

1 9 8 8 A N N U A L R E P O R T

100 YEARS STATEHOOD

1988

70 YEARS BANKING

BANK OF NORTH DAKOTA

**ABOUT THE
1988 ANNUAL REPORT COVER**

This is the second year of the Bank's competition for the design of our Annual Report Cover. The 1988 competition was focused on the dual themes of the State's centennial celebration and the Bank's 70th anniversary. All employees were invited to submit design entries and judging was done by an outside team of experts.

Our 1988 winner is Kurt Schirado, an employee in our Support Services area. We want to congratulate Kurt for his work and thank everyone who took part in the competition.

Bank of North Dakota Advisory Board

*back row - Dan O'Day, Myron Just
front row - Les Nesvig, Roger Berglund, Al Wahl, Don Porter, Jim Duncan*

(The Bank exhibit is courtesy of the State Historical Society of North Dakota at the North Dakota Heritage Center in Bismarck.)



North Dakota Industrial Commission

*l-r: Sec. to the Industrial Commission, Karlene Fine;
Gov. George A. Sinner; Commissioner of Agriculture
Sarah Vogel; Attorney Gen. Nicholas J. Spaeth*



Annual Report

In 1919, the people of North Dakota took a dramatic step in "encouraging and promoting agriculture, commerce and industry in North Dakota". In that year, new legislation created the nation's only state owned bank. Seventy years later, in this the State's centennial celebration, the Bank of North Dakota has become one of the State's most valuable assets.

Over the years, the Bank has continued to maintain its long and steady capital growth pattern. In the past 10 years alone, total capitalization has increased over 130 percent to a record high of \$83.5 million. The Bank's capital to asset ratio has increased from 6.3 percent in 1978 to 9.3 percent in 1988.

The corner stone of our 1988 effort was "service", both to the State's financial institutions and the communities they serve. This effort was tied to three major focus areas:

CUSTOMER SERVICE — By identifying and meeting customer needs swiftly and effectively, we have been able to add value to their business and a stronger relationship with us. We have simplified our organizational structure, providing a faster response time. We have expanded our communications efforts through community meetings and the calling program. We have broadened our service capabilities and our product lines. We have taken a closer review of the manner in which our products are offered to ensure that these products meet real needs.

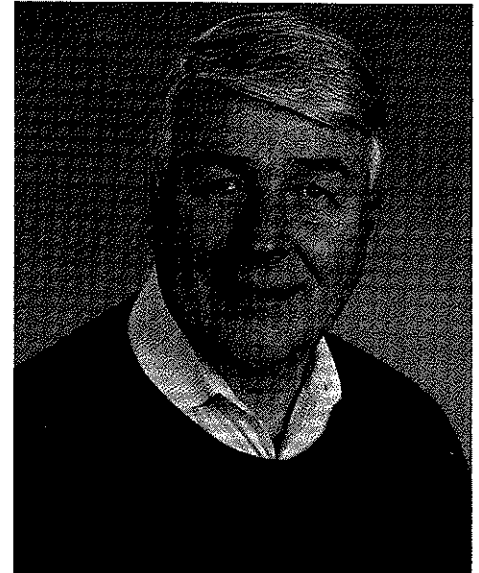
CREDIT QUALITY — During 1988, we continued to focus on improving our credit quality. While our mission requires us to assume a higher risk in our lending practices, we have strengthened that portfolio by assuring that our review procedures and documentation are not compromised. Our policies and procedures have assured strong controls to better manage the risk inherent in our portfolio.

EMPLOYEES — As a team, our employees are the source of our strength and our competitive advantage. Their customer focus and commitment to service continues to make the Bank of North Dakota a vital element in the State's financial community. To strengthen this talent base, we have made a major commitment to broaden the training foundation of our staff.

In 1988, the Bank's student loan program, Student Loans of North Dakota, made or acquired nearly 30,000 student loans totaling over \$33 million. While assisting these students, we managed to maintain one of the nation's lowest default rates, 4.3 percent, and collected in excess of \$550,000 in defaulted loans. Since the program began, we have administered over \$335 million in loan financing for students.

