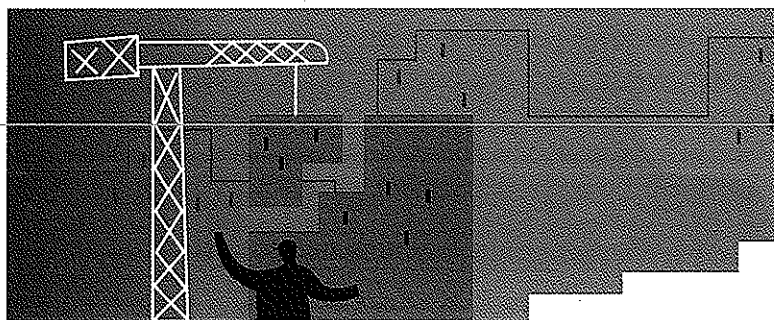


**Bank of North Dakota  
Annual Report 2003**



**B**UILDING  
**N**ORTH  
**D**AKOTA

# BUILDING NORTH DAKOTA



## *President's Message...*

The heart of Bank of North Dakota's (BND) mission is to deliver quality, sound financial services that promote agriculture, commerce and industry in North Dakota. We strive to provide quality programs and services to help "Build North Dakota."

BND ended the year with a stable performance and net income of \$31.7 million in spite of the lowest interest rates in 40 years. We experienced a return on average assets of 1.63 percent and return on average equity of 20.7 percent, compared to 1.64 percent and 18.7 percent in 2002.

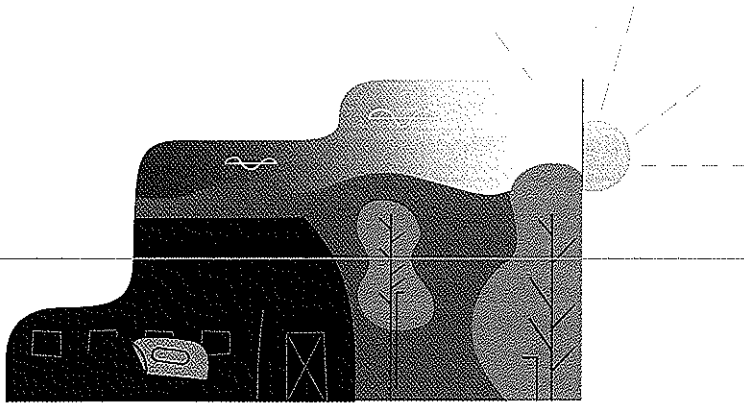


*Eric Hardmeyer,  
President*

This year, the Bank increased equity by \$4.6 million and BND remained a well-capitalized bank with a tier one leverage ratio of 8.09 percent and primary capital (capital plus loan loss reserve) of 9.23 percent.

During 2003, BND transferred an additional \$18.7 million to the state general fund. This transfer, along with the state's sound fiscal management, helped balance the state budget when many other states across the nation operated with deficits. The extra funds are in addition to \$60 million transferred through the normal appropriation process. All together for the 2001-2003 biennium, BND transferred a total of \$78.7 million to the general fund. Being able to provide financial assistance during challenging times illustrates our ability to support the state in multiple ways. The Bank remains among the top five revenue generators for North Dakota's general fund.

BND continues to strive to be a model of efficient government as we look at ways to streamline, capitalize on efficiencies and provide consistent earnings. We are embracing change, working to manage effectively and invest wisely to position the Bank for future growth.



## New legislative programs implemented

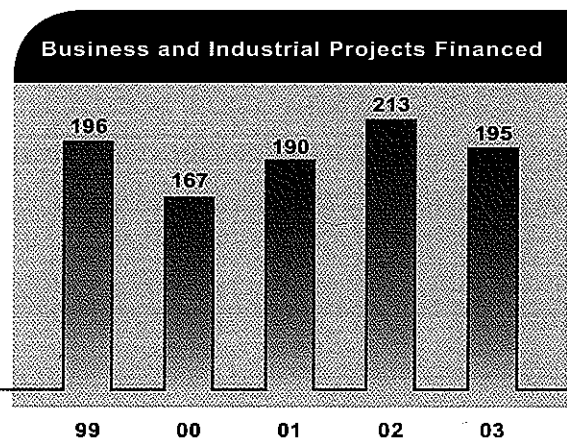
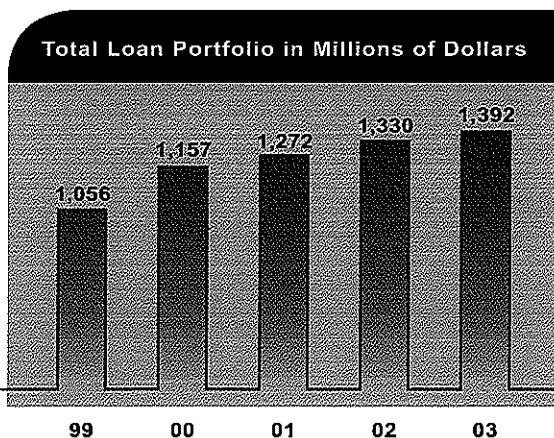
Bank of North Dakota is proud to be part of programs passed by the State Legislature in 2003. The three new programs introduced at the legislative session include a farm real estate guarantee program, student loan program for truck driver training (called DESL for Drivers Education Student Loan), and a venture capital program. BND will partner with financial institutions and agencies to provide these new programs throughout the state.

This year BND obtained legislative approval to provide Trust Preferred Security financing to bank holding companies on a direct basis. The ability to provide this type of financing will compliment BND's existing bank stock loan features.

## Loan programs build strength

BND also provides other innovative programs to add value to the state and help build a variety of areas including agriculture, small business, economic development and education. Lending is an essential tool at BND. We worked with private financial institutions and business owners to create programs that, in 2003, funded 195 business and industrial projects.

Numerous loan programs are constructed to help benefit local communities and provide a variety of options for customers. A few examples of such loan programs are the BND PACE program, which is a resource utilized for commercial industry, while the Chattel and Beginning Farmer programs work in agricultural application. Some of the projects funded by the PACE program and other BND loan programs are featured in this year's annual report.



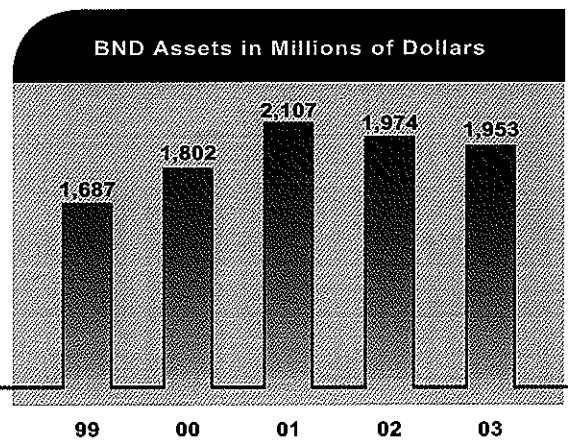
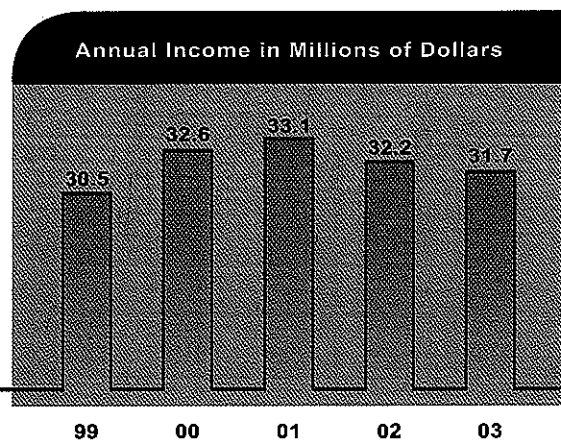
Our commitment to “Build North Dakota” is illustrated in our loan portfolio. The loan portfolio grew by \$62 million in 2003, which is important due to the fact that BND sold approximately \$52 million in student loans to the Student Loan Trust. Loan development expanded in several loan areas with commercial loans leading the way:

