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Alaska Commercial Fishing and Agriculture Bank

1985 Annual Report
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C FAB was created to serve a genuine
and legitimate need...

Alaska Commercial Fishing & Agriculture Bank

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Executive Message

Elsewhere in this 1985 Annual Report is a presentation of Touche Ross & Co.'s report on its examination of CFAB's financial statements for the years ended December 31, 1984, and December 31, 1985. That report is worthy of some careful scrutiny by members.

Numbers tend to be boring for all of us. However, since CFAB is a financial institution there is much about it which is best expressed by numbers. We therefore invite your attention to some of those numbers and the matters they represent.

Since CFAB is a financial institution there is much about it which is best expressed by numbers.

During 1985, CFAB's total assets were reduced by about \$34,557,000. While this represented a reduction of all classes of assets generally, most of it was concentrated

in a few areas. Early in the year, \$5,628,000 of proceeds from maturing certificates of deposit were used to reduce CFAB's borrowings and, therefore, its net interest expense. Another \$1,021,000 of the net reduction was in CFAB's accrued interest receivable on loans; this was essentially the effect of reduced loan volume.

The largest single component of the reduction, \$26,993,000, was in CFAB's net loans outstanding. The composition of that number is significant, since CFAB's loan portfolio consists of two general groups of loans — "earning" and "non-earning." (The latter is referred to by accountants as "non-accrual"). An earning loan is one on which all payment terms have been met and are anticipated to continue to be met. A non-earning loan, on the other hand, is one on which a contractual payment is delinquent by 90 days or more and/or which CFAB's management has reason to believe represents a continuing and serious problem.

The changes within and between those two general groups represent significant progress for CFAB during 1985. They are referred to in NOTE B to the financial statements and are shown below:

	<u>December 31, 1985</u>	<u>December 31, 1984</u>	<u>Change</u>
Earning Loans	\$50,283,591	\$62,827,217	\$(12,543,626)
Non-Earning Loans	<u>15,653,345</u>	<u>31,979,416</u>	<u>(16,326,101)</u>
Gross Loans	\$65,936,936	\$94,806,663	\$(28,869,727)
Loan Loss Allowance	<u>(3,441,130)</u>	<u>(5,317,621)</u>	<u>1,876,491</u>
Net Loans	<u><u>\$62,495,806</u></u>	<u><u>\$89,489,042</u></u>	<u><u>\$(26,993,236)</u></u>

Of the \$16,326,000 reduction in non-earning loans, about \$3,486,000 was charged to CFAB's allowance for loan losses. Most of those losses had been recognized by establishment of an allowance prior to December 31, 1984, so there was no significant impact on CFAB's balance sheet or on its 1985 operating statement. The remaining \$12,840,000 of the reduction in non-earning loans represents, in general, either (a) collection of actual cash or (b) modification or restructuring of individual loans to an extent at which future performance can reasonably be expected. This is of great importance to CFAB and its borrower-owners, since the effect is to enhance CFAB's net interest earnings by about \$1.5 million on an annualized basis.

C *FAB reduced its interest-bearing obligations to the Spokane Bank for Cooperatives by \$32,306,000.*

Some further insight into the effect of 1985 developments may be gained also by noting the reduction in CFAB's liabilities. In particular, and as discussed in NOTE D to the financial statements, CFAB reduced its interest-bearing obligations to the Spokane Bank for Cooperatives by \$32,306,000. Again because CFAB is a financial institution, there is probably no more reliable indicator of its immediate and short-term health than the relationship between its interest-earning assets and its interest-bearing obligations. The contrast between the respective year-ends should be encouraging to CFAB's borrower-owners:

	<u>December 31, 1985</u>	<u>December 31, 1984</u>
Certificates of Deposit	\$ 3,200,000	\$ 8,827,865
Earning Loans	<u>50,283,591</u>	<u>62,827,217</u>
Total Earning Assets	\$53,483,591	\$71,655,082
Interest-Bearing Obligations	<u>(48,268,294)</u>	<u>(80,574,285)</u>
Net (Deficit) Earning Assets	<u>\$ 5,215,297</u>	<u>\$ (8,919,203)</u>

A *nother big factor was a \$391,000 reduction in basic operating expenses.*

The shift illustrated above took place over the 12-month period. The effects of the shift will be transmitted to CFAB's statement of operations (its profit and loss statement) over an even longer period of time. Nevertheless, there was a dramatic improvement in CFAB's net operating results — from a \$9,978,000 loss in 1984 to modest net revenues of \$114,000 in 1985, a positive difference of about \$10,092,000. Most of that difference can be found in the reduced provision for loan losses; there were very few major new loan losses projected during 1985. Another big factor was a \$391,000 reduction in basic operating expenses. For the four years 1981 through 1984 CFAB's annual operating expenses had averaged about \$3.2 million. It was a challenge to achieve a significant reduction; many cost-reduction actions had a one-time cost by themselves, and most were in effect for only a few months of 1985. We are striving for a further reduction of \$500,000 to \$600,000 of operating expenses during 1986.

The net result of 1985 operations, as mentioned above, was a margin of \$114,187. The Board of Directors, in accordance with CFAB's by-laws, applied that amount to reduce the unallocated and undistributed patronage loss remaining from 1984 operations.

A year ago, when CFAB's 1984 Annual Report was prepared, the 1985 financial outlook was uncertain at best. It is more pleasant, certainly, to be able to report a reversal of trends and that a degree of stability has been achieved. Nevertheless, a core of difficult problems remains and must be dealt with. Borrower-owners' interests continue to be impaired, and the fact that (at least at year-end) CFAB is not earning or collecting interest on nearly 24 percent of its loans means that performing borrowers have been unable yet to receive the benefit of interest rates which are generally trending downward.

CFAB's directors, management, and staff share with borrower-owners the frustrations of bearing the burdens imposed by a relative handful of non-performing loan accounts. While CFAB's non-earning loans total nearly 24 percent of its loan portfolio in dollars, they involve only **nine** percent of its total loans by number!

What is in the future for CFAB and its borrower-owners?

How do credit and liquidity problems get resolved? What is in the future for CFAB and its borrower-owners? The first question is easier to address than the second. There is really only one general strategy available to a lender confronted by a large number of non-performing loan accounts: A careful, objective, one-by-one analysis resulting in an establishment of priorities and the development of a specific strategy for each account. That in itself is a time-consuming process. The corrective action, assuming one is developed in a particular case, usually takes time also — if a borrower has cash readily available, the loan presumably would not be in default in the first place! Even in those instances in which foreclosure is the only logical alternative, the realities of the legal process involve extraordinary delays. We are pleased, within that context, to report the results of 1985 with respect to non-earning loans. Those results reflect unusual and dedicated effort by every single member of CFAB's staff.

Your directors, management, and staff are totally committed...

CFAB's future is a subject much more difficult to express with definition. Your directors, management, and staff are totally committed to structuring and operating CFAB to meet the constructive needs and demand of its mandated markets. However, CFAB really cannot influence the extent or nature of those markets. The Alaska commercial fishing, agriculture, and timber industries are each affected — often dramatically — by a broad range of external, uncontrollable, and often unforeseeable factors. Each of them is an industry which requires major commitments of capital, either owned or borrowed, but in which financial and operational stability over an extended period is an exception rather than a norm. An individual operator, and his ability to service an obligation incurred years earlier, can be severely and detrimentally impacted by uncontrollable factors. As an example, the rational business decisions by a couple of processors in a given area to not operate in a particular season can totally eliminate what has been a reliable market opportunity for dozens of fishermen. That is a difficult environment in which to oper-

ate, both for participants and for their lenders.

CFAB was created to serve a genuine and legitimate need: the need for commercial fishermen and others to have access to a reliable source of credit. The need continues to exist today. However, while it is a general need, neither CFAB nor any other lender can respond to it in a general way. The response, and the delivery of credit services, **must** be predicated upon the objective evaluation of the credit worthiness of **individual** applicants. CFAB will make loans to specific borrowers; it will **not** make loans to "the industry"!

A member's overall interests are probably best served by avoiding unnecessary new debt for the 1986 season.