North Dakota has also begun the long process of diversifying its economy. Along with agriculture, the major growth components are energy (including oil, gas, coal mining, coal gasification and power generation), medical services, aeronautics and light manufacturing. In conjunction with other state agencies and with community support, we have engaged in an aggressive effort to attract new businesses to broaden the state's economic base.

We look to 1989 with confidence and the wisdom gained from 70 years of service. Our decisions over the past few years have positioned us well for continued success in the years to come.



Joseph S. Lamb, President

Eide Helmeke & Co.

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT

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, 1988, and 1987, and the related statements of income, changes in capital funds 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 generally accepted auditing standards. Those standards require that we plan and perform the audits 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.

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, 1988, and 1987, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Eide Helmeke & Co.

January 27, 1989, except for Note 13
as to which the date is March 2, 1989
Bismarck, North Dakota

Balance Sheets

December 31, 1988, and 1987

	1988	1987
ASSETS		
CASH AND DUE FROM BANKS	<u>\$ 44,426,359</u>	<u>\$ 60,006,904</u>
INVESTMENT SECURITIES (Note 3):		
U.S. Treasury securities	252,056,840	270,217,621
Obligations of other U.S. Government agencies	48,429,624	129,657,725
Obligations of states and political subdivisions	4,971,255	14,450,355
Banker's acceptances	56,978,721	
Other securities	<u>1,434,420</u>	<u>1,434,420</u>
	363,870,860	415,760,121
Less allowance for investment losses (Note 3)	<u>1,302,417</u>	<u>1,249,764</u>
	<u>362,568,443</u>	<u>414,510,357</u>
FEDERAL FUNDS SOLD	<u>278,875,000</u>	<u>198,715,000</u>
LOANS:		
FHA and VA home loans (Note 6)	105,744,361	117,561,817
Bank participation loans	32,394,003	33,589,417
Guaranteed student loans	29,375,984	21,203,919
Bank stock loans	5,974,924	7,093,327
SBA participation loans	1,541,331	2,505,464
Farm real estate loans	7,745,074	6,932,373
Farm survival and agribusiness operating loans	1,741,774	3,485,908
Farm debt restructuring loans	7,487,105	7,507,555
Other	<u>17,189,312</u>	<u>7,267,591</u>
	209,193,868	207,147,371
Less allowance for loan losses (Note 4)	<u>12,904,838</u>	<u>12,928,714</u>
	<u>196,289,030</u>	<u>194,218,657</u>
BANK PREMISES, EQUIPMENT AND SOFTWARE, NET (Note 5)	<u>2,093,985</u>	<u>2,280,971</u>
ACCRUED INTEREST RECEIVABLE	<u>9,433,528</u>	<u>9,669,433</u>
OTHER ASSETS	<u>1,770,066</u>	<u>1,591,992</u>
	<u>\$ 895,456,411</u>	<u>\$ 880,993,314</u>
LIABILITIES AND CAPITAL FUNDS		
DEPOSITS:		
Demand	\$ 51,807,102	\$ 71,262,926
NOW accounts	68,228,071	60,618,792
Savings	129,286,089	302,865,634
Time	<u>209,607,311</u>	<u>125,147,720</u>
	458,928,573	559,895,072
FEDERAL FUNDS PURCHASED AND SECURITIES SOLD UNDER REPURCHASE AGREEMENTS (Note 3)	274,433,750	162,500,000
LONG-TERM DEBT (Note 6)	72,203,125	77,165,625
ACCRUED INTEREST PAYABLE	4,781,855	1,906,081
OTHER LIABILITIES	1,565,392	2,723,369
APPROPRIATION DUE THE STATE OF NORTH DAKOTA GENERAL FUND (Note 7)	<u>-</u>	<u>6,000,000</u>
Total liabilities	<u>811,912,695</u>	<u>810,190,147</u>
COMMITMENTS AND CONTINGENT LIABILITIES (Note 12)		
CAPITAL FUNDS (Note 8):		
Capital	22,000,000	22,000,000
Surplus	22,000,000	22,000,000
Contributed capital	1,394,420	1,394,420
Undivided profits	<u>38,149,296</u>	<u>25,408,747</u>
Total capital funds	<u>83,543,716</u>	<u>70,803,167</u>
	<u>\$ 895,456,411</u>	<u>\$ 880,993,314</u>

The accompanying notes to financial statements are an integral part of these statements.