- *Commercial and business loan volume was strong with an \$18 million increase, illustrating the Bank’s dedication to economic development and commitment to help “Build North Dakota.” BND loan programs financed 195 business and industrial projects.*
- *Residential loans grew by \$9 million, even though BND booked over \$137 million in new loan volume, refinancing played a significant role in reducing net growth.*
- *Agricultural loans increased by \$8 million. Interest in farm real estate spurred activity in beginning farm programs.*
- *Overall, student loan volume grew by \$7 million as BND worked with higher education to provide student loans throughout the nation.*



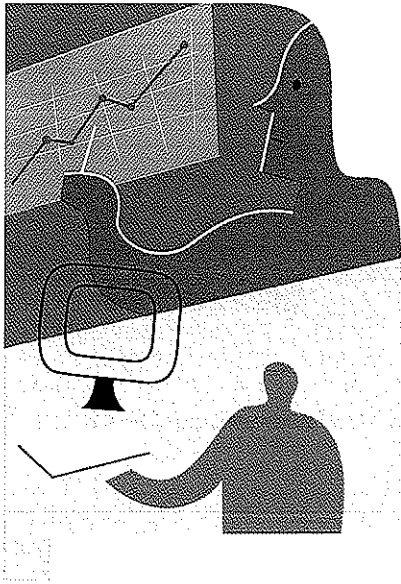
BND offers a conclusive financial package created to compliment and support lending by private financial institutions. We provide lending services in four major areas: business, agriculture, student and home lending. All of these areas support diversification as BND’s loan portfolio remains well-balanced with commercial loans accounting for 34 percent, student loans 27 percent, residential loans 23 percent and agricultural loans 16 percent.

BND’s loan loss reserve of approximately \$25 million calculates to a 1.82 percent reserve, which exceeds the North Dakota average of 1.74 percent. Because of the nature of the portfolio, the Bank uses federal guaranty programs to reduce risk, with nearly 51 percent of BND’s loan portfolio federally guaranteed.



## Building partnerships across the state

The Bank's financial strength is built on partnerships with financial institutions, guarantee agencies and customers. BND works with an advisory board comprised of financial and business experts who work and live in various regions of North Dakota. BND also partners with the State Industrial Commission, Business Resource Center, community economic development organizations, and other agencies to promote growth and provide opportunities across the state. We work with our partners and customers to help build a framework for the future whether it is a college education, agricultural operation or small business.

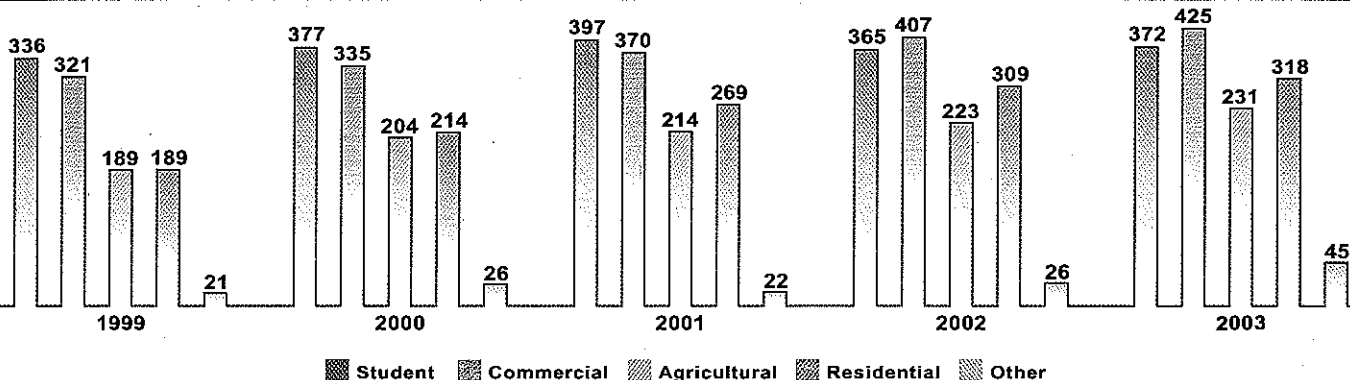


In addition to partnerships, BND programs continue to grow as we maintain implementation of Web-based technology to improve banking services. The BND Direct WEB program, which allows financial institutions and colleges to easily access important account information, currently serves 98 North Dakota banks, state colleges and other corporations.

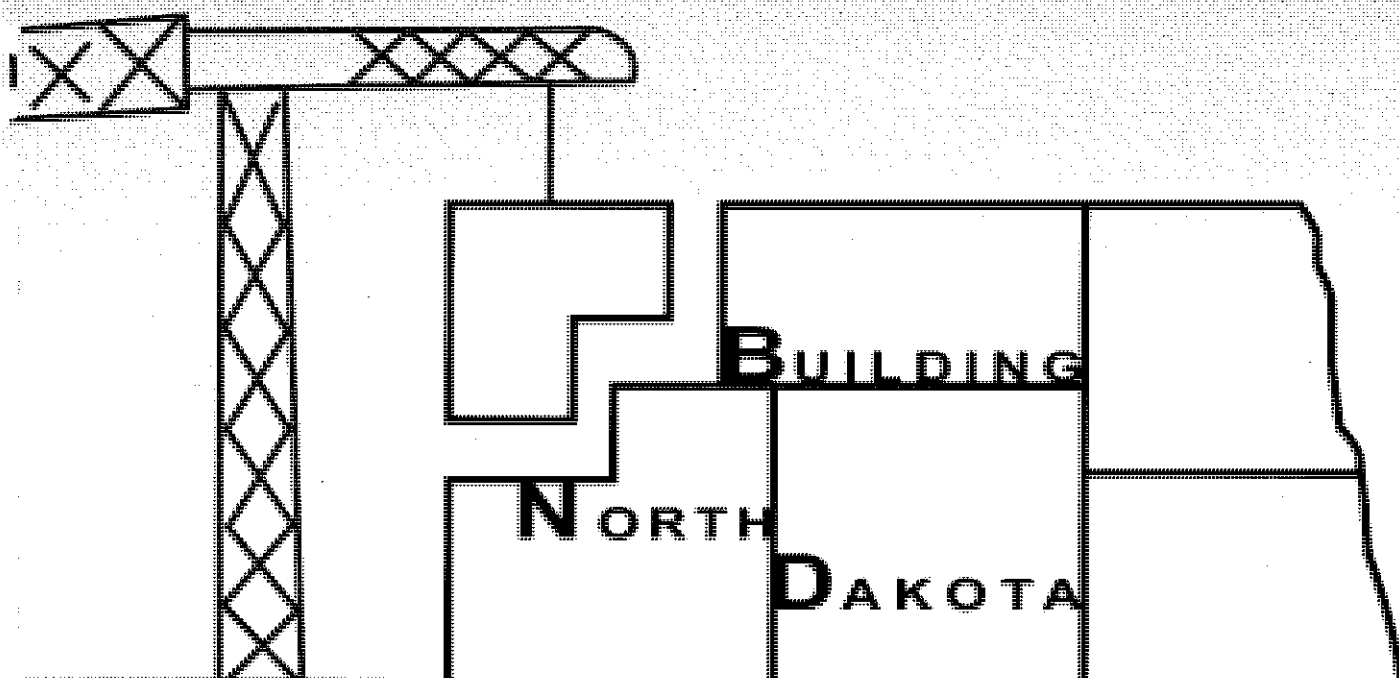
Student Loans of North Dakota helped students and parents meet the costs of college through a variety of loans. In addition to federal loans, the Dakota Education Alternative Loan (DEAL), a supplemental loan provided through BND, saw an increase in loan volume from \$6.2 million in 2002 to \$8.2 million in 2003.