As this message is written in the early spring of 1986, the immediate future seems to hold special challenges for CFAB in its quest for sound growth, especially in commercial fishing. The outlook for certain species and certain products is questionable, and there are indications that a number of processing plants will not operate. The cost and availability of insurance has become a major problem for many operators. In addition, and as discussed earlier, CFAB's financial circumstances require that its interest rates be maintained at a level higher than those offered to some applicants by some other lenders. Realistically, and in spite of the fact that CFAB's management is committed to positive progress in the institution's circumstances and effectiveness, a member's overall interests are probably best served by avoiding unnecessary new debt for the 1986 season.

It is not unusual for CFAB members to visit with directors or with management and to compare CFAB's current terms and programs with those perceived to be widely offered by other institutions. Indeed, within CFAB itself we often lapse into discussions about "the competition." The facts are, however, that CFAB is unique: that there is no true competition. There is no other private lender committed and mandated to exclusively serve the commercial fishing, agriculture, and timber industries in Alaska. There are other lenders which have, in the interests of diversification and corporate responsibility, committed a **portion** of their lending capacities to those industries or to segments of them. The basic responsibilities of those lenders' managements, however, are to protect and enhance the interests of their owners and, in some instances, their depositors. Accordingly, loan programs and terms are structured to attract and accommodate the most stable industry participants.

We take pride in being a part of the Alaska financial community as a whole.

CFAB's purposes and objectives are considerably different. CFAB has no alternative markets for its services. It must strive to attract a broad cross-section of each of the industries it serves. While it must avoid the more speculative loan proposals presented to it, CFAB cannot on the other hand structure its programs and policies to fit only those applicants who do have other financing alternatives. We have a high regard for other lenders and the services they provide; we cooperate and participate with other lenders whenever appropriate; and we take pride in being a part of the Alaska financial community as a whole. However, we are convinced that success for CFAB — no matter what standards may be used to measure that success — can be achieved only through constant and realistic evaluation of its own capabilities and of the viability of its borrower/members. Emulation of other institutions, or pursuit of objectives whose only merits are popular and temporary appeal are courses that have proven themselves unsuitable at best.

During 1985 CFAB's foundations were strengthened, its structural weaknesses were addressed, and a framework for more effective and meaningful service to borrower-owners was established. Many of those actions had an immediate and high level of visibility, while others will attain significance over a period of time. Some of the more important events or actions were:

- The closure of regional service offices in Cordova, Homer, Ketchikan, and Kodiak.
- The development of a differential interest rate program, under which unusually creditworthy borrowers may be offered lower interest rates.
- Introduction of a new Class B Preferred Stock program, effective January 1, 1986, which provides for an investment of genuine risk capital by CFAB's borrower-owners.
- A determined and ongoing effort to permanently reduce and better control CFAB's basic overhead expenses.
- Elimination of allocated patronage credits from earlier year's operations, reducing the amount of the

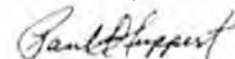
1984 loss carried on CFAB's books. While this appeared on the surface to be destructive to the interests of the holders of those credits, the action actually created opportunities for those members to realize cash benefits from an asset of undeterminable value with the extent of the benefit depending upon the members' respective Federal income tax situations.

- Establishment of a modified level payment program for many kinds of loans, enabling borrowers to make more reliable provisions for cash requirements.
- A special, one-time, arrangement for a professional qualitative review and analysis of CFAB's total loan portfolio by the State of Alaska's bank examiners.

We urge you to mark the appropriate date on your calendar now.

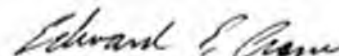
A major disappointment during 1985 was the failure to achieve a quorum at CFAB's annual meeting. Our conclusion has been that the failure was due not to apathy on the part of members, but rather to the difficulty and expense for members throughout Alaska to attend an annual meeting at a single location. Accordingly, the Board of Directors has decided to hold CFAB's 1986 annual meeting in three sessions, with appropriate recesses, and at three different locations: October 9 at Ketchikan, October 11 at Anchorage, and October 13 at Cordova. We urge you to mark the appropriate date on your calendar now. Furthermore, due to a coincidence of events in 1985 and early 1986, it is necessary that **all five** of CFAB's elected director positions be subject to election in 1986. The nomination process for director candidates will begin in mid-1986, and it is vitally important that each CFAB member take an interest and play an active role in the election of qualified directors.

Paul A. Huppert



Chairman, Board of Directors

Edward E. Crane



President

1985 Loan Activity & Economic Impact

CFAB's founding statute requires that its annual report include "...a description of the bank's loan activity during the period..." as well as "...an analysis of economic and other effects of loan decisions on the state's commercial fishing and agriculture industries..."

As shown in CFAB's financial statements and as discussed in the Executive Message, there was a significant decline in the total loan dollars outstanding during 1985. Loan balances totaled about \$65.9 million on December 31, 1985; a year earlier that total had been about \$94.8 million.

That comparison suggests clearly and accurately, that much of CFAB's 1985 activity was focused on the liquidation of non-performing loans and on the resolution of other loan problems. In addition, the general decline in interest rates offered by some other financial institutions during 1985 attracted a number of CFAB's borrowers whose financial circumstances would permit re-financing by those institutions.

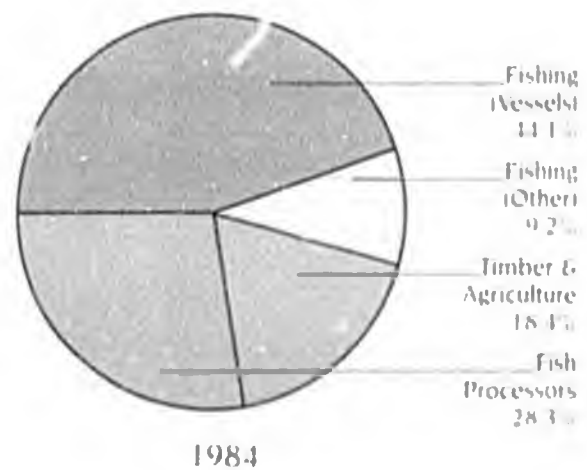
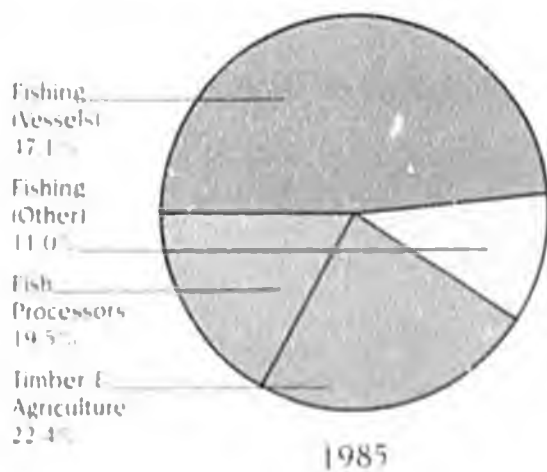
Although there were significant net reductions in both the numbers and amounts of loans outstanding, CFAB did continue to be responsive to the constructive financing needs of both new applicants and existing borrowers. CFAB made 83 new loans during 1985; 40 of them totaling \$3.1 million, were to new members while the remainder totaling \$1.2 million, were to existing members.

CFAB continues to be of special importance to individual participants of the commercial fishing industry. It is that general segment of the industry which appears to have the most limited access to alternative sources of financing. A large part - over 60 percent - of the net reduc-

tion in CFAB's year-end loan volumes was in the fish processing portion of the industry. The resulting shift in the composition of CFAB's loan portfolio is shown below.

Despite the language of the statute mentioned earlier, it would be speculative and perhaps pretentious to assert that CFAB's loan decisions have a major effect on its mandated industries in total. Those industries are based on massive amounts of capital, both borrowed and invested; their participants are globally based and their conditions and trends are influenced by multitudinous factors. It is doubtful that CFAB's activities, or the activities of any other single financial institution, exert much influence on developments in those industries.

On the other hand, it is clear that CFAB's presence and decisions have a significant and continuing effect on members of those industries, whether they are individuals or corporations. Each new loan action by CFAB establishes a means whereby an Alaskan individual or corporation may participate more effectively in the fishing, agriculture, or timber industry. In addition to the direct impact on the borrower, there is a cumulative effect on the Alaska communities in which the particular industry is concentrated. This is especially true of the commercial fishing industry. For example, CFAB has 168 members in the Cordova-Prince William Sound area, 183 in the Homer-Kenai Peninsula area, and 98 in the Dillingham-Bristol Bay area. There are numerous other concentrations throughout the state. While CFAB bases its loan decisions strictly on an objective evaluation of the creditworthiness of the individual borrower/applicant, it seems reasonable to conclude that the collective impact of those decisions has enhanced the stability of local participation in the industries.