Statements of Income

For the years ended December 31, 1988, and 1987

	<u>1988</u>	<u>1987</u>
INTEREST INCOME		
Interest and fees on loans	\$ 18,035,085	\$ 18,505,689
Interest on investment securities		
U.S. Treasury securities	22,159,727	23,650,470
Obligations of other U.S. Government agencies	5,157,737	8,652,941
Obligations of states and political subdivisions	527,302	5101
Banker's acceptances	1,152,119	
Other securities	287,049	1,158,436
Interest on federal funds sold	<u>21,565,359</u>	<u>16,115,251</u>
	<u>68,884,378</u>	<u>68,638,888</u>
INTEREST EXPENSE:		
Interest on deposits	28,069,321	26,849,469
Interest on federal funds purchased and securities sold under repurchase agreements	14,735,027	14,607,642
Interest on long-term debt (Note 6)	<u>6,767,207</u>	<u>6,764,094</u>
	<u>49,571,555</u>	<u>48,221,205</u>
Net interest income	19,312,823	20,417,683
PROVISION FOR LOAN LOSSES (Note 4)	<u>750,000</u>	<u>2,000,000</u>
Net interest income after provision for loan losses	<u>18,562,823</u>	<u>18,417,683</u>
OTHER INCOME:		
Service fees and other	3,041,143	2,815,173
Securities gains, net	<u>15,711</u>	<u>656,620</u>
	<u>3,056,854</u>	<u>3,471,793</u>
OTHER EXPENSE:		
Salaries	2,539,523	2,527,340
Pensions and other employee benefits (Note 9)	636,014	586,704
Data processing	970,960	828,987
Other operating expenses	1,868,063	1,618,868
North Dakota Real Estate Bond Expense (Note 12)	2,460,000	3,347,688
Depreciation and amortization (Note 5)	<u>404,568</u>	<u>277,207</u>
	<u>8,879,128</u>	<u>9,186,794</u>
NET INCOME	<u>\$ 12,740,549</u>	<u>\$ 12,702,682</u>

The accompanying notes to financial statements are an integral part of these statements.

Statements of Changes in Capital Funds

For the years ended December 31, 1988, and 1987

	<u>Capital</u>	<u>Surplus</u>	<u>Contributed Capital</u>	<u>Undivided Profits</u>	<u>Total</u>
BALANCES, DECEMBER 31, 1986	\$ 22,000,000	\$22,000,000	-	\$ 24,706,065	\$ 68,706,065
Net income	-	-	-	12,702,682	12,702,682
Transfer from undivided profits to appropriation due the State of North Dakota General Fund (Note 7)	-	-	-	(12,000,000)	(12,000,000)
Receipt of donated assets from Industrial Development Revenue Bond Fund (Note 8)	-	-	<u>1,394,420</u>	-	<u>1,394,420</u>
BALANCES, DECEMBER 31, 1987	22,000,000	22,000,000	1,394,420	25,408,747	70,803,167
Net income	-	-	-	<u>12,740,549</u>	<u>12,740,549</u>
BALANCES, DECEMBER 31, 1988	<u>\$ 22,000,000</u>	<u>\$ 22,000,000</u>	<u>\$ 1,394,420</u>	<u>\$ 38,149,296</u>	<u>\$ 83,543,716</u>

The accompanying notes to financial statements are an integral part of these statements.