BND builds and designs unique programs in addition to providing quality service. The employees are the foundation of BND as we strive to serve our customers and the residents of North Dakota. Our unwavering commitment to manage efficiently and develop diverse talent in our employees is the catalyst for BND's financial success as we continue to "Build North Dakota."

Loan Portfolio Balances in Millions of Dollars







**BND continues to enrich North Dakota's future by expanding and implementing loan programs to assist residents and businesses across the state. The Bank is on firm ground and positioned as a partner to help diversify and build North Dakota.**

# BUILDING NORTH DAKOTA

## **Baker Boy**

Started originally as a family baking business in the 1950's by Marvin Moos, Baker Boy has witnessed tremendous growth and opportunity during the last several decades. Recognizing the need for a regional provider of quality dough products to serve the baking industry, a small facility was constructed in 1979 to manufacture frozen dough products.

The original 3,000 square foot facility has grown over the years, doubling in size and capacity several times. It now encompasses an 85,000 square foot, technologically advanced production facility and employs 242 workers, according to current president, Guy Moos. Today, Baker Boy has earned a position as one of the leading bakery manufacturers in the Upper Midwest and Northwest. The company provides over 500 bakery products in frozen dough, pre-fried, par-baked, fully baked and finished forms for distribution in the food service, co-pack and retail markets.



A recent dough production/processing line expansion was partially funded by BND's PACE program in conjunction with Wells Fargo of Dickinson, ensuring continued growth for the future.

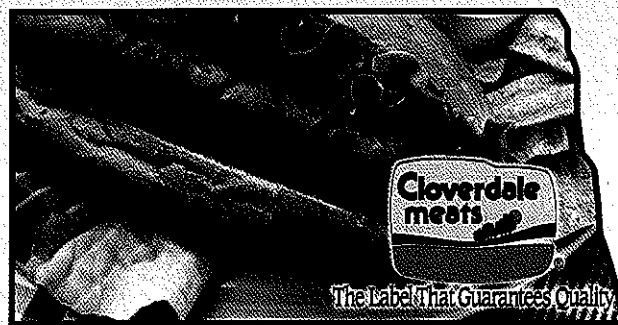
## **Cloverdale Food**

Cloverdale Foods, started four generations ago by Hoy Russell, remains a staple in Mandan. Today, the company is known for its mouth watering ham, bacon, sausage, franks and deli meats as Cloverdale Foods continues its tradition of excellence that began more than 85 years ago. The company's 310 employees help maintain and preserve this tradition to provide the finest quality meat products in the Midwest today.

Since 1999, Cloverdale Foods has been the "Official Hot Dog of the Seattle Mariners." In addition to this, Cloverdale is the "Official Hot Dog of the Seattle Seahawks and Supersonics."

Cloverdale Foods utilized BND's PACE program for an internal plant expansion that included the purchase of state-of-the-art material handling and packaging equipment.

According to current CEO and President T.J. Russell, this will allow Cloverdale to be more efficient and increase production 20 percent from 30 million pounds of meat per year to 36 million pounds of meat per year. In addition, with these improvements made possible from the PACE loan, Cloverdale plans to add 20 jobs.



## Huether Cattle Ranch

Nathan and Sandy Huether recently turned a long time dream into reality by beginning a family cattle operation near Mott. When the opportunity to purchase land for a ranch became available, they looked for financing options. Bank of North Dakota, in partnership with Commercial Bank of Mott, was able to qualify them for both Chattel and Beginning Farmer Real Estate loans.

“Bank of North Dakota not only made it possible for us to begin our cattle operation but also use our local banker, which was important to us,” said Nathan.

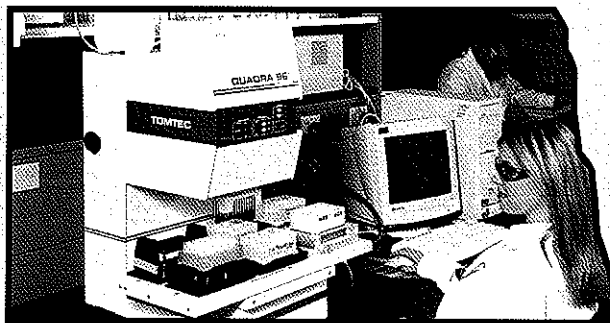
In addition to acquiring 960 acres and a herd of 91 cattle, the Huether’s purchased a tractor, feed wagon and baler. The Huether family looks forward to the future as new baby, seven month old Samuel, will one day help his parents with the business, ensuring a new generation of North Dakotan’s remains connected to the land.



## PRACS Institute, Ltd.

When PRACS Institute, Ltd. decided to quadruple its work space in 2000 to a 123,000 square foot facility, funding was difficult to find. But thanks to the BND PACE program, initiated through Alerus Financial in Fargo, the results have been staggering.

Started in 1983 and privately owned by Dr. James Carlson, PRACS offers clinical, bio-analytical, and statistical and information services for the pharmacy industry. With 310 employees in Fargo and East Grand Forks, PRACS completed 330 projects in 2003 and has gone from total revenue of \$2 million in 1993 to \$36 million in 2003. In addition, the pool of clinical participants has gone from 1,000 people in 1993 to 10,000 people in 2003, and the amount paid to study participants has jumped from \$500,000 to \$8 million.

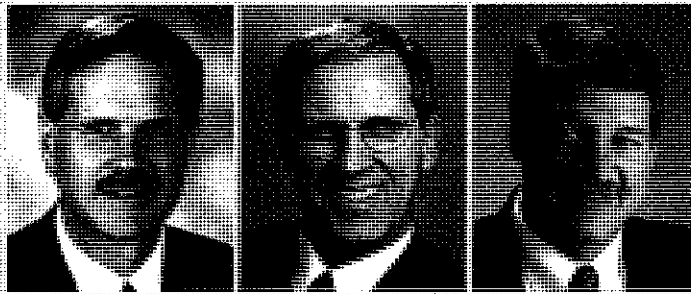


“With approval of our second PACE loan we have now sealed the future of PRACS with our state-of-the-art Bioanalytical Laboratory and plans are already being made for an expansion,” said Dr. Carlson. “We can now target high-tech positions in the industry and build our own pool of experts in North Dakota.”



# LEADING THE BUILDERS

## North Dakota Industrial Commission



**John Hooven**  
Governor

**Roger Johnson**  
Appraiser  
Commissioner

**Wayne Stenshjem**  
Insurance General

## BND Advisory Board



standing: Frank Larsen, Gary Peterson, Bill Kungstary, Jean Stewart  
seated: Elaine Frenning, Martya Brown, Stanley Montgomery

## BND Executive Committee



back row: Ed Sather, Don Harrison, Ellyn Mertz, Tim Anderson, Dale Duerksen  
front row: Gayle Casavalla, Eric Handmeyer, Jane Robinson, Phyllis Linder

# FINANCIAL STATEMENTS

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# INDEPENDENT AUDITOR'S REPORT

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The Industrial Commission  
State of North Dakota  
Bismarck, North Dakota

We have audited the accompanying balance sheets of the Bank of North Dakota as of December 31, 2003 and 2002, and the related statements of income, equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, the Bank of North Dakota is included as part of the primary government in the State of North Dakota's reporting entity. However, the Bank of North Dakota has prepared the accompanying financial statements in accordance with Financial Accounting Standards Board pronouncements, which is generally accepted accounting principles for financial institutions. This basis of accounting is a comprehensive basis of accounting other than generally accepted accounting principles applicable to governmental units.

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, 2003 and 2002, and the results of its operations and its cash flows for the years then ended on the basis of accounting described in Note 1.