Touche Ross & Co.

January 31, 1986

Board of Directors
Alaska Commercial Fishing and
Agriculture Bank
Anchorage, Alaska

We have examined the balance sheets of Alaska Commercial Fishing and Agriculture Bank as of December 31, 1985 and 1984, and the related statements of operations, changes in capital and allocated/unallocated undistributed patronage earnings (loss), and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Alaska Commercial Fishing and Agriculture Bank as of December 31, 1985 and 1984, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Certified Public Accountants

Balance Sheets

	December 31,	
	1985	1984
Assets		
Cash	\$ 106,773	\$ 123,331
Certificates of deposit	3,200,000	8,827,865
Loans, net of allowance for loan losses of \$3,441,130 and \$5,317,621	62,495,806	89,489,042
Accrued interest receivable:		
Certificates of deposit	44,144	112,306
Loans	2,071,202	3,092,629
Investment in Spokane Bank for Cooperatives	5,252,423	4,738,734
Bank premises, furniture and equipment, net	471,503	648,231
Acquired assets held for resale	1,606,164	2,361,305
Other assets	90,563	502,048
	<u>\$75,338,578</u>	<u>\$109,895,491</u>
Liabilities		
Accounts payable and accrued expenses	\$ 308,016	\$ 372,016
Accrued interest payable	416,780	2,369,853
Notes payable	48,268,294	80,574,285
	<u>48,993,090</u>	<u>83,316,154</u>
Commitments and Contingent Liabilities (Note H)		
Capital and Patronage Earnings		
Share capital —		
Class C special preferred stock, \$10,000 par value, authorized 4,000 shares, outstanding 3,180 shares	31,800,000	31,800,000
Class B preferred stock, \$100 par value, authorized 400,000 shares, outstanding 65,845 and 95,177 shares	6,584,500	9,517,700
Loans receivable on Class B preferred stock	(6,584,500)	(9,517,700)
Class A membership stock, \$10 par value, authorized 10,000 shares, outstanding 931 and 888 shares	9,310	8,880
	<u>31,809,310</u>	<u>31,808,880</u>
C Stock retirement pool	92,152	10,260
Capital in excess of par value	82,980	79,110
Contributed capital	144,626	144,626
	<u>32,129,068</u>	<u>32,042,876</u>
Allocated undistributed patronage earnings	1,045,365	4,514,237
Unallocated undistributed patronage loss	(6,828,945)	(9,977,776)
	<u>26,345,488</u>	<u>26,579,337</u>
	<u>\$75,338,578</u>	<u>\$109,895,491</u>

See notes to financial statements

Statements of Operations

	<u>Year Ended December 31,</u>	
	1985	1984
Interest Income:		
Interest on loans	\$10,141,090	\$ 11,992,708
Interest on certificates of deposit	<u>362,767</u>	<u>918,081</u>
	<u>10,503,857</u>	<u>12,910,789</u>
Interest expense	<u>6,267,003</u>	8,386,607
Loss on assets held for resale	<u>91,127</u>	72,356
Provision for loan losses	<u>1,234,930</u>	<u>11,241,619</u>
	<u>7,593,060</u>	<u>19,700,582</u>
	<u>2,910,797</u>	<u>16,789,793</u>
Other Expenses:		
Salaries and benefits	1,705,780	1,785,281
Occupancy expense	252,300	260,544
Office operations	126,717	201,133
Advertising and promotion	79,922	197,182
Travel, lodging and meals	136,675	192,661
Depreciation and amortization	160,279	180,127
Professional fees	150,191	148,654
Telephone and postage	87,238	114,774
Directors' fees	46,954	71,113
Miscellaneous	50,554	36,514
	<u>2,796,610</u>	<u>3,187,983</u>
Unallocated undistributed patronage earnings (unallocated undistributed patronage loss) before income tax expense and extraordinary credit	114,187	(9,977,776)
Income tax expense	<u>32,200</u>	<u> </u>
Unallocated undistributed patronage earnings (unallocated undistributed patronage loss) before extraordinary credit	81,987	(9,977,776)
Extraordinary credit — utilization of net operating loss carryforward	<u>32,200</u>	<u> </u>
Unallocated undistributed patronage earnings (unallocated undistributed patronage loss) (Note G)	<u>\$ 114,187</u>	<u>\$ (9,977,776)</u>

See notes to financial statements

Statements of Changes in Capital and Allocated / Unallocated Undistributed**Patronage Earnings (Loss)**

	<u>Share Capital</u>	<u>C Stock Retirement Pool</u>	<u>Capital In Excess Of Par Value</u>
Balance, January 1, 1984	\$ 31,808,280	\$ —	\$ 73,710
Issuance (redemption) of stock during the year:			
Class B preferred stock, 8,655 shares, net	(865,500)		
Class A stock, 60 shares	600		5,400
C stock retirement pool:			
Class B preferred stock assessments		89,507	
Less: Assessments receivable		(79,247)	
Reduction in loans receivable on Class B preferred stock	865,500		
Loan principal charged against allocated undistributed patronage			
Unallocated undistributed patronage loss			
Balance, December 31, 1984	<u>31,808,880</u>	<u>10,260</u>	<u>79,110</u>
Issuance (redemption) of stock during the year:			
Class B preferred stock, 2,932,200 shares, net	(2,933,200)		
Class A stock, 43 shares	430		3,870
Reduction in loans receivable on Class B preferred stock	2,933,200		
C stock retirement pool:			
Class B preferred stock assessments		171,398	
Less: Assessments receivable		(89,506)	
Loan principal charged against allocated undistributed patronage earnings			
Unallocated undistributed patronage earnings			
Allocation to unallocated undistributed patronage loss			
Balance, December 31, 1985	<u><u>\$31,809,310</u></u>	<u><u>\$92,152</u></u>	<u><u>\$82,980</u></u>
See notes to financial statements			

<u>Contributed Capital</u>	<u>Allocated Undistributed Patronage Earnings</u>	<u>Unallocated Undistributed Patronage Earnings</u>	<u>Unallocated Undistributed Patronage Loss</u>	<u>Total</u>
\$144,626	\$4,764,918	\$ —	\$ —	\$36,791,534
				(865,500)
				6,000
				89,507
				(79,247)
				865,500
	(250,681)			(250,681)
			(9,977,776)	(9,977,776)
<u>144,626</u>	<u>4,514,237</u>	<u>—</u>	<u>(9,977,776)</u>	<u>26,579,337</u>
				(2,933,200)
				4,300
				2,933,200
				171,398
				(89,506)
	(434,228)			(434,228)
		114,187		114,187
	(3,034,644)	(114,187)	3,148,831	
<u>\$144,626</u>	<u>\$1,045,365</u>	<u>\$ —</u>	<u>\$ (6,828,945)</u>	<u>\$26,345,488</u>

Statements of Changes in Financial Position

	<u>Year Ended December 31,</u>	
	1985	1984
Source of Funds:		
From Operations —		
Allocated undistributed patronage earnings		
(unallocated undistributed patronage loss)	\$ 114,187	\$ (9,977,776)
Items not requiring the use of funds:		
Depreciation and amortization	160,279	180,127
Provision for loan loss	1,234,930	11,241,619
Gain on sale of assets	(839)	
Funds provided from operations	<u>1,508,557</u>	<u>1,443,970</u>
Net proceeds from sale of assets	20,924	
Net proceeds from stock issuance	4,300	6,000
Decrease in cash	16,558	568,945
Decrease in certificates of deposit	5,627,865	
Decrease in acquired assets held for resale	755,141	
Decrease in loans	28,869,727	8,800,349
Decrease in other assets	411,485	
Decrease in accrued interest receivable	1,089,589	2,634,426
Increase in accrued interest payable		244,769
Increase in notes payable		1,167,917
Increase in Class B preferred stock assessments net	81,892	10,260
	<u>\$38,386,038</u>	<u>\$14,876,636</u>
Use of Funds:		
Loans charged off net of recoveries	\$ 3,111,420	\$ 10,063,534
Loan principal charged against allocated undistributed patronage earnings	434,228	250,681
Increase in certificates of deposit		827,865
Increase in investment in Spokane Bank for Cooperatives	513,689	1,030,091
Increase in bank premises furniture and equipment	3,637	106,400
Increase in acquired assets held for resale		2,148,813
Increase in other assets		275,644
Decrease in accounts payable and accrued expenses	64,000	131,348
Decrease in accrued interest payable	1,953,073	
Decrease in notes payable	32,305,991	
Decrease in patronage dividend payable		42,260
	<u>\$38,386,038</u>	<u>\$14,876,636</u>

See notes to financial statements

Notes to Financial Statements

Note A — Summary of Significant Accounting Policies:

Operations: The Alaska Commercial Fishing and Agriculture Bank (CFAB) was incorporated on May 4, 1979 to promote growth of Alaska agriculture and fishing by providing debt financing to resident-owned businesses engaged in harvesting, processing or marketing, and to promote its own growth as a strong user-oriented institution through cooperative ownership and self-governance.