Statements of Cash Flows

For the years ended December 31, 1988, and 1987

	<u>1988</u>	<u>1987</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 12,740,549	\$ 12,702,682
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	536,921	385,448
Provision for loan losses	750,000	2,000,000
Amortization of premiums and accretion of discounts on investment securities	(1,701,017)	(598,976)
Securities gains, net	(15,711)	(656,620)
Changes in assets and liabilities:		
Decrease in accrued interest receivable	235,905	722,585
(Increase) decrease in other assets, net	46,375	160,102
Increase (decrease) in accrued interest payable	2,875,774	(2,914,789)
Increase (decrease) in other liabilities	(1,157,977)	673,381
Net cash provided by operating activities	<u>14,310,819</u>	<u>12,473,813</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of investment securities	235,418,032	287,534,701
Purchase of investment securities	(181,759,390)	(357,259,545)
Principal collected on loans	358,952,330	278,147,563
Loans made to customers	(362,092,005)	(272,705,183)
Purchases of equipment and software	(217,582)	(959,657)
Net cash provided by (used in) investing activities	<u>50,301,385</u>	<u>(65,242,121)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in demand deposits, NOW and savings accounts	(185,426,090)	77,036,766
Proceeds from sales of time deposits	645,438,332	638,696,427
Payments for maturing time deposits	(560,978,741)	(727,383,332)
Payment of long-term debt issue costs		(163,828)
Increase (decrease) in federal funds purchased and securities sold under repurchase agreements	111,933,750	(55,376,924)
Principal payments on long-term debt	(5,000,000)	
Payment of appropriations due	(6,000,000)	(8,250,000)
Receipt of donated assets from Industrial Development Revenue Bond Fund		1,394,420
Net cash used in financing activities	<u>(32,749)</u>	<u>(74,046,471)</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	64,579,455	(126,814,779)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>258,721,904</u>	<u>385,536,683</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 323,301,359</u>	<u>\$ 258,721,904</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash payments for:		
Interest paid to depositors	\$ 25,287,923	\$ 29,709,698
Interest paid on federal funds purchased and securities sold under repurchase agreements	14,602,109	14,662,202
Interest paid on long-term debt	6,481,250	6,481,250
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING FINANCING ACTIVITIES:		
Other real estate acquired in settlement of loans	\$ 319,302	\$ 25,637
Transfer from undivided profits to appropriation due the State of North Dakota General Fund		12,000,000

The accompanying notes to financial statements are an integral part of these statements.

Notes to Financial Statements

For the years ended December 31, 1988, and 1987

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting entity — In accordance with National Council of Governmental Accounting Statement No. 3, Defining the Governmental Reporting Entity, for financial reporting purposes, a reporting entity's financial statements should include all component units over which that component unit (oversight unit) exercises oversight responsibility. Oversight responsibility includes such aspects as appointment of governing body members, designation of management, the ability to significantly influence operations and accountability for fiscal matters.

Based on the criteria of Statement No. 3, there are no component units to be included within the Bank of North Dakota as a reporting entity; however, the Bank of North Dakota is includable as a component unit within the State of North Dakota as a reporting entity.

Cash and cash equivalents — For purposes of reporting cash flows, the Bank considers cash and due from banks, federal funds sold and securities purchased under reverse repurchase agreements to be cash equivalents. Cash and due from banks includes cash on hand and amounts due from banks, including cash items in process of clearing.

Investment securities and allowance for investment losses — Securities, including nonmarketable stock, are stated at cost reduced by an allowance for investment losses, and adjusted for amortization of premiums and accretion of discounts which are recognized as adjustments to interest income. Gains or losses on disposition are based on the net proceeds and the adjusted carrying amount of the securities sold, using the specific identification method. The allowance for investment losses is established through a provision for investment losses charged to expenses and is attributable to specific adverse conditions for particular securities.

Loans and allowance for loan losses — Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses. Interest on loans is calculated by using the simple interest method on the principal amount outstanding. The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes the collectibility of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrowers' ability to pay. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, that the borrowers' financial condition is such that collection of interest is doubtful.

Bank premises, equipment and software — Bank premises, equipment and software are stated at cost. Expenditures for renewals and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Expenditures for maintenance and repairs are charged to expense currently. When properties are retired or sold, the cost and related accumulated depreciation or amortization are eliminated from the accounts and the resultant gain or loss is reflected in income.

Depreciation and amortization is provided over the estimated useful lives of the individual assets using the straight-line method. The estimated useful lives used in the computation of depreciation or amortization are 25 years for the bank premises, 5 years for equipment and software and 10 years for furniture.

Leasing arrangements — The Bank leases office space for its student loan department. The lease is classified as an operating lease and expires on June 30, 1989.

Long-term debt issue costs — Long-term debt issue costs are being amortized over the term of the related long-term debt using the outstanding debt method.

Pension plan — The Bank funds amounts equal to pension costs accrued.

NOTE 2 — NATURE OF ORGANIZATION AND RELATED PARTY TRANSACTIONS

The Bank of North Dakota 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. In the course of business 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. These transactions are a normal part of bank business and, accordingly, are included in the Bank's financial statements.