*Eide Bailly LLP*

Fargo, North Dakota  
January 22, 2004

**BANK OF NORTH DAKOTA**  
**BALANCE SHEETS**  
**DECEMBER 31, 2003 AND 2002**

	(In Thousands)	
	2003	2002
<b>ASSETS</b>		
Cash and due from banks	\$ 186,752	\$ 199,389
Federal funds sold	89,915	209,205
Cash and cash equivalents	276,667	408,594
Securities	284,272	235,365
Loans	1,391,583	1,329,985
Less allowance for loan losses	(25,334)	(25,091)
	1,366,249	1,304,894
Bank premises, equipment, and software, net	4,809	5,141
Interest receivable	15,242	17,625
Other assets	5,939	2,829
Total assets	<u>\$ 1,953,178</u>	<u>\$ 1,974,448</u>
<b>LIABILITIES AND EQUITY</b>		
Deposits		
Non-interest bearing	\$ 214,275	\$ 209,112
Interest bearing	843,111	861,741
	1,057,386	1,070,853
Federal funds purchased and securities sold under agreements to repurchase	190,597	296,688
Short and long-term debt	525,795	421,065
Other liabilities	25,656	36,729
Total liabilities	1,799,434	1,825,335
Equity		
Capital	2,000	2,000
Capital surplus	42,000	42,000
Undivided profits	110,947	104,237
Unrealized gain (loss) on securities available for sale	(1,203)	876
Total equity	153,744	149,113
Total liabilities and equity	<u>\$ 1,953,178</u>	<u>\$ 1,974,448</u>



**BANK OF NORTH DAKOTA**  
**STATEMENTS OF INCOME**  
**YEARS ENDED DECEMBER 31, 2003 AND 2002**

	(In Thousands)	
	2003	2002
<b>INTEREST INCOME</b>		
Federal funds sold	\$ 1,849	\$ 4,361
Securities	7,292	7,943
Loans	70,322	78,011
Total interest income	<u>79,463</u>	<u>90,315</u>
<b>INTEREST EXPENSE</b>		
Deposits	14,843	22,833
Federal funds purchased and securities sold under agreements to repurchase	2,799	3,653
Short and long-term debt	24,113	24,180
Total interest expense	<u>41,755</u>	<u>50,666</u>
<b>NET INTEREST INCOME</b>	<u>37,708</u>	39,649
<b>PROVISION FOR LOAN LOSSES</b>	<u>2,000</u>	<u>2,200</u>
<b>NET INTEREST AFTER PROVISION FOR LOAN LOSSES</b>	<u>35,708</u>	<u>37,449</u>
<b>NON-INTEREST INCOME</b>		
Service fees and other	<u>11,474</u>	<u>9,764</u>
<b>NON-INTEREST EXPENSE</b>		
Salaries	5,789	5,689
Pensions and other employee benefits	1,859	1,877
Data processing	2,496	2,506
Other operating expenses	4,404	3,936
Depreciation and amortization	940	1,014
Total non-interest expenses	<u>15,488</u>	<u>15,022</u>
<b>NET INCOME</b>	<u>\$ 31,694</u>	<u>\$ 32,191</u>

See Notes to Financial Statements

**BANK OF NORTH DAKOTA**  
**STATEMENTS OF EQUITY**  
**YEARS ENDED DECEMBER 31, 2003 AND 2002**

	(In Thousands)				
	Capital	Capital Surplus	Undivided Profits	Unrealized Gain (Loss) on Securities Available for Sale	Total
BALANCE, DECEMBER 31, 2001	\$ 2,000	\$ 42,000	\$ 126,237	\$ 259	<u>\$ 170,496</u>
Comprehensive income					
Net income			32,191		32,191
Unrealized gain on securities available for sale				617	<u>617</u>
Total comprehensive income					32,808
Transfers to state					
general fund from current earnings			(32,191)		(32,191)
Contingency transfers to state					
general fund from undivided profits			(22,000)		<u>(22,000)</u>
BALANCE, DECEMBER 31, 2002	2,000	42,000	104,237	876	<u>149,113</u>
Comprehensive income					
Net income			31,694		31,694
Unrealized loss on securities available for sale				(2,079)	<u>(2,079)</u>
Total comprehensive income					29,615
Transfers to state					
general fund from current earnings			(28,209)		(28,209)
Reduction in contingency transfers to state general fund			3,300		3,300
Transfer to Industrial Commission			(85)		(85)
Reduction in transfer to Industrial Commission			10		<u>10</u>
BALANCE, DECEMBER 31, 2003	<u>\$ 2,000</u>	<u>\$ 42,000</u>	<u>\$ 110,947</u>	<u>\$ (1,203)</u>	<u>\$ 153,744</u>

**BANK OF NORTH DAKOTA**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2003 AND 2002**

	(In Thousands)	
	2003	2002
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 31,694	\$ 32,191
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	940	1,014
Provision for loan losses	2,000	2,200
Net amortization of securities	2,034	1,822
Gain on sale of loans	(96)	(465)
Loss on retirement of equipment and software	-	11
Gain on sale of other real estate and property owned	(69)	(24)
Decrease in interest receivable	2,383	2,920
(Increase) in other assets	(94)	(387)
Decrease in other liabilities	(2,020)	(519)
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>36,772</b>	<b>38,763</b>
<b>INVESTING ACTIVITIES</b>		
Securities available for sale transactions		
Purchase of securities	(331,457)	(642,021)
Proceeds from sales, maturities, and principal repayments	249,526	717,085
Securities held to maturity transactions		
Purchase of securities	-	(11,669)
Proceeds from sales, maturities, and principal repayments	33,651	30,730
Purchase of Federal Home Loan Bank stock	(9,610)	(1,063)
Sale of Federal Home Loan Bank stock	4,870	-
Proceeds from sales of loans	65,001	91,871
Net increase in loans	(131,828)	(146,124)
Purchases of equipment and software	(608)	(2,195)
Proceeds from sale of other real estate and property owned	621	133
<b>NET CASH FROM (USED FOR) INVESTING ACTIVITIES</b>	<b>(119,834)</b>	<b>36,747</b>
<b>FINANCING ACTIVITIES</b>		
Net increase in non-interest bearing deposits	5,163	15,758
Net (decrease) in interest bearing deposits	(18,630)	(153,506)
Net (decrease) in federal funds purchased and securities sold under repurchase agreements	(106,091)	(19,025)
Proceeds from issuance of short and long-term debt	1,210,000	48,000
Payment of short and long-term debt	(1,105,270)	(26,488)
Payment of transfers	(34,037)	(30,036)
<b>NET CASH (USED FOR) FROM FINANCING ACTIVITIES</b>	<b>(48,865)</b>	<b>(165,297)</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(131,927)</b>	<b>(89,787)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>408,594</b>	<b>498,381</b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 276,667</b>	<b>\$ 408,594</b>

See Notes to Financial Statements

**BANK OF NORTH DAKOTA**  
**NOTES TO FINANCIAL STATEMENTS**  
**DECEMBER 31, 2003 AND 2002**

**NOTE 1 - SUMMARY OF 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 made in tandem with financial institutions throughout the State of North Dakota. BND's primary deposit products are interest-bearing accounts for state and political subdivisions.

Bank of North Dakota is included as part of the primary government in the State of North Dakota's reporting entity. As such, BND is required to follow the pronouncements of the Government Accounting Standards Board (GASB), which is the nationally accepted standard setting body for establishing generally accepted accounting principles for governmental entities. In accordance with GASB Statement No. 20, BND follows all applicable GASB pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements issued, including those issued after November 30, 1989, unless they conflict with the GASB pronouncements.

However, the accompanying financial statements are prepared in accordance with Financial Accounting Standards Board pronouncements, which is generally accepted accounting principles for financial institutions. This basis of accounting is a comprehensive basis of accounting other than generally accepted accounting principles applicable to governmental units.