CFAB is a cooperative corporation and intends to refund any allocated undistributed patronage earnings at such time as the Board of Directors finds that the financial condition of CFAB will so permit.

Interest on loans: The accrual of income on loans is discontinued when interest or principal is contractually past due more than 90 days.

Patronage dividends: Patronage dividends received from Spokane Bank for Cooperatives (SBC), of which CFAB is a member, reduce interest expense to SBC in the year declared.

Allowance for loan losses: The allowance for loan losses is based upon specific identification of known uncollectible loans and a general reserve for those loans not specifically identified.

Acquired assets held for resale: Acquired assets held for resale include those assets acquired through foreclosure. These assets are carried at the lower of fair market value or the recorded investment in the related loan. Holding costs are expensed when incurred unless such costs increase the fair market value of the asset.

Bank premises, furniture and equipment: Bank premises, furniture and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are charged to operations by use of the straight-line method over estimated useful lives of three to ten years. Expenditures for maintenance and repairs are charged to operating expense as incurred. Expenditures for renewals or improvements which extend the life of an asset are capitalized at cost and depreciated as stated above. Upon sale, retirement or other dispositions of property, the cost and accumulated depreciation are removed from the respective accounts and the resulting gain or loss is recorded in income.

Income taxes: Amounts provided for income tax expense are based on earnings reported for financial statement purposes, rather than on the taxable income shown on the corporate income tax return. These amounts may differ because certain items are recorded as income or expense in different years for financial statement and tax return purposes.

CFAB uses the flow-through method of accounting for investment tax credits, which results in a reduction of income taxes in the year credits are utilized. That portion of investment tax credit not utilized in any year is not available for carryforward to a cooperative organization.

Reclassifications: Certain reclassifications have been made to the 1984 financial statements to conform with 1985 presentation.

Note B — Loans:

CFAB's loan portfolio by major category is as follows:

	December 31,	
	1985	1984
Vessels	\$34,135,387	\$46,450,679
Fish processors	14,172,810	29,506,571
Agriculture and timber	16,221,453	19,110,057
Gear, entry permits and other	<u>7,991,786</u>	<u>9,257,056</u>
	72,521,436	104,324,363
Less loans receivable on Class B preferred stock	<u>(6,584,500)</u>	<u>(9,517,700)</u>
	65,936,936	94,806,663
Less allowance for loan losses	<u>(3,441,130)</u>	<u>(5,317,621)</u>
	<u>\$62,495,806</u>	<u>\$89,489,042</u>

The loan portfolio includes loans which have been classified as nonaccrual. Nonaccrual loans by major category are as follows:

	December 31,	
	1985	1984
Fish processors	\$ 5,246,914	\$15,069,775
Vessels	4,480,381	5,956,277
Agriculture and timber	3,740,558	8,934,494
Gear, entry permits and other	<u>2,185,492</u>	<u>2,018,900</u>
	<u>\$15,653,345</u>	<u>\$31,979,446</u>

Notes to Financial Statements *continued*

Activity in the allowance for loan losses is as follows:

	<u>December 31,</u>	
	1985	1984
Balance at beginning of year	\$ 5,317,621	\$ 4,139,536
Charged to expense	1,234,929	11,241,619
Recoveries on loans previously charged off	<u>374,889</u>	<u>470,093</u>
	6,927,439	15,851,248
Loans charged off	<u>(3,486,309)</u>	<u>(10,533,627)</u>
Balance at end of year	<u>\$ 3,441,130</u>	<u>\$ 5,317,621</u>

CFAB serves the financial needs of the commercial fishing and agricultural industries in the State of Alaska. These industries are subject to seasonal and cyclical fluctuations which could affect the borrowers' ability to repay loans on a timely basis.

Related Party Loans In the ordinary course of business, CFAB

makes loans to members who serve on CFAB's Board of Directors. Loans to members who serve on the Board of Directors must be approved by the SBC. Total loans to these members were \$1,613,378 and \$3,182,794 in 1985 and 1984, respectively.

Note C — Bank Premises, Furniture And Equipment:

The following represents a classification of bank premises, furniture and equipment by major category:

	<u>December 31,</u>	
	1985	1984
Furniture, fixtures and equipment	\$ 889,432	\$ 976,203
Leasehold improvements	<u>147,202</u>	<u>147,202</u>
	1,036,634	1,123,405
Less accumulated depreciation and amortization	<u>(565,131)</u>	<u>(475,174)</u>
	<u>\$ 471,503</u>	<u>\$ 648,231</u>

Note D — Notes Payable:

Notes payable consisted of the following:

	<u>December 31,</u>	
	1985	1984
Spokane Bank for Cooperatives (SBC) seasonal loan, credit line of \$29,000,000 expiring on April 1, 1986, bearing interest at 10.25% at December 31, 1985 (interest paid quarterly based upon floating rates)	\$ 1,020,081	\$ 15,535,000
SBC matched funds short-term notes with interest rates ranging from 8.7% to 9.1% maturing at various dates in 1986	19,200,000	35,000,000
SBC long-term notes including matched funds with interest rates ranging from 10.544% to 11.75% maturing at various dates to January, 1993	28,000,000	30,000,000
Other notes payable and capitalized equipment leases with various interest rates and maturity dates	<u>48,213</u>	<u>39,285</u>
	<u>\$48,268,294</u>	<u>\$80,574,285</u>

The loans are secured by substantially all CFAB assets

Notes to Financial Statements *continued*

Principal payments required on notes payable are as follows:

Year Ending December 31,	Amount
1986	\$23,263,294
1987	15,000,000
1988	—
1989 and beyond	10,000,000

SBC's matched funding loan program allows CFAB to borrow both short-term and long-term funds under its established line-of-credit at fixed rates of interest, generally providing a lower cost of funds.

CFAB must invest in SBC's Class C stock in an amount equal to at least 5% of the cumulative average loan balance maintained with SBC. The amount of CFAB's investment in SBC's Class C stock and equity in allocated surplus was \$5,252,423 and \$4,738,734 at December 31, 1985 and 1984, respectively.

Note E — Income Taxes:

During the year ended December 31, 1985, \$3,035,000 of unallocated undistributed patronage loss was allocated to patrons. As a result of this allocation and the use of the loss to offset current year patronage earnings, the remaining unallocated undistributed patronage loss for financial statement purposes is \$6,830,000.

There was no income tax benefit from the unallocated undistributed patronage loss for the year ended December 31, 1984.

Note F — Pension and Profit Sharing Plans:

CFAB has pension and profit sharing plans covering substantially all employees. The total cost charged to operations for 1985 and 1984 was \$58,372 and \$82,736, respectively.

A comparison of accumulated plan benefits and plan net assets as of January 1, 1985 and 1984 of the Company's defined benefit plan is as follows:

	1985	1984
Actuarial present value of accumulated plan benefits:		
Vested	\$ —	\$ 702
Nonvested	—	—
	<u>\$ —</u>	<u>\$ 702</u>
Net assets available for benefits	<u>\$ 28,244</u>	<u>\$ 27,138</u>
Assumed rate of return used in determining actuarial present value of accumulated plan benefits	<u>8%</u>	<u>8%</u>

Information with respect to the actuarial computed value of vested benefits and pension fund assets as of December 31, 1985 is not available.