NOTE 3 - INVESTMENT SECURITIES

Carrying amounts and approximate market value of investment securities as of December 31, 1988, and 1987 are summarized as follows:

	1988		1987	
	Carrying Amount	Approximate Market Value	Carrying Amount	Approximate Market Value
U.S. Treasury securities	\$ 252,056,840	\$ 247,786,000	\$ 270,217,621	\$ 271,979,000
Obligations of other U.S. Government agencies	48,429,624	46,510,000	129,657,725	128,308,000
Obligations of states and political subdivisions	4,971,255	-	14,450,355	-
Banker's acceptances	56,978,721	56,950,000	-	-
Other securities	1,434,420	-	1,434,420	-
	<u>\$ 363,870,860</u>		<u>\$ 415,760,121</u>	

(Continued on next page)

Obligations of states and political subdivisions held by the Bank are primarily city and county obligations. Due to the nature of these securities, a market value is not readily available.

At December 31, 1988, other securities includes nonmarketable stock of the Myron G. Nelson Fund, Inc. at a cost of \$1,394,420. The Myron G. Nelson Fund, Inc. is an investment capital fund incorporated under the North Dakota Century Code. The Bank accounts for this investment under the cost method because the criteria for use of the equity method are not satisfied. By the terms of the legislation creating the Myron G. Nelson Fund, Inc., the Bank was obligated to purchase the stock with funds received from liquidation of the Industrial Development Revenue Bond Fund.

Changes in the allowance for investment losses were as follows:

	Year Ended December 31,	
	1988	1987
Balance, beginning of year	\$ 1,249,764	\$ 1,500,000
Investments charged off	-	(256,769)
Recoveries	52,653	6,533
Balance, end of year	<u>\$ 1,302,417</u>	<u>\$ 1,249,764</u>

The Bank has pledged investment securities and has sold securities under agreements to repurchase as follows:

	Amounts at Par	
	1988	1987
Investment securities pledged	<u>\$ 28,550,000</u>	<u>\$ 26,900,000</u>
Securities sold under agreements to repurchase	<u>\$ 193,903,000</u>	<u>\$ 69,577,000</u>

NOTE 4 — LOANS

Loans on which the accrual of interest has been discontinued amounted to approximately \$3,599,000 and \$4,439,000 as of December 31, 1988, and 1987, respectively. If interest on those loans had been accrued, such income would have approximated \$338,000 and \$420,000 for 1988 and 1987, respectively.

Changes in the allowance for loan losses were as follows:

	Year Ended December 31,	
	1988	1987
Balance, beginning of year	\$ 12,928,714	\$ 11,988,141
Provision charged to operations	750,000	2,000,000
Loans charged off	(1,344,042)	(1,880,397)
Recoveries	570,166	820,970
Balance, end of year	<u>\$ 12,904,838</u>	<u>\$ 12,928,714</u>

NOTE 5 — BANK PREMISES, EQUIPMENT AND SOFTWARE

Major classifications of fixed assets as of December 31, 1988, and 1987 are summarized as follows:

	1988			1987
	Cost	Accumulated Depreciation	Net	Net
Land	\$ 287,331	\$ -	\$ 287,331	\$ 287,331
Building	1,316,128	700,918	615,210	667,856
Equipment	979,492	524,456	455,036	526,054
Furniture	419,070	179,173	239,897	229,639
Software	<u>692,442</u>	<u>195,931</u>	<u>496,511</u>	<u>570,091</u>
	<u>\$ 3,694,463</u>	<u>\$ 1,600,478</u>	<u>\$ 2,093,985</u>	<u>\$ 2,280,971</u>

Depreciation and amortization expense on the above assets amounted to \$404,568 and \$277,207 in 1988 and 1987, respectively.