BND also prepares financial statements in accordance with GASB pronouncements.

*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 balance sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses.

*Significant Group Concentrations of Credit Risk*

Most of the Bank's lending activities are with customers within the State of North Dakota. Due to the pervasive nature of agriculture in the economy of the state, all loans, regardless of type, are impacted by agriculture. The Bank's loan portfolio is comprised of the following concentrations as of December 31, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Student loans, of which 98% are federally guaranteed	27%	27%
Commercial loans, of which 7% and 8% are federally guaranteed	34%	33%
Residential loans, of which 84% are federally guaranteed	23%	23%
Agricultural loans, of which 20% and 25% are federally guaranteed	16%	17%
	<u>100%</u>	<u>100%</u>



## NOTES TO FINANCIAL STATEMENTS

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### *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*

Securities that may be sold before maturity in response to changes in interest rates or prepayment risk, or due to liquidity needs or changes in funding sources or terms, are classified as securities available for sale. These securities are recorded at fair value, with unrealized holding gains and losses, reported in equity. The change in unrealized holding gains and losses are excluded from earnings and reported in other comprehensive income. Securities that management has the positive intent and ability to hold to maturity are classified as securities held to maturity and recorded at amortized cost.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. Gains and losses on the sale of securities are recorded on the settlement date and are determined using the specific identification method.

Because of its borrowing arrangement with the Federal Home Loan Bank, the Bank is required to hold Federal Home Loan Bank stock. Since ownership of this stock is restricted, these securities are carried at cost and evaluated periodically for impairment.

### *Loans*

Loans are stated at the outstanding unpaid principal balance. Interest income on loans is accrued at the specific rate on the unpaid principal balance.

The accrual of interest is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received.

### *Allowance for Loan Losses*

The Bank uses the allowance method in providing for loan losses. Accordingly, the allowance is increased by the current year's provision for loan losses charged to operations and reduced by net charge-offs.

The adequacy of the allowance for loan losses and the provision for loan losses charged to operations are based on management's evaluation of a number of factors, including recent loan loss experience, continuous evaluation of the loan portfolio quality, current and anticipated economic conditions, and other pertinent factors. Loans are charged to the allowance when management believes the collection of the principal is doubtful.

## NOTES TO FINANCIAL STATEMENTS

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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 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.

### *Loan Servicing*

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of residential loans. Purchased servicing rights are capitalized at the cost to acquire the rights. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future estimated future net servicing income of the underlying residential loans. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income prepayment speeds and default rates and losses. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche.

### *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.

### *Bank Premises, Equipment, and Software*

Bank premises, equipment, and software are stated at cost less accumulated depreciation or amortization. Depreciation and amortization are provided over the estimated useful lives of the individual assets using the straight-line method.

## NOTES TO FINANCIAL STATEMENTS

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### *Other Real Estate and Property Owned*

Other real estate and property owned, which are included in other assets, represent assets acquired through loan foreclosure or other proceedings. Other real estate and property owned 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 other real estate and property owned 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. Other real estate and property owned totaled \$3,050,000 and \$34,000 as of December 31, 2003 and 2002.

### *Defined Benefit Plan*

The Bank funds amounts equal to pension costs accrued.

### *Income Taxes*

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

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

Federal Reserve Board regulations require reserve balances on deposits to be maintained by BND with the Federal Reserve Bank. BND also maintains a clearing balance of \$4 million with the Federal Reserve Bank.

## **NOTE 3 - DEBT AND EQUITY SECURITIES**

Debt and equity securities have been classified in the financial statements according to management's intent. The carrying value of securities as of December 31, 2003 and 2002, consists of the following:

	(In Thousands)	
	2003	2002
Securities available for sale, at fair value	\$ 241,022	\$ 163,136
Securities held to maturity, at amortized cost	17,485	51,204
Federal Home Loan Bank stock, at cost	25,765	21,025
	<u>\$ 284,272</u>	<u>\$ 235,365</u>

## NOTES TO FINANCIAL STATEMENTS

The amortized cost and fair value of securities with gross unrealized gains and losses follows:

	(In Thousands)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>DECEMBER 31, 2003</b>				
Securities available for sale				
Federal agency	\$ 84,335	\$ 323	\$ 242	\$ 84,416
Mortgage-backed	157,890	68	1,352	156,606
	<u>\$ 242,225</u>	<u>\$ 391</u>	<u>\$ 1,594</u>	<u>\$ 241,022</u>
Securities held to maturity				
Mortgage-backed	\$ 11,025	\$ 11	\$ 30	\$ 11,006
State and municipal	6,460	-	-	6,460
	<u>\$ 17,485</u>	<u>\$ 11</u>	<u>\$ 30</u>	<u>\$ 17,466</u>

	(In Thousands)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>DECEMBER 31, 2002</b>				
Securities available for sale				
Federal agency	\$ 126,300	\$ 693	\$ 1	\$ 126,992
Mortgage-backed	35,960	313	129	36,144
	<u>\$ 162,260</u>	<u>\$ 1,006</u>	<u>\$ 130</u>	<u>\$ 163,136</u>
Securities held to maturity				
Mortgage-backed	\$ 34,863	\$ 319	\$ 29	\$ 35,153
State and municipal	16,341	-	-	16,341
	<u>\$ 51,204</u>	<u>\$ 319</u>	<u>\$ 29</u>	<u>\$ 51,494</u>

Securities carried at \$20,854,000 at December 31, 2003, and \$19,821,000 at December 31, 2002, were used for securities sold under agreements to repurchase and for other required pledging purposes. FHLB stock totaling \$25,765,000 at December 31, 2003 and \$21,025,000 at December 31, 2002 are pledged on the FHLB advances (Note 9).



## NOTES TO FINANCIAL STATEMENTS

The maturity distribution of debt securities at December 31, 2003, 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.

	(In Thousands)			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$ -	\$ -	\$ 4,823	\$ 4,826
Over one year through five years	217,623	216,560	5,422	5,410
Over five years through ten years	15,921	15,877	1,765	1,759
Over ten years	8,681	8,585	5,475	5,471
	<u>\$ 242,225</u>	<u>\$ 241,022</u>	<u>\$ 17,485</u>	<u>\$ 17,466</u>

There were no sales of securities during 2003 and 2002.

### NOTE 4 - LOANS

The composition of the loan portfolio at December 31, 2003 and 2002, is as follows:

	(In Thousands)	
	2003	2002
Guaranteed student loans	\$ 372,362	\$ 364,816
Bank participation loans:		
Commercial	369,458	356,576
Agricultural	140,556	146,378
Residential loans	318,067	309,267
Farm real estate loans	90,686	76,584
State institutions	45,134	25,954
Bank stock	55,320	50,410
	<u>1,391,583</u>	<u>1,329,985</u>
Allowance for loan losses	25,334	25,091
	<u>\$ 1,366,249</u>	<u>\$ 1,304,894</u>

## NOTES TO FINANCIAL STATEMENTS

Unamortized deferred student loan costs totaled \$2,114,000 and \$1,713,000 as of December 31, 2003 and 2002. Net unamortized loan premiums and discounts, including purchased servicing rights, on residential loans totaled \$2,215,000 and \$2,168,000 as of December 31, 2003 and 2002.