Note G — Capital and Patronage Earnings:

Share Capital Shares purchased by the State of Alaska must be repurchased by CFAB on or before July 20, 2000.

Preferential shareholders' rights on dissolution are attached in the order of Class C, Class B and Class A.

The following rights apply to the three categories of stock:

- Class C - No voting or dividend rights. May only be issued to the State of Alaska.
- Class B - No voting rights. Class B stock may only be held by members of CFAB, and dividends paid shall not exceed \$10 per share annually. Prior to December 31, 1985 all loans required a purchase of Class B stock in an amount equal to 10% of the loan balance; however, this purchase was not funded but was evidenced by notes. On loans made subsequent to December 31, 1985, each borrower will be required to make a cash purchase of Class B stock in an amount equal to 5% of the total loan. This investment will remain in place until retired by the Board of Directors.
- Class A - No dividend rights. Each member of CFAB must own one share of Class A stock. Each share of stock carries one vote. To vote, a member must be engaged in commercial fishing or agriculture and must be a current borrower or have borrowed from CFAB during the preceding two years or have a minimum retained patronage earnings with CFAB of \$2,500.

Unallocated Undistributed Patronage Loss: At December 31, 1984 Alaska Commercial Fishing and Agriculture Bank's financial statements reflected an unallocated undistributed patronage loss in the amount of \$9,977,776. During 1985, in accordance with Alaska Commercial Fishing and Agriculture Bank by-laws, the Board of Directors acted to reduce that amount as follows: 1) by allocating \$3,034,644 to allocated undistributed patronage earnings of prior years; and 2) by charging \$114,187 to 1985 unallocated undistributed patronage earnings. At December 31, 1985 the remaining unallocated undistributed patronage loss amount was \$6,828,945.

Class C Stock Repurchase Plan: In accordance with AS 44.81.010(b), on or before July 20, 2000, CFAB is required to repurchase its Class C stock issued to the State of Alaska. On November 10, 1982 an agreement was signed with the State of Alaska outlining the principles of a plan which calls for the repurchase of outstanding Class C stock with CFAB capital funds to be provided by CFAB's member-borrowers over a period of future operations. On December 12, 1983, CFAB implemented its Class C Stock Redemption Program.

Note H — Contingencies and Commitments:

Contingencies: CFAB is a defendant in several legal actions arising from normal business activities including actions related to delinquent loans and foreclosures. CFAB reserves for potential losses on delinquent loans as described in Note A. As to litigation outside of delinquencies and foreclosures, management believes that those actions are without merit or that the ultimate liability, if any, resulting from them will not materially affect CFAB's financial position or its results of operations.

Commitments: CFAB has entered into certain noncancelable long-term operating lease agreements for buildings. Rental expense under these leases totaled \$231,549 and \$234,076 for the years ended December 31, 1985 and 1984, respectively. Minimum annual lease payments are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
1986	\$68,000
1987	27,000
1988	8,000

Board of Directors and Staff

Board of Directors

Paul A. Huppert
Chairman

Robert Waldrop
Vice Chairman

Thomas E. Thompson
Secretary/Treasurer

Roseleen "Snooks" Moore
Director
(Resigned April 1986)

Dale R. Philman
Director

Harvey H. Samuelsen
Director

Hyoung "Henry" Kim
Director
(Appointed February 1986)

Gilbert Gunderson
Director
(Appointed April 1986)

Staff

Iver H. Amundsen
Assistant Vice President

Karol A. Askerman
Assistant Vice President

Karl E. Barnard
Vice President

Cynthia D. Blush
Senior Bookkeeper

Darleen S. Church
Vice President

Robert H. Clark
Assistant Vice President

Edward E. Crane
President

John W. Enge
Fisheries Analyst

Terrence H. Hayden
Assistant Vice President

Judy A. Metcalf
Receptionist

Sharon A. Morgan
Secretary

Deanne L. Osha
Documentation & Information Specialist

Daydra R. Presley
Communications Manager

David G. Rogers
Senior Vice President

Chianne G. Sanchez
Executive Secretary

Douglas W. Sindt
Data Processing Supervisor

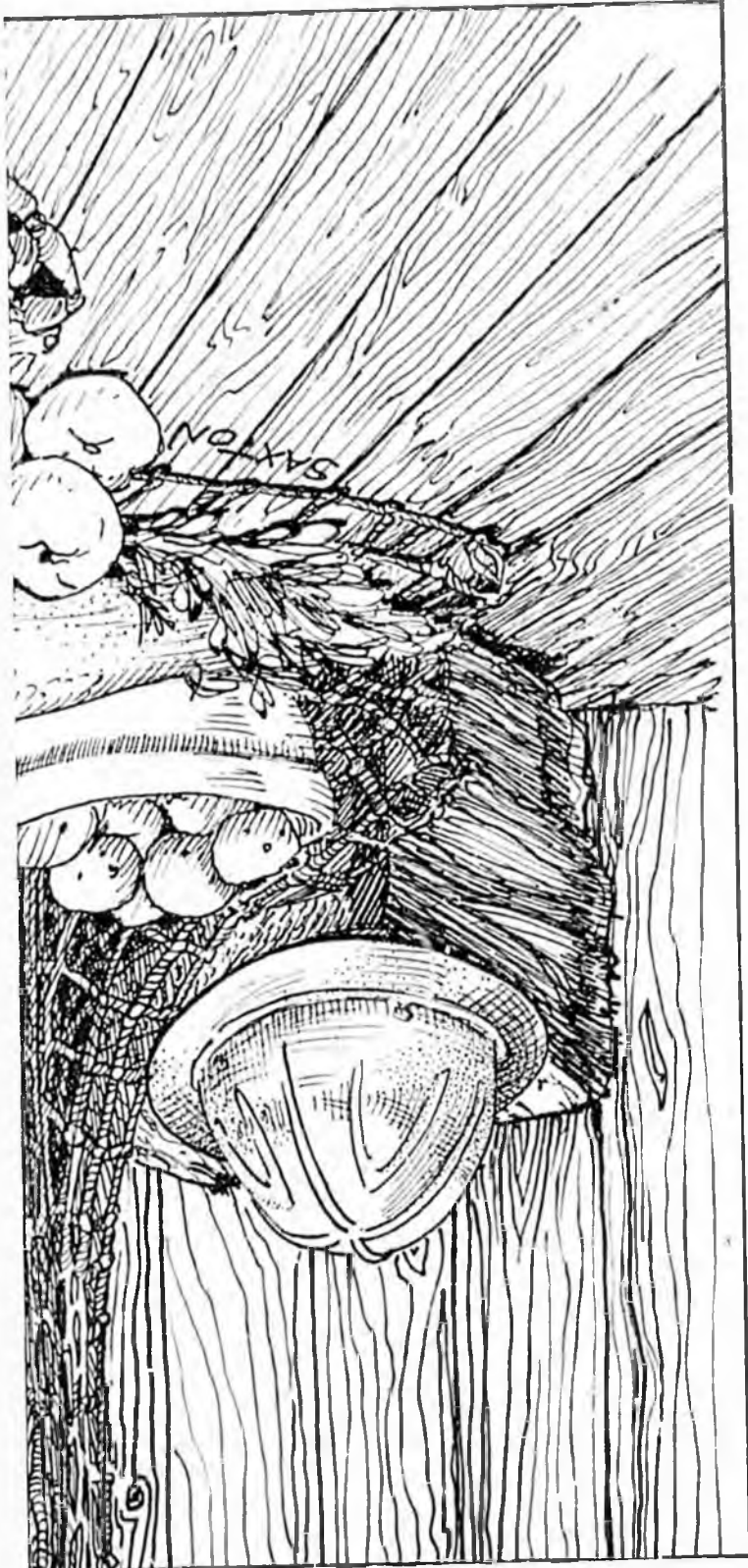
Lora C. Smith
Senior Bookkeeper

Deborah A. Tosch-Price
Documentation Paralegal

Godelieve C. Van Lint
Courier

DeLories M. vonGemmingen
Executive Secretary

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1984 ANNUAL REPORT
Alaska Commercial Fishing
and Agriculture Bank

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1984 was a difficult and eventful year for CFAB. It was a year of heightened awareness and realization by its Board of Directors and by its management team. It was a year in which decisions were made, and direction given, by the Board to realistically identify and evaluate the total circumstances and condition of CFAB. The results of those efforts and activities are set forth in the financial statements section of this report, and are discussed in the President's Message.