NOTE 6 — LONG-TERM DEBT

Long-term debt consists of:

	1988	1987
Collateralized long-term bonds, 9.25%, issued December 1978, due December 1993	\$ 22,500,000	\$ 27,500,000
Long-term notes, 7.875%, (effective interest rate 7.94%) issued December 1986, due December 1996, net of unamortized discount (1988 - \$296,875; 1987 - \$334,375)	49,703,125	49,665,625
	<u>\$ 72,203,125</u>	<u>\$ 77,165,625</u>

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Collateralized long-term bonds — An annual sinking fund payment of \$5,000,000 is due each December 1 beginning December 1, 1989 through December 1, 1993 when the bonds mature. At its option, the Bank may redeem on the due date of any mandatory sinking fund redemption, at 100% of the principal amount thereof plus interest accrued thereon to such date, an additional principal amount of bonds up to the principal amount of bonds required to be redeemed on such date. During 1988 the Bank exercised its option to redeem \$2,500,000 of bonds at 100% of the principal amount in addition to the mandatory sinking fund redemption of \$2,500,000. The Bank did not redeem any bonds during 1987; but rather applied the \$2,500,000 optional retirement in 1986 to satisfy 1987 sinking fund requirements. Redemption of the bonds may be accelerated by paying a premium which decreases proportionately from 108.538% at December, 1979 until it is eliminated after December, 1990. The bonds are collateralized by FHA and VA guaranteed loans with principal balances of approximately \$37,429,000 and \$7,700,000 in U.S. Government securities as of December 31, 1988.

The bank is required to maintain an amount of eligible collateral such that the sum of (a) the discounted value of eligible mortgage notes divided by 150%, (b) the fair market value of government securities and eligible money market instruments divided by 125% and (c) the fair market value of cash is not less than 100% of the initial series of bonds outstanding. However, the sum of (x) the discounted value of eligible mortgage notes, (y) the fair market value of government securities and eligible money market instruments and (z) the fair market value of cash shall in no event be less than 115% of the aggregate principal amount of the bonds outstanding. The bond indenture contains certain restrictive covenants which, among other things, require the maintenance of a ratio of deposits and collateralized long-term debt to all capital funds no greater than 20 to 1. The Bank is in compliance with all provisions of the indenture agreement as of December 31, 1988.

Long-term notes — These notes may not be redeemed prior to maturity. Interest is payable semiannually on June 15 and December 15 of each year. The Bank of North Dakota entered into a letter of credit agreement dated December 1, 1986 with the Fuji Bank, Ltd. whereby the Fuji Bank has agreed to provide funds sufficient to pay the principal amount of the notes and up to 198 days' interest on the notes. Simultaneously with the letter of credit agreement, the Bank of North Dakota entered into a security agreement in which the Bank of North Dakota agreed to pledge eligible collateral. The notes are collateralized by FHA and VA guaranteed loans with principal balances of approximately \$50,126,000 and \$10,000,000 in U.S. Government securities as of December 31, 1988. The Bank is required to maintain an amount of eligible collateral such that the applicable value of the collateral is not less than 102.5% of the stated amount of the Fuji Bank letter of credit. The indenture of trust contains certain restrictive covenants, all of which the Bank of North Dakota is in compliance with as of December 31, 1988.

NOTE 7 — APPROPRIATIONS DUE

The North Dakota State Legislature appropriated \$12,000,000 for the State General Fund from undivided profits of the Bank. Such monies shall be transferred during the biennium beginning July 1, 1987. The remaining amount due at December 31, 1987 was \$6,000,000. At December 31, 1988 the entire appropriation has been transferred.

NOTE 8 — CAPITAL FUNDS TRANSACTIONS

During 1987 the Bank received \$1,394,420 from the Industrial Development Revenue Bond Fund pursuant to Section 10-30.2-04 of the North Dakota Century Code, which has been recorded as contributed capital of the Bank. By the terms of the legislation creating the Myron G. Nelson Fund, Inc., the Bank was obligated to purchase shares of the Myron G. Nelson Fund, Inc. with the donated funds.

NOTE 9 — DEFINED BENEFIT PENSION PLAN

All eligible employees of the Bank of North Dakota participate in the North Dakota Public Employees Retirement System (System), a multiple-employer public employee retirement system. The payroll for employees covered by the System for the year ended December 31, 1988 was approximately \$2,516,000; the Bank's total payroll was approximately \$2,540,000.

All employees of the Bank are eligible to participate in the System if they meet the following requirements: (1) Be at least 18 years old; (2) Position must be full-time, that is at least 20 hours per week for at least five months per year; and (3) Position must be permanent, that is regularly funded and not of limited duration. Employees are entitled to annual pension benefits beginning at normal retirement age (65) equal to 1.50% of their final average annual salary for each year of service. The System permits early retirement at ages 55-64, with eight or more years of service. Employees may elect to receive the pension benefits in the form of a normal retirement, joint and survivor, social security adjustment or guaranteed payment annuity. The System also provides death and disability benefits. Benefits are established by State statute.