The composition of the allowance for loan losses for the years ended December 31, 2003 and 2002, is as follows:

	(In Thousands)	
	2003	2002
Balance - beginning of year	\$ 25,091	\$ 23,958
Provision for loan losses	2,000	2,200
Loans charged off	(1,976)	(1,113)
Recoveries	219	46
Balance - end of year	<u>\$ 25,334</u>	<u>\$ 25,091</u>

At December 31, 2003 and 2002, the Bank had loans amounting to \$4,225,000 and \$8,854,000 that were specifically classified as impaired, of which \$4,043,000 and \$8,167,000 have a valuation allowance. As of December 31, 2003 and 2002, the allowance for loan losses related to these impaired loans was \$1,416,000 and \$1,992,000. At December 31, 2003 and 2002, impaired loans of \$182,000 and \$687,000 did not have a valuation allowance since these impaired loans have adequate collateral and/or guarantees. The average balance of impaired loans was \$8,927,000 and \$7,531,000 during 2003 and 2002. The interest income recorded on impaired loans is not significant.

At December 31, 2003 and 2002, the Bank had loans amounting to \$4,225,000 and \$8,854,000 on nonaccrual status. Loans 90 days or more past due and still accruing interest totaled \$25,687,000 and \$22,368,000 as of December 31, 2003 and 2002. Accruing loans 90 days or more past due include guaranteed student loans of \$13,762,000 and \$16,311,000 as of December 31, 2003 and 2002. The Bank is entitled to reimbursement from the guarantor 270 days after default in the case of a student loan payable in monthly installments and 330 days in the case of a student loan payable in less frequent installments.

The total amount of restructured loans was \$12,594,000 and \$13,987,000 at December 31, 2003 and 2002.

There were no material commitments to lend additional funds to customers whose loans were classified as impaired or restructured at December 31, 2003.

## NOTES TO FINANCIAL STATEMENTS

### NOTE 5 - LOAN SALES AND LOAN SERVICING

A summary of BND's loan sales during 2003 and 2002 follows:

	(In Thousands)	
	2003	2002
Student loans sold to North Dakota Student Loan Trust	\$ 51,957	\$ 85,882
Residential loans sold on the secondary market	12,948	5,524

BND recognized gains on sale of loans of \$96,000 and \$465,000 in 2003 and 2002, which is included in non-interest income on the Statements of Income.

A servicing asset or liability was not recognized in the student loan sales since BND receives adequate compensation relative to current market servicing prices to service the student loans sold. Servicing assets were recognized on the sale of residential loans.

BND has contracts to provide servicing of loans for others. These loans are not included in the accompanying balance sheets. The unpaid principal balances of loans serviced for others as of December 31, 2003 and 2002 were as follows:

	(In Thousands)	
	2003	2002
Student loans		
North Dakota Student Loan Trust	\$ 153,854	\$ 136,305
Others	5,646	5,601
Residential loans	31,867	35,368
Other state fund loans		
Board of University and School Lands	26,802	41,302
Community Water Facility Loan Fund	16,522	16,254
Beginning Farmer Revolving Loan Fund	9,086	9,705
Developmentally Disabled Facility Loan Program	3,421	6,472
Department of Human Services	9,620	5,148
Credit Review Board	3	4

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 existing residential loan servicing agreements, the Bank generally agrees to reimburse lenders for all losses, damages, judgments or legal expenses that resulted from the actions or inactions of the Bank. Any potential liability for claims under these agreements is not considered significant.

## NOTES TO FINANCIAL STATEMENTS

The balance of capitalized servicing rights, net of valuation allowances, included in other assets at December 31, 2003 and 2002, was \$251,000 and \$248,000. The fair value of these rights was \$368,000 and \$408,000 at December 31, 2003 and 2002.

The following table summarizes the changes in capitalized servicing rights for the years ended December 31, 2003 and 2002:

	(In Thousands)	
	2003	2002
Balance - beginning of year	\$ 248	\$ 327
Purchases	142	58
Amortization	(139)	(137)
	<u>251</u>	<u>248</u>
Less valuation allowance	-	-
Balance - end of year	<u>\$ 251</u>	<u>\$ 248</u>

### NOTE 6 - BANK PREMISES, EQUIPMENT, AND SOFTWARE

A summary of changes in bank premises, equipment, furniture, and software at December 31, 2003 and 2002, is as follows:

	(In Thousands)			
	Balance 2002	Additions	Retirements	Balance 2003
Land	\$ 672	\$ -	\$ -	\$ 672
Building	4,285	-	-	4,285
Equipment	1,546	105	92	1,559
Furniture	518	29	14	533
Software	6,168	474	9	6,633
	<u>13,189</u>	<u>608</u>	<u>115</u>	<u>13,682</u>
Less accumulated depreciation	8,048	940	115	8,873
	<u>\$ 5,141</u>	<u>\$ (332)</u>	<u>\$ -</u>	<u>\$ 4,809</u>

## NOTES TO FINANCIAL STATEMENTS

	(In Thousands)			Balance 2002
	Balance 2001	Additions	Retirements	
Land	\$ 672	\$ -	\$ -	\$ 672
Building	4,285	-	-	4,285
Equipment	1,608	53	115	1,546
Furniture	502	23	7	518
Software	4,049	2,119	-	6,168
	<u>11,116</u>	<u>2,195</u>	<u>122</u>	<u>13,189</u>
Less accumulated depreciation	<u>7,145</u>	<u>1,014</u>	<u>111</u>	<u>8,048</u>
	<u>\$ 3,971</u>	<u>\$ 1,181</u>	<u>\$ 11</u>	<u>\$ 5,141</u>

Depreciation and amortization expense on the above assets amounted to \$940,000 and \$1,014,000 in 2003 and 2002.

### NOTE 7 - DEPOSITS

The aggregate amount of locally sold certificates of deposit larger than \$100,000 was \$464,369,000 and \$454,027,000 as of December 31, 2003 and 2002. Certificates of deposit sold on the national market were \$65,000,000 as of December 31, 2002, and all are in denominations of \$10,000,000 or more.

At December 31, 2003, the scheduled maturities of certificates of deposits are as follows:

	(In Thousands)
2004	\$ 389,466
2005	34,429
2006	14,384
2007	5,521
2008	6,156
Later years	<u>30,672</u>
	<u>\$ 480,628</u>

## NOTES TO FINANCIAL STATEMENTS

### NOTE 8 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Bank enters into securities sold under agreements to repurchase the same securities. These agreements may have a fixed maturity or be open-ended, callable at any time. These agreements are secured by Fed book-entry securities.

### NOTE 9 - SHORT AND LONG-TERM DEBT

Short and long-term debt consist of:

	(In Thousands)	
	2003	2002
Federal Home Loan Bank advances - short-term	\$ 125,000	\$ 25,000
Federal Home Loan Bank advances - long-term	400,330	395,499
North Dakota Municipal Bond Bank, 3%, matures from September 2007 through September 2009	465	566
	<u>\$ 525,795</u>	<u>\$ 421,065</u>

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

	(In Thousands)		
	Principal	Interest	Total
2004	\$ 148,039	\$ 22,391	\$ 170,430
2005	63,979	20,453	84,432
2006	23,572	17,576	41,148
2007	14,926	16,584	31,510
2008	95,202	11,816	107,018
Later years	180,077	64,809	244,886
Totals	<u>\$ 525,795</u>	<u>\$ 153,629</u>	<u>\$ 679,424</u>

The Federal Home Loan Bank (FHLB) short-term advance outstanding at December 31, 2003, matures on January 6, 2004 and bears interest at 1.04%. The FHLB long-term advances outstanding at December 31, 2003, mature from January 2004 through April 2022. The FHLB long-term advances have fixed rate interest, ranging from 2.98% to 7.35%. The advances must be secured by minimum qualifying collateral maintenance levels by pledging residential loans totaling \$304,388,000 in 2003 and \$303,628,000 in 2002 and guaranteed student loans totaling \$316,157,000 in 2003 and \$191,096,000 in 2002.

The North Dakota Municipal Bond Bank long-term borrowing is unsecured. Proceeds from the long-term borrowing are used to make irrigation loans at Bank of North Dakota.