Cooperatives are formed and intended — in principle, by statute, and as a matter of philosophy — to serve the interests of their members. They function most effectively and efficiently when the needs and interests of the members are homogeneous, or nearly so. That premise places an unusual burden on a cooperative formed to provide credit services, as is CFAB. While the needs of its members have a basic but superficial sameness — each of them requires, or is seeking, an extension of credit — each of them in reality represents a totally unique combination of factors and circumstances. Every loan application requires a subjective analysis and evaluation of risk factors; risk factors which are different in each case from those of any and every other case. CFAB is obliged to maintain and apply standards and policies which are rational and appropriate for a financing institution and against which each member's and each applicant's credit worthiness may be fairly and equitably evaluated. Each member, and each applicant, has the right to such an evaluation. However, there is no feature inherent to cooperative structure, or cooperative philosophy, or cooperative principle which provides protection from the laws of nature or the fundamental rules of credit and business economics. Although CFAB serves a specific purpose and is charged with a unique mission, it cannot accept risks which would be unacceptable to any other reasonable lender. As a matter of fact, since by statute and by its Articles and Bylaws CFAB is limited to serving a very narrow market, a concentration which is avoided by most lenders, it might be argued that CFAB must be especially stringent in its evaluation and acceptance of individual risks.

Historically, CFAB has attempted to be a compassionate and tolerant lender, both in practice and as a matter of philosophy. It is difficult to take issue with that general posture. However, it is clear — and it

must be recognized and endorsed by you, the member-owners — that each time CFAB makes an adventurous or speculative concession to a single borrower, it is an action erosive to the aggregate interests of *all* of you. CFAB's Board of Directors and its management are determined that the future application of its credit policies will reflect their intent and obligation to protect and enhance the interests of its total ownership.

A thoughtful and perceptive observer will recognize many successes and many elements of constructive service to the Alaskan commercial fishing and agriculture industries; they should not be totally overshadowed by the difficult circumstances of today. For example, nearly 90 percent of the approximately 1,400 loans CFAB has made through 1984 have either been paid in full or are being paid in accordance with their respective terms. That CFAB serves a broad spectrum of Alaskans is demonstrated by the fact that, if the loan balances associated with the largest ten percent of CFAB's borrowers are eliminated from the calculation, the average loan balance is about \$46,000. In the context of today's economy, and especially in the capital-intensive industries which CFAB serves, \$46,000 is not a "large" amount; and it suggests that CFAB is providing credit support for a large number of individual fishermen and farmers. Another more subjective point often overlooked is that CFAB serves the interests of *every* eligible person in its market, whether he or she is a CFAB borrower or not. That is because CFAB's presence throughout all of the Alaskan commercial fishing and agriculture industries is a competitive factor which affects the availability and cost of loan funds offered by every lender.

It has been necessary for CFAB to undergo an inevitable evolutionary process to bridge the gap between its creative and visionary founding statute and the hard realities of renewable resource financing. That process has taken a toll, both in dollars and in human resources. As with any evolutionary process, however, the emerging organization is one which has been tempered and shaped by both successes and failures and is now better suited than ever before to survive and prosper within its environment.

The Board of Directors is confident and determined that CFAB will be restored to a position of

vigor and productive service to its member-owners. That will not "just happen" — it can only be the result of consistent and long-term effort at the Board, management, and staff level. It will also require continued support by each of you; support in the form of contractual performance in your roles as borrowers, and in the form of communications in your roles as member-borrowers. As in any corporation, CFAB's Directors are charged with preserving and furthering the interests of the member-owners as a body rather than with representing the interest of individuals in their dealings with CFAB; it is imperative, then that you seek an understanding and perspective of CFAB's total mission and circumstances and that you express your views on them to the Board of Directors as opportunities arise or are created.

It is with deep regret that I must announce that, subsequent to year-end, Frank Homan tendered his resignation from your Board of Direc-

tors. Frank was a founding Director of CFAB, and served as its first Chairman. His service continued through re-appointment to the Board by Governor Sheffield, and his experience, judgment, and dedication have been invaluable to his fellow Directors. His record of service is worthy of the respect and thanks of every present and prospective CFAB member-owner.

Again, I urge each of you to look to the future, to participate in a positive way in the election of Directors and in CFAB's annual meeting on October 12, 1985; and to provide your support in assuring the ultimate success of your financing cooperative.



Paul A. Huppert
Chairman of the Board

Member Loan Analysis 12/31/84

	<u>No. Members</u>	<u>No. Loans</u>	<u>Percent of Loans</u>	<u>Principal Outstanding</u>	<u>Percent of Principal Amount</u>
Under 25,000	251	253	33.4%	\$ 3,341,216	3.5%
25,000 - 74,999	239	254	33.5%	10,850,620	11.4%
75,000 - 149,999	127	141	18.7%	12,640,122	13.4%
150,000 - 499,999	62	68	9.0%	14,776,490	15.6%
500,000 - 999,999	13	16	2.1%	9,205,052	9.7%
Over 1,000,000	15	25	3.3%	43,993,163	46.4%
	<u>707</u>	<u>757</u>	<u>100%</u>	<u>\$94,806,663</u>	<u>100%</u>

Alaska Commercial Fishing and Agriculture Bank — your bank — opened its doors for business in April, 1980. December 31, 1984, marked the completion of over four years of lending activity. They have been years of dramatic peaks and valleys. The financial statements presented in this annual report show clearly that, no matter how 1984 might be evaluated and characterized as a single year of operation, it was a year in which the cumulative effects of several forces generated over the course of previous years were recognized, confronted, and acknowledged. It was a year in which CEAB was aggressive in identifying the realities of weaknesses among its borrowers, and equally aggressive in using all of the tools and methods available to it in dealing with those weaknesses on an individual basis. Unfortunately, as is true with *any* lender, those tools and methods are limited; and they tend to be costly and destructive both to the borrower involved and to CEAB as an institution.

As shown in the 1984 Statement of Income, CEAB suffered a loss of about \$10.0 million in the year just ended. The principal component of that loss was approximately \$11.2 million used to build the provision for loan losses to a level which would absorb identified and anticipated shortfalls on loans to certain borrowers.

The basic effect of the 1984 loss is a diminishment of owners' equities and other interests. As expressed in the Balance Sheet, the net book value of owners' equities decreased from \$36,791,534 at December 31, 1983, to \$26,579,537 at December 31, 1984. Effectively, this means that at year-end the ownership interest of each member-owner was impaired; it was a negative number. As with any corporation, this does not mean that any member-owner has a financial obligation to CEAB (aside from any borrower relationship that may exist). However, it does mean that had CEAB been liquidated at December 31, 1984, at or near the book value of its assets, there would have been no net proceeds available for distribution to member-owners. More significantly, it means that CEAB has a major deficit to overcome through the effective and efficient management of its operations in order to rebuild an ownership interest for its member-owners.

Some aspects of CEAB's circumstances today can be best understood within the context of a review

of CEAB's origins, purposes, and philosophical foundations. CEAB was created to fill a void — to provide credit facilities to a market which, when judged on the basis of demonstrated commitment and activity, had been found unattractive by investor-owned, profit-oriented, lending institutions. The very existence of that void suggests that there had been a cumulative awareness of unusual risk by those traditional lenders. CEAB also was founded to serve *only* the Alaskan-owned segments of two basic industries — *commercial fishing and agriculture* — which are not only inherently volatile but are subject to a myriad of external and often unpredictable pressures. There has been no opportunity or provision for the risk-moderating effects of diversification.

Perhaps there is never a "best time" — or even a "worst time" — to introduce a new concept or to begin a new business. For all entities and organisms, birth and childhood involve an abrupt entry into an environment which can be hostile. Looking backward from the vantage point of early 1985, one can identify several factors or circumstances of the late 1970's and early 1980's which influenced the early attitudes and philosophies of CEAB, its supporters, and its markets. During that period, the acceptance and assumption of continuing inflation was widespread and a "borrow to prosper" strategy was common to many individuals, industries, and businesses. A related factor was the relatively weak U.S. dollar of those years; export volumes were growing, and the future seemed bright. Among those market segments important to CEAB, the brightest future appeared to most to belong to the King Crab industry — and that industry as a whole committed to horrendous levels of capital investment (much of it borrowed). As we know today, those 1980 outlooks proved to be ill-founded.

