Dakota 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

Aberdeen, South Dakota
April 19, 2016

# BANK OF NORTH DAKOTA
**SCHEDULE OF APPROPRIATED EXPENDITURES** **EXHIBIT B-1**
**BIENNIUM ENDED JUNE 30, 2015**
**(In Thousands)**

| | Biennium Appropriation July 1, 2013 to June 30, 2015 | Expenditures for Year Ended June 30, 2015 | Expenditures for Year Ended June 30, 2014 | Unexpended Appropriations |
|---|---|---|---|---|
| APPROPRIATED EXPENDITURES: | | | | |
| Operating Expenses | $ 51,482 | $ 23,530 | $ 22,806 | $ 5,146 |
| Capital Assets | 745 | 469 | 136 | 140 |
| | $ 52,227 | $ 23,999 | $ 22,942 | $ 5,286 |
| * **Expenditures Reconciliation:** | | | | |
| Total expenses per financial statements- | | | | |
| Interest expense | | $ 32,164 | $ 31,455 | |
| Provision for loan losses | | 12,500 | 8,000 | |
| Operating expenses | | 26,414 | 31,565 | |
| | | 71,078 | 71,020 | |
| Non-appropriated expenditures: | | | | |
| Interest expense | | 32,164 | 31,455 | |
| Provision for loan losses | | 12,500 | 8,000 | |
| Long-term debt prepayment fee | | - | 6,819 | |
| Correspondent fees | | 887 | 913 | |
| Depreciation and amortization | | 742 | 771 | |
| Other real estate expense | | - | 1 | |
| Loan collection expenses | | 224 | 235 | |
| Loan servicing fee expense | | 569 | 495 | |
| Other expenses | | 278 | 89 | |
| Nonappropriated expenditures | | 47,364 | 48,778 | |
| Equipment capitalized | | 72 | 75 | |
| Land capitalized | | - | - | |
| Facility capitalized | | 105 | - | |
| Hardware capitalized | | - | 158 | |
| Software capitalized | | 453 | 258 | |
| Salaries capitalized | | 93 | 92 | |
| | | 723 | 583 | |
| Timing differences for appropriated expenditures: | | | | |
| July 1, 2015 to December 31, 2015 | | (11,730) | - | |
| July 1, 2014 to December 31, 2014 | | 11,292 | (11,292) | |
| July 1, 2013 to December 31, 2013 | | - | 11,409 | |
| | | (438) | 117 | |
| Appropriated Expenditures for the fiscal year | | $ 23,999 | $ 22,942 | |

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

# BANK OF NORTH DAKOTA
## DETAILED SCHEDULE OF APPROPRIATED EXPENDITURES — EXHIBIT B-2
## YEARS ENDED JUNE 30, 2015 AND 2014

| | 2015 | 2014 | Total |
|---|---|---|---|
| Operating | | | |
| Salaries and wages | **$ 10,271** | $ 9,703 | $ 19,974 |
| Social security | **781** | 744 | 1,525 |
| Hospital insurance | **1,979** | 1,980 | 3,959 |
| State retirement contribution | **1,204** | 1,085 | 2,289 |
| Vacation and sick leave benefits | **112** | 130 | 242 |
| Unemployment insurance and worker's compensation premium | **8** | 8 | 16 |
| Building expenses | **304** | 323 | 627 |
| Furniture and equipment expenses | **71** | 90 | 161 |
| Processing and development expenses | **1,883** | 1,929 | 3,812 |
| Software/IT supplies | **156** | 189 | 345 |
| Contractual services/repairs | **2,270** | 1,996 | 4,266 |
| IT equipment < $5,000 | **31** | 93 | 124 |
| Telephone | **240** | 265 | 505 |
| Marketing | **1,296** | 1,691 | 2,987 |
| Professional services | **1,076** | 861 | 1,937 |
| Travel | **196** | 175 | 371 |
| Dues and publications | **195** | 183 | 378 |
| Supplies | **256** | 133 | 389 |
| Postage | **705** | 682 | 1,387 |
| Other operating expenses | **446** | 396 | 842 |
| Contingency | **50** | 150 | 200 |
| | **23,530** | 22,806 | 46,336 |
| Capital assets | **469** | 136 | 605 |
| | **$ 23,999** | $ 22,942 | $ 46,941 |

CPAs & BUSINESS ADVISORS

To the Industrial Commission
State of North Dakota
Bismarck, North Dakota

We have audited the GASB financial statements of the business-type activities of the Bank of North Dakota for the year ended December 31, 2015. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards* and Title 2 U.S. Code of Federal Regulation (CFR) Part 200, *Uniform Administrative Requirements, Costs Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), 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 15, 2015. 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 GASB financial statements.

As described in Notes 1 and 17, the Bank of North Dakota changed accounting policies related to disclosures for the fair value of investments by early adopting GASB Statement No. 72 – *Fair Value Measurement and Application* in 2015. The statement provides guidance for determining a fair value measurement for financial reporting purposes and for applying fair value to certain investments and disclosures related to all fair value measurements.

We noted no transactions entered into by the Bank of North Dakota 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 estimates affecting the Bank of North Dakota's financial statements were:



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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 statement of net position 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 evaluated the key factors and assumptions used to develop the allowance for loan losses in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of the fair value of their Fed Funds interest rate swaps is based on the valuation techniques performed by a third party specialist. Management's specialist completes a quarterly pricing analysis, as well as tests the effectiveness of the hedge, which complies with appropriate GASB Accounting Standards for hedge accounting. We evaluated the key factors and assumptions used to develop the fair value of the interest rate swaps in determining that it is reasonable in relation to the financial statements taken as a whole.

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

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

**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 clearly trivial, and communicate them to the appropriate level of management. There were no corrected or uncorrected misstatements identified during the course of the audit.

**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 19, 2016.

**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 Bank of North Dakota'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**

We applied certain limited procedures to the Management's Discussion and Analysis, Schedule of Bank's Share of Net Pension Liability, and Schedule of Bank Contributions, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding 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 did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the schedule of appropriated expenditures and the schedule of expenditures of federal awards (supplementary information), which accompany the financial statements but are not RSI. With respect to this supplementary information, 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, Bank of North Dakota 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

Aberdeen, South Dakota
April 19, 2016