## NOTES TO FINANCIAL STATEMENTS

### NOTE 10 - OTHER LIABILITIES

Other liabilities consist of:

	(In Thousands)	
	2003	2002
Transfers payable	\$ 15,594	\$ 24,647
Buydown interest	3,560	3,213
Escrow balances	1,813	2,107
ACH clearing account	632	826
Interest payable	1,350	2,718
Student loan origination fee payable	326	162
Official checks	407	797
Accrued expenses	1,233	1,461
Other	741	798
	<u>\$ 25,656</u>	<u>\$ 36,729</u>

The 2003 North Dakota Legislature passed Senate Bill 2015 which provides for two transfers to the State's General Fund from the Bank during the biennium beginning July 1, 2003 and ending June 30, 2005.

A transfer up to \$60,000,000 was approved from the current earnings and the accumulated undivided profits of the Bank. No more than \$15,000,000 of the amount transferred may come from accumulated undivided profits. The moneys must be transferred in the amounts and at such times as requested by the director of the Office of Management and Budget.

A contingent Bank transfer will be required if during the biennium ending June 30, 2005 the director of the Office of Management and Budget determines through revised projections that general fund revenue collections will not meet the revenues as forecast in the March 2003 legislative forecast. The Industrial Commission shall transfer this additional amount as determined by the director of the Office of Management and Budget and approved by the budget section from the earnings and accumulated undivided profits of the Bank. The moneys must be transferred in amounts and at such times as requested by the director of the Office of Management and Budget. The additional amount transferred may not exceed the lesser of \$9,000,000 or the revenue shortfall of actual collections compared to the March 2003 legislative forecast. The director may determine what portion of the shortfall will be covered by this contingent transfer and what portion will be covered by allotment pursuant to section 54-44.1-12 of the North Dakota century code. As of December 31, 2003, projected revenues exceed the March 2003 legislative forecast for projected revenues.

Any transfer authorized by the fifty-eighth legislative assembly may only be made to the extent the transfer does not reduce the Bank's capital structure below \$140,000,000.



## NOTES TO FINANCIAL STATEMENTS

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### NOTE 11 - PENSION PLAN

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

NDPERS is a cost-sharing multiple-employer defined benefit pension plan covering substantially all classified employees of Bank of North Dakota. The plan provides retirement, disability, and death benefits. If an active employee dies with less than three years of credited service, a death benefit equal to the value of the employee's accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than three years of credited service, the surviving spouse will be entitled to a single payment refund, lifetime monthly payments in an amount equal to 50% of the employee's accrued normal retirement benefit, 60 monthly payments equal to the employee's accrued normal retirement benefit calculated as if the employee were age 65 the day before death occurred, or monthly payments in an amount equal to the employee's accrued 100% joint and survivor retirement benefit if the member had reached normal retirement age prior to date of death. If the surviving spouse dies before the employee's accumulated pension benefits are paid, the balance will be payable to the surviving spouse's designated beneficiary.

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

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

Benefit and contribution provisions are administered in accordance with chapter 54-52 of the North Dakota Century Code. This state statute requires that 4% of the participant's salary be contributed to the plan by either the employee or by the employer under a "salary reduction" agreement. Bank of North Dakota has implemented a salary reduction agreement and is currently contributing the employees share. Bank of North Dakota is required to contribute 4.12% of each participant's salary as the employer's share. In addition to the 4.12% employer contribution, the employer is required to contribute 1% of each participating employee's gross wage to a prefunded retiree health insurance program. The required contributions are determined using an entry age normal actuarial funding method. The North Dakota Retirement Board was created by the State Legislature and is the governing authority of NDPERS. Bank of North Dakota's required and actual contributions to NDPERS for the fiscal years ending December 31, 2003, and 2002, were approximately \$513,000 and \$510,000.

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

## NOTES TO FINANCIAL STATEMENTS

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### NOTE 12 - COMMITMENTS AND CONTINGENT LIABILITIES

#### *State Water Development Projects*

The 2003 North Dakota Legislature passed Senate Bill 2022, which included the statewide water development goals. In connection with these goals, the bill provides that a line of credit – contingent appropriation be made. If determined necessary by the state water commission, Bank of North Dakota shall extend a line of credit, not to exceed \$25,000,000, or so much of the sum as may be necessary, to the state water commission for the purpose of interim financing until bonds are issued under chapters 61-02 and 61-02.1, for the biennium beginning July 1, 2003, and ending June 30, 2005. As of December 31, 2003, Bank of North Dakota has not funded and has not committed to fund any amount under the line of credit.

#### *Farm Real Estate Loan Guarantee Program*

The 2003 North Dakota Legislature passed House Bill 1321 which provided 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 \$400,000. The Bank of North Dakota may have no more than \$5,000,000 in outstanding loan guarantees under this program. The Bank of North Dakota 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, 2003, the Bank of North Dakota has not guaranteed or committed to guarantee any loans under this program.

#### *Beginning Entrepreneur Loan Guarantee Program*

The 2001 North Dakota Legislature passed Senate Bill 2349 which amended the Beginning Entrepreneur Loan Guarantee Program. The program provides that the Bank of North Dakota enters into 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 of North Dakota shall pay the lender the amount agreed upon up to 85 percent of the amount of principal due the lender on a loan at the time the claim is approved. A lender may apply to the Bank of North Dakota for a loan guarantee for a loan of up to \$100,000. The term of the guarantee may not exceed five years. The Bank may provide guarantees totaling \$3,400,000. As of December 31, 2003 and 2002, the Bank has provided guarantees totaling \$1,346,000 and \$1,122,000, and has guarantee commitments outstanding of \$32,000 and \$17,000 included in commitments to extend credit.

### NOTE 13 - RELATED PARTY 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 5 for disclosure relating to loans sold to the North Dakota Student Loan Trust and loans serviced for the North Dakota Student Loan Trust and other state funds.

## NOTES TO FINANCIAL STATEMENTS

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### NOTE 14 - OFF-BALANCE-SHEET ACTIVITIES

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

At December 31, 2003 and 2002, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount (In Thousands)	
	2003	2002
Commitments to extend credit	\$ 237,582	\$ 236,381
Financial standby letters of credit	124,636	88,509

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

Financial standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The likelihood of funding any of these letters of credit is considered to be remote. The Bank generally holds collateral supporting those commitments if deemed necessary.

## NOTES TO FINANCIAL STATEMENTS

### NOTE 15 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Statement of Financial Accounting Standards No. 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Bank.

The carrying values and estimated fair values of the Bank's financial instruments as of December 31, 2003 and 2002, were as follows:

	(In Thousands)			
	2003		2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets</b>				
Cash and cash equivalents	\$ 276,667	\$ 276,667	\$ 408,594	\$ 408,594
Securities	284,272	284,253	235,365	235,655
Interest receivable	15,242	15,242	17,625	17,625
<b>Loans</b>				
Guaranteed student loans	372,362	372,362	364,816	370,044
Residential loans	318,067	337,684	309,267	348,394
Other loans	701,154	699,956	655,902	653,390
Allowance for loan losses	(25,334)	-	(25,091)	-
<b>Total loans</b>	<b>1,366,249</b>	<b>1,410,002</b>	<b>1,304,894</b>	<b>1,371,828</b>
<b>Total financial assets</b>	<b>\$ 1,942,430</b>	<b>\$ 1,986,164</b>	<b>\$ 1,966,478</b>	<b>\$ 2,033,702</b>
<b>Financial liabilities</b>				
Non-maturity deposits	\$ 576,758	\$ 576,758	\$ 535,908	\$ 535,908
Deposits with stated maturities	480,628	481,634	534,945	543,456
Federal funds purchased and securities sold under agreements to repurchase	190,597	190,597	296,688	296,688
Short and long-term debt	525,795	544,276	421,065	447,755
Other liabilities	25,656	25,656	36,729	36,729
<b>Total financial liabilities</b>	<b>\$ 1,799,434</b>	<b>\$ 1,818,921</b>	<b>\$ 1,825,335</b>	<b>\$ 1,860,536</b>

## NOTES TO FINANCIAL STATEMENTS

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The following methods and assumptions were used by the Bank in estimating fair value disclosures for financial instruments:

### *Cash and Cash Equivalents*

The carrying amounts of cash and cash equivalents approximate fair value due to the relatively short period of time between the origination of the instruments and their expected realization.