State statute requires that 4% of the employees' salary be contributed to the plan by either the employee or by the employer under a "salary reduction" agreement. The same statute requires the Bank to contribute 5.12% of the employee salary. The contribution requirement for the year ended December 31, 1988 was approximately \$212,000.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the System's funding status on a going-concern basis, assess progress comparisons among PERS and employers. The System does not make separate measurements of assets and pension benefit obligation for individual employers. The pension benefit obligation at June 30, 1988 for the System as a whole, was \$218.6 million. The System's net assets available for benefits on that date (valued at market) were \$270.8 million, leaving an over funded pension benefit obligation of \$52.2 million. The Bank's contribution represented approximately 0.9% of total contributions required of all participating entities.

Ten-year historical trend information showing the System's progress in accumulating sufficient assets to pay benefits when due is presented in the System's June 30, 1988 annual financial report.

NOTE 10 — TRUST ASSETS

Property (other than cash deposits) held by the Bank in fiduciary or agency capacities for its customers is not included in the accompanying balance sheets since such items are not assets of the Bank.

NOTE 11 — INSURANCE COVERAGE

Effective October 21, 1987, the Bank of North Dakota cancelled its director's and officer's liability insurance coverage.

The Bank of North Dakota has provided for indemnification, under certain circumstances, of the members of the Industrial Commission, Bank Advisory Board and Bank officers and employees for obligations they may incur in connection with defense of actions arising from their respective capacities with regard to the Bank.

The Bank of North Dakota has not purchased insurance to cover its potential exposure for such indemnification.

NOTE 12 — COMMITMENTS AND CONTINGENT LIABILITIES

In 1984 and 1986 the State of North Dakota issued long-term bonds of which part of the proceeds were used to purchase farm loans from the Bank of North Dakota. In connection with these bond issues, the Bank of North Dakota is obligated to purchase bonds when there are insufficient monies in any of the pledged funds for payment of the bonds as they become due. It is probable that the Bank of North Dakota will incur a liability on these bond issues. An estimate of this liability cannot be made until such time as Bank management can estimate cash flows for the collateral loans and the bonds. The Bank funded cash flow shortages totaling \$2,460,000 in 1988 and \$3,347,688 in 1987 which are included in other expenses.

On December 12, 1988, the Industrial Commission authorized and directed the Bank of North Dakota to subscribe to and purchase shares of stock of the Myron G. Nelson Fund in the amount of \$5,000,000 (See Note 3). In determining the amount of the annual investment to be made by the Bank, the Industrial Commission is directed by the North Dakota Century Code to consider the level of private investments in the Corporation and to attempt to match the private investments on a dollar-for-dollar basis. On January 4, 1989, the Bank committed to subscribe for and purchase 500,000 shares of common stock of the Corporation at a price of \$10 per share. The subscription for and purchase of shares of common stock of the Corporation will be in 10 increments of fifty thousand shares each. The payment for the first increment will be made in equal installments of \$125,000, with the first installment paid upon execution of the subscription agreement and an installment due in each of the three succeeding anniversary dates of the agreement. The payment for each of the 9 additional increments of the subscription will be due in four equal installments of \$125,000 upon receipt by the Bank of a certification from the Corporation stating that the Corporation has entered into subscription agreements for the purchase of limited partnership units in the aggregate of \$500,000 of which at least \$125,000 has been collected.

In the normal course of business, the Bank makes various commitments and incurs contingent liabilities that are not presented in the accompanying financial statements. The commitments and contingent liabilities include various guarantees, commitments to extend credit and standby letters of credit. At December 31, 1988 standby letters of credit aggregated approximately \$39,594,000 and commitments to extend credit aggregated approximately \$11,440,000. The Bank has included any anticipated losses as a result of the commitments in the allowance for loan losses.