Although most of the efforts and circumstances which have affected CEAB or which CEAB has shaped have been positive, there have been unanticipated events over the past four years which have placed extreme negative pressures on our borrowers and, therefore, on CEAB. Among them have been:

1. The dramatic strengthening of the U.S. dollar, which has greatly inhibited export opportunities.

2. Inconsistent management of certain fisheries.
3. Financial distress or failure of non-borrowers, rendering them unable to fulfill their obligations to CEAB members.
4. The canned salmon "botulism scare" of 1981, the pervasive effects of which are significant yet today.
5. Major fishermen's strikes which, regardless of their merit, inevitably result in a reduction of total industry proceeds.

All of the above are external and largely uncontrollable factors. To them must be added the fact of human weaknesses: of imprudent judgments both by CEAB personnel and by borrowers. Clearly, the exuberance associated with building, or patronizing, a new entity created a climate conducive to speculative lending relationships.

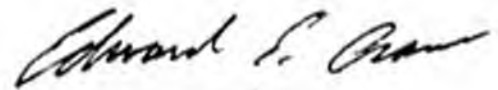
None of these are offered as excuses or rationalizations; they are presented as matters of reality and of factual background. A greater reality which must be recognized by CEAB's Board of Directors, management staff, member-owners, creditors, and other interested parties is that while the past provides lessons to be heeded, it is only the future which can be influenced and molded.

CEAB is owned by its member-owners and by the State of Alaska. Paradoxically, while the latter has the greater number of dollars at risk, it is only the member-owners who have the right (and responsibility) to vote and to otherwise influence the directions and policies of CEAB. This is a more formidable and burdensome challenge than might appear to be so.

Undeniably, CEAB is handicapped at present by the effects of its credit losses in recent years. The handicap will not be quickly or easily overcome. However, the fundamental bases for recovery are in place. There is a continuing need and market for its services; there remains a reliable source of loan funds; CEAB's fundamental policies and practices — particularly as they have been influenced by events of the past few years — are designed to protect the interests of both the borrower and CEAB as an institution, and the Board, management, and staff have been seasoned by the stresses of CEAB's "start-up" years.

Each of us prefers good news to bad, and each of us is receptive to a promise of better circumstances on an immediate basis. There is a great temptation to commit to you that 1985 will bring about a sharp reversal of trends and a major recovery of past losses. This is not realistic, however. Entrenched and endemic credit problems cannot, in general, be cured or resolved within a predictably early time-frame. Precipitous actions tend to drastically and negatively impact the interests of both lender and borrower. Most massive efforts are best conducted and concluded by attention to detail and through the identification of individual and smaller steps implemented on the basis of well-chosen priorities. CEAB is following that general strategy. Our commitment to you is that CEAB's staff and management will diligently, professionally, and rationally pursue a course of maximum recovery and benefit to the institution while at the same time seeking the sound and constructive expansion of service and substance to new and existing member-owners.

CEAB is your institution. It represents a significant investment and commitment by each of you. The implication of that may well be difficult to appreciate on a routine, day-to-day basis; many member-owners may have occasion to think about CEAB only a couple of times a year. Nevertheless, each of you has the right — and the obligation — to objectively and constructively influence its directions. There are many channels of expression and communications open to you. We encourage your participation and attendance at CEAB's annual meeting and at occasional area meetings. We urge you to join actively in the process of nomination and election of qualified individuals to serve as directors of CEAB, and to communicate with those individuals. Your management also earnestly and sincerely solicits your observations, questions, and suggestions. The ultimate success of this organization will only be measured by the extent to which it serves the legitimate financing needs and purposes of the Alaskan industries to which it is committed.



Edward E. Crane
President

The 1984 loan activity of the Bank reflected a marked change from the trend of growth established over the previous four years. The decline in loan volume is considered reflective of the generally difficult economic environment being experienced by the fishing, agriculture and timber industries throughout the state. Although there are segments which have maintained economic stability, for the most part the industries served by the Bank have experienced significant challenges.

CFAB has committed itself to provide credit even during these difficult times. Because of this commitment, the Bank has had a stabilizing influence upon all sources of credit. During periods of economic depression the Alaska fisherman has often found no ready sources of credit. CFAB has continued to provide funds for those Alaskans able to demonstrate credit-worthiness, thereby helping them to maintain a high level of productivity.

The following is a summary of the Bank's loan portfolio outstanding at year-end, December 31, 1984.

	<u>Outstanding Loans</u>	<u>Percentage</u>
Processors	\$ 26,876,130	28.3%
Timber	17,020,989	18.0
Vessels	11,807,481	12.1
Fishing Other	8,739,846	9.2
Agriculture	362,217	.4
	<u>\$94,806,663</u>	<u>100.0%</u>

The year-end loan balance was down 8 percent from the year-end 1983 balance of \$103,607,012. There were a total of 757 loans outstanding, and 888

Cooperative members, at year-end. CFAB approved 54 loans to new members during 1984 totaling \$3.5 million and 80 loans to existing members for \$13.4 million.

The Bank's credit activities were concentrated in areas other than loan approvals during 1984. The major emphasis during the year was on the resolution of problem loans and on the liquidation of loan accounts whose viability could not be established.

The economic impact of credit decisions will vary from area to area and among individual borrowers. The decision to foreclose on a vessel or to make demand on a processor has a definite and quantifiable impact on both the borrower and the Bank. However, for a given area or for an industry as a whole, the impact of these and other decisions is not felt to be concentrated so as to be measurable. Both processing and harvesting capacities have been and should continue to be sufficient to absorb the effects of the Bank's decisions to proceed against non-performing borrowers.

The most significant challenge facing all segments of the fishing and timber industries is the strong U.S. dollar. Both of these industries are dependent on foreign markets, so the problem is particularly acute. It is reasonable to expect that the value of the U.S. dollar will be realigned in the future and that demand and price should be stimulated.

CFAB will continue to be a source of financial services for those eligible applicants who can demonstrate the appropriate level of credit-worthiness. Although the Bank remains optimistic about the future for the fishing industry, it will maintain a guarded position toward the seafood processing sectors and toward the timber industry.

May 17, 1985

Board of Directors
Alaska Commercial Fishing and Agriculture Bank
Anchorage, Alaska

We have examined the balance sheet of Alaska Commercial Fishing and Agriculture Bank as of December 31, 1984, and the related statements of operations, changes in capital and allocated, unallocated undistributed patronage earnings (loss), and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of Alaska Commercial Fishing and Agriculture Bank for the year ended December 31, 1983, were examined by other auditors whose report dated January 24, 1984, expressed an unqualified opinion on those statements prior to the restatement as described in Note I.

In our opinion, the 1984 financial statements referred to above present fairly the financial position of Alaska Commercial Fishing and Agriculture Bank as of December 31, 1984, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year after giving retroactive effect to the change, with which we concur, in the method of reporting Class B preferred stock as described in Note I, to the financial statements.

We also reviewed the reclassifications described in Note I, that were applied to restate the 1983 financial statements. In our opinion, such reclassifications are appropriate and have been properly applied to the 1983 financial statements.