### *Securities*

The fair value for securities is based on quoted market values, when available. If quoted market prices were not available, fair value was estimated using quoted market prices for similar assets.

### *Guaranteed Student Loans*

The fair value for student loans is based on quoted market values.

### *Residential Loans*

The fair value for residential loans has been estimated by discounting future cash flows to reflect management's estimate of current rates for financing borrowers under substantially similar terms and degrees of risk. Projected cash flows on non-accrual loans were reduced by the amount of the estimated losses in the portfolio.

### *Other Loans*

The fair value for all other categories of loans has been estimated by discounting future cash flows to reflect management's estimate of current rates for financing borrowers under substantially similar terms and degrees of risk. Projected cash flows on non-accrual loans were reduced by the amount of the estimated losses on the portfolio.

### *Interest Receivable and Payable*

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

### *Non-Maturity Deposits*

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

### *Deposits With Stated Maturities*

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

## NOTES TO FINANCIAL STATEMENTS

### *Federal Funds Purchased and Securities Sold Under Agreements to Repurchase*

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

### *Short and Long-Term Debt*

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

### *Other Liabilities*

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

### *Off-Balance-Sheet Instruments*

Fair values of off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The carrying amount and fair value of off-balance-sheet instruments are not significant.

## NOTE 16 - COMPREHENSIVE INCOME

The Bank recognizes and includes revenue, expenses, gains and losses in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Changes in and determination of accumulated other comprehensive income are as follows:

	(In Thousands)	
	Unrealized Gain (Loss) on Securities Available for Sale	
	2003	2002
Balance, beginning of year	\$ 876	\$ 259
Unrealized holding gains (losses) arising during the period	(2,079)	617
Reclassification adjustment for (gains) losses realized in net income	-	-
Other comprehensive income	(2,079)	617
Balance, end of year	\$ (1,203)	\$ 876

## NOTES TO FINANCIAL STATEMENTS

### NOTE 17 - SUPPLEMENTAL DISCLOSURES RELATED TO STATEMENTS OF CASH FLOWS

	(In Thousands)	
	2003	2002
Supplemental disclosures of cash flow information		
Cash payments for:		
Interest paid to customers	\$ 16,209	\$ 24,388
Interest paid on federal funds purchased and securities sold under repurchase agreements	2,802	3,658
Interest paid on short and long-term debt	24,112	24,181
Supplemental schedule of noncash investing and financing activities		
Reduction in transfers payable	(3,310)	-
Transfers from undivided profits to other liabilities	28,294	32,191
Contingency transfers from undivided profit to other liabilities	-	22,000
Net change in unrealized gain (loss) on securities available for sale	(2,079)	617
Other real estate and property owned acquired in exchange for loans	3,568	-



**BANK OF NORTH DAKOTA**  
**TEN-YEAR SUMMARY**

	2003	2002	2001
<b>OPERATING RESULTS (in thousands)</b>			
Interest income	\$ 79,463	\$ 90,315	\$ 114,490
Interest expense	41,755	50,666	82,840
Net interest income	37,708	39,649	41,650
Provision for loan losses	2,000	2,200	2,700
Net interest income after provision for loan losses	35,708	37,449	38,950
Non-interest income	11,474	9,764	8,646
Non-interest expense	15,488	15,022	14,537
Net income	31,694	32,191	33,059
Payments to general fund	34,000	30,000	50,000
<b>BALANCE SHEET - YEAR END (in thousands)</b>			
<b>TOTAL ASSETS</b>	1,953,178	1,974,448	2,107,456
<b>FEDERAL FUNDS SOLD AND SECURITIES PURCHASED UNDER REVERSE REPURCHASE AGREEMENTS</b>			
	89,915	209,205	257,830
<b>SECURITIES</b>	284,272	235,365	329,632
<b>LOANS</b>			
Loans held for sale	-	-	-
Residential loans	318,067	309,267	271,385
Guaranteed student loans	372,362	364,816	399,002
Bank participation loans			
Commercial	369,458	356,576	356,848
Agriculture	140,556	146,378	150,042
Farm real estate loans	90,686	76,584	63,699
State institutions	45,134	25,954	21,808
Bank stock	55,320	50,410	13,550
<b>DEPOSITS</b>	1,057,386	1,070,853	1,208,601
Non-interest bearing	214,275	209,112	193,354
Interest bearing	843,111	861,741	1,015,247
<b>FEDERAL FUNDS PURCHASED AND SECURITIES SOLD UNDER REPURCHASE AGREEMENTS</b>			
	190,597	296,688	315,713
<b>SHORT AND LONG-TERM DEBT</b>	525,795	421,065	399,553
<b>EQUITY</b>			
Capital	2,000	2,000	2,000
Capital Surplus	42,000	42,000	42,000
Contributed capital	-	-	-
Unrealized gain (loss) on securities available for sale	(1,203)	876	259
Undivided profits	110,947	104,237	126,237

2000	1999	1998	1997	1996	1995	1994
\$ 117,163	\$ 99,350	\$ 87,788	\$ 70,891	\$ 67,377	\$ 62,742	\$ 51,273
75,774	62,487	53,852	40,768	39,865	37,595	28,564
41,389	36,863	33,936	30,123	27,512	25,147	22,709
2,700	1,600	1,700	600	600	1,700	2,500
38,689	35,263	32,236	29,523	26,912	23,447	20,209
7,224	7,838	8,651	8,189	7,812	9,514	9,597
1,331	12,642	12,750	12,168	11,533	11,322	11,775
32,582	30,459	28,137	25,544	23,191	21,639	18,031
-	15,000	29,600	12,715	37,500	-	10,000
1,806,517	1,687,167	1,609,039	1,162,415	1,068,082	1,033,816	935,070
271,510	249,565	206,095	128,180	86,470	67,045	79,810
192,093	235,007	427,842	269,860	284,491	347,180	358,399
1,156,614	1,056,232	835,654	623,532	554,001	487,297	393,756
-	-	-	-	-	-	203
213,009	188,474	113,934	38,089	29,595	27,808	32,913
376,535	335,687	292,896	244,154	205,787	168,755	122,714
328,205	311,787	228,723	190,088	181,179	155,654	120,918
138,753	127,131	94,971	75,528	82,253	83,217	68,514
65,377	62,080	61,205	45,217	40,035	33,314	31,255
25,487	21,037	34,678	20,561	5,947	11,271	10,459
9,248	10,036	9,247	9,895	9,205	7,278	6,780
1,135,731	910,652	943,537	719,508	728,122	676,798	587,837
130,470	83,798	133,307	117,708	106,120	117,579	98,337
1,005,261	826,854	810,230	601,800	622,002	559,219	489,500
215,072	250,985	309,496	234,114	198,108	164,956	155,527
254,439	363,076	203,779	54,087	14,500	57,000	53,455
153,045	139,275	139,931	128,888	98,477	76,000	100,206
2,000	2,000	22,000	22,000	22,000	22,000	22,000
42,000	42,000	22,000	22,000	22,000	22,000	22,000
-	-	-	-	-	-	1,394
338	(1,428)	195	102	(61)	508	206
108,707	96,703	95,736	84,786	54,538	31,492	54,606

# **Bank of North Dakota**

## **Core Values**

**Service - *Excel And Deliver***

**Teamwork - *Together We Accomplish More***

**Ethics - *Do The Right Thing***

**People - *Set Us Apart***