NOTE 13 — OPERATING LEASE AND SUBSEQUENT EVENT

The Bank has leased office space for its student loan department under a noncancelable agreement that expires on June 30, 1989. Services and utilities are provided by the lessor. The Bank rents a portion of the space to North Dakota Guaranteed Student Loan Program on a month-to-month basis for \$2,437 per month. The minimum rental commitment for 1989 is \$55,255. The minimum rental commitment has not been reduced by future sublease rentals.

The net rental expense included in the statement of income for the years ended December 31, 1988, and 1987 is as follows:

	<u>1988</u>	<u>1987</u>
Minimum rentals	\$ 110,510	\$ 107,656
Sublease rentals	(29,240)	(29,413)
	<u>\$ 81,270</u>	<u>\$ 78,243</u>

On March 2, 1989, the Bank executed a purchase agreement whereby the Bank agrees to purchase an interest under a lease and purchase the building located on the leased property for \$700,000. At or before closing, the Bank shall have obtained the approval of the North Dakota Industrial Commission and, if deemed necessary by the North Dakota Attorney General, an appropriation by the North Dakota legislature for this purchase.

NOTE 14 — RESTATEMENT

For the year ended December 31, 1988, the Bank has presented a statement of cash flows as required by Statement of Financial Accounting Standards No. 95. The statement of changes in financial position presented in the prior year has been restated to conform with this presentation.

Five Year Summary

	1988	1987	1986	1985	1984
OPERATING RESULTS (000 omitted)					
Total Income	\$ 71,941	\$ 72,111	\$ 79,856	\$ 79,650	\$ 82,532
Interest Expenses	49,572	48,221	52,680	55,765	60,296
Other Oper. Expenses	8,879	9,187	7,241	4,657	4,128
NET EARNINGS (profit)	12,741	12,703	9,782	12,335	9,318
Paid to St. Treas. (dividend)		7,750	3,500	3,000	2,500
BALANCE AT YEAR END (000 omitted)					
Total Resources	895,456	880,993	944,377	980,348	829,623
Total Deposits	458,928	559,895	571,545	628,871	590,800
Demand Deposits	120,035	131,882	125,116	122,728	104,288
Time Deposits	338,893	428,013	446,429	506,143	486,512
Federal Funds Purchased and Securities Sold Under Repurchase Agreements	274,434	162,500	217,877	246,585	140,840
Federal Funds Sold and Securities Purchased Under Reverse Repurchase Agreements	278,875	198,715	301,575	255,530	262,355
TOTAL INVESTMENT SECURITIES (000 omitted)					
U.S. Government	362,568	414,510	343,530	390,914	235,629
Federal Agencies	252,057	270,218	267,828	300,934	160,028
Other Money Market Instruments	48,430	129,658	67,638	66,400	63,551
ND Political Sub. Bds.	58,413	1,434	2,577	3,228	3,192
	4,971	14,450	6,987	20,352	8,898
TOTAL LOANS (000 omitted)					
Guaranteed Student Loans	196,289	194,219	201,687	236,868	264,804
Farm Real Estate Loans	29,376	21,204	23,745	21,336	27,676
FHA Home Loans	7,745	6,932	5,773	4,941	2,186
GI Home Loans	75,697	84,175	92,060	103,888	111,267
Small Business Adm. Loans	30,047	33,387	36,567	40,456	42,771
Bank Participation Loans	1,541	2,505	3,766	5,569	7,878
Other Loans	32,394	33,589	38,337	53,439	71,146
	32,393	25,355	13,426	13,604	7,627
CAPITAL AND RESERVES (000 omitted)					
Capital	83,543	70,803	68,706	58,924	55,589
Surplus	22,000	22,000	22,000	20,000	18,000
Contributed Capital	22,000	22,000	22,000	20,000	20,000
Undivided Profits	1,394	1,394	-	-	-
Reserve for Contingencies	38,149	25,409	24,706	15,424	14,089
		-	-	3,500	3,500
OTHER DATA (Numbers)					
Financial Inst. with BND Accts.	185	204	211	209	205
Individual Checking Accounts	2,348	2,469	2,876	3,000	3,264
Individual Savings Accounts	2,231	2,616	2,935	3,178	4,825
Guaranteed Student Loans (made or purchased)	29,699	27,456	26,668	20,997	15,772
SBA & BI Loans On Hand	23	38	52	69	91
Bank Participation Loans On Hand	332	233	273	534	471
Number of Employees	146	146	147	144	130