Touche Ross & Co.,
Certified Public Accountants

Balance Sheet

	Year Ended December 31,	
	1984	1983
Assets		
Cash	\$ 123,331	\$ 692,276
Operating reserve, at cost, which approximates market value	8,827,865	8,000,000
Investment in Spokane Bank for Cooperatives	4,738,734	3,708,643
Loans, net of allowance for loan losses of \$5,317,621 and \$4,139,536	89,489,042	99,467,476
Accrued interest receivable:		
Operating reserve	112,306	73,646
Loans	3,092,629	5,765,715
Organization costs, net of amortization of \$141,982 and \$127,785		14,197
Bank premises, furniture and equipment, net	648,231	707,761
Acquired assets held for resale	2,361,305	212,492
Other assets	502,048	226,404
	<u>\$109,895,491</u>	<u>\$118,868,610</u>
Liabilities		
Accounts payable and accrued expenses	\$ 165,163	\$ 167,433
Accrued interest payable	2,369,853	2,125,084
Notes payable	80,574,285	79,406,368
Spokane Bank for Cooperatives participation payable	206,853	335,931
Patronage dividend payable		42,260
	<u>83,316,154</u>	<u>82,077,076</u>
Commitments and Contingent Liabilities (Note K)		
Capital And Patronage Earnings		
Share capital —		
Class C special preferred stock, \$10,000 par value, authorized 1,000 shares, outstanding 3,180 shares	31,800,000	31,800,000
Class B preferred stock, \$100 par value, authorized 100,000 shares, outstanding 95,177 shares and 103,832 shares	9,517,700	10,383,200
Loans receivable on Class B preferred stock	(9,517,700)	(10,383,200)
Class A membership stock, \$10 par value, authorized 10,000 shares, outstanding 888 and 828 shares	8,880	8,280
C Stock Retirement Pool:		
Class B preferred stock assessments	89,507	86
Less: assessments receivable	(79,247)	(86)
Capital in excess of par value	79,110	73,710
Contributed capital	<u>144,626</u>	<u>144,626</u>
	32,042,876	32,026,616
Allocated undistributed patronage earnings	4,514,237	4,764,918
Unallocated undistributed patronage loss	(9,977,776)	
	<u>26,579,337</u>	<u>36,791,534</u>
	<u>\$109,895,491</u>	<u>\$118,868,610</u>

See notes to financial statements

Statements of Operations

	<u>Year Ended December 31,</u>	
	<u>1984</u>	<u>1983</u>
Interest Income:		
Interest on loans	\$ 11,992,708	\$ 13,914,312
Interest on operating reserve	918,081	751,779
	<u>12,910,789</u>	<u>14,666,091</u>
Interest expense	<u>8,386,607</u>	<u>7,234,370</u>
	4,524,182	7,431,721
Provision for loan losses	11,241,619	3,890,135
	<u>(6,717,437)</u>	<u>3,541,586</u>
Other Expenses:		
Salaries and benefits	1,785,281	1,707,350
Occupancy expense	260,544	266,825
Office operations	201,133	160,555
Advertising and promotion	197,182	181,911
Travel, lodging and meals	192,661	186,241
Depreciation and amortization	180,127	170,132
Professional fees	148,654	302,822
Telephone and postage	114,774	114,493
Loss on assets held for resale	72,356	
Directors' fees	71,113	88,091
Miscellaneous	30,514	53,693
	<u>3,260,339</u>	<u>3,232,113</u>
Allocated undistributed patronage earnings		
(unallocated undistributed patronage loss)	<u>\$ (9,977,776)</u>	<u>\$ 309,473</u>

See notes to financial statements

Statements of Changes in Capital and Allocated, Unallocated Undistributed Patronage Earnings (Loss)

	Share Capital	Class B Preferred Stock Assessment	Capital In Excess Of Par Value	Contributed Capital	Allocated Undistributed Patronage Earnings	Unallocated Undistributed Patronage Loss	Total
Balance, January 1, 1983	\$31,805,640	\$ -	\$ 49,950	\$ 144,626	\$ 4,570,546	\$ -	\$ 36,570,762
Issuance of stock during the year:							
Class B stock, 27,349 shares, net	2,734,900						2,734,900
Class A stock, 264 shares	2,640		23,760				26,400
Loans receivable on Class B preferred stock issued	(2,734,900)						(2,734,900)
Class B preferred stock assessments		86					86
Less: Assessments receivable		(86)					(86)
Dividends payable					(42,260)		(42,260)
Loan principal charged against allocated undistributed patronage					(72,841)		(72,841)
Unallocated undistributed patronage earnings					309,473		309,473
Balance, December 31, 1983	31,808,280		73,710	144,626	4,764,918		36,791,534
Issuance (redemption) of stock during the year:							
Class B stock, 8,655 shares, net	(865,500)						(865,500)
Class A stock, 60 shares	600		5,400				6,000
Reduction in loans receivable on Class B preferred stock redemption	865,500						865,500
Class B preferred stock assessments		89,507					89,507
Less: Assessments receivable		(79,247)					(79,247)
Loan principal charged against allocated undistributed patronage					(250,681)		(250,681)
Unallocated undistributed patronage loss						(9,977,776)	(9,977,776)
Balance, December 31, 1984	<u>\$31,808,880</u>	<u>\$10,260</u>	<u>\$79,110</u>	<u>\$144,626</u>	<u>\$4,514,237</u>	<u>\$(9,977,776)</u>	<u>\$26,579,337</u>

See notes to financial statements

Statements of Changes in Financial Position

Year Ended December 31,

1984

1983

Source of Funds:

From Operations —		
Allocated undistributed patronage earnings		
(unallocated undistributed patronage loss)	\$ (9,977,776)	\$ 309,473
Items not requiring the use of funds:		
Depreciation and amortization	180,127	170,132
Provision for loan loss	11,241,619	3,890,135
Gain on sale of assets		(8,976)
Funds provided from operations	1,443,970	4,360,764
Net proceeds from sale of assets		256,248
Net proceeds from stock issuance	6,000	2,761,300
Decrease In —		
Cash	568,945	
Loans, net	8,800,349	
Accrued interest receivable	2,634,426	
Increase In —		
Accrued interest payable	244,769	319,806
Notes payable	1,167,917	28,725,892
Class B preferred stock assessments, net	10,260	
	<u>\$ 14,876,636</u>	<u>\$ 36,424,010</u>

Use of Funds:

Loans charged off, net of recoveries	\$ 10,063,534	\$ 1,750,599
Loan principal charged against		
allocated undistributed patronage earnings	250,681	72,841
Patronage dividends paid payable		42,200
Increase In —		
Cash		241,860
Operating reserve	827,865	
Investment in Spokane Bank for Cooperatives	1,030,091	1,328,193
Loans		30,033,366
Accrued interest receivable		1,774,137
Bank premises, furniture and equipment	106,400	236,940
Acquired assets held for resale	2,148,813	
Other assets	275,644	150,501
Decrease In —		
Accounts payable and accrued expenses	2,270	184,193
Spokane Bank for Cooperatives participation payable	129,678	90,509
Patronage dividend payable	42,200	509,611
	<u>\$ 14,876,636</u>	<u>\$ 36,424,010</u>

See notes to financial statements

Note A — Summary of Significant Accounting Policies:

Operations: The Alaska Commercial Fishing and Agriculture Bank (CFAB) was incorporated on May 4, 1979 to promote the sustained growth of Alaska agriculture and fishing through the provision of debt financing and financial services to resident-owned businesses engaged in harvesting, processing or marketing, and to promote its own growth as a strong user-oriented institution through cooperative ownership and self-governance.

CFAB is a cooperative corporation and intends to refund any allocated undistributed patronage earnings at such time as the Board of Directors finds that the financial condition of CFAB will so permit.

Operating Reserves and Income: Board designated operating reserve investments in short-term instruments are stated at cost, which approximates market.

Interest on Loans: The accrual of income on loans is discontinued when interest or principal is contractually past due more than 90 days (See Note L).

Patronage Dividends: Patronage dividends received from Spokane Bank for Cooperatives (SBC), of which CFAB is a member, are shown as a reduction of interest expense to SBC in the year in which those dividends are declared by SBC.

Allowance for Loan Losses: Additions to the allowance for loan losses are provided from charges to income based on management's evaluation of the loan portfolio under existing economic conditions.

Acquired Assets Held for Resale: Acquired assets held for resale are valued at the lower of fair market value or the recorded investment in the related loan. Holding costs are expensed when incurred unless such costs increase the fair market value of the asset.

Bank Premises, Furniture and Equipment: Bank premises, furniture and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are charged to operations by use of the straight-line method over estimated useful lives of three to ten years. Expenditures for maintenance and repairs are charged to operating expense as incurred. Expenditures for renewals or improvements which extend the life of an asset are capitalized at cost and depreciated as stated above. Upon sale, retirement or other dispositions of property, the cost and accumulated depreciation are removed from the respective accounts and the resulting gain or loss is recorded in income.

Organization Costs: Certain costs related to the feasibility, capital needs and incorporation phases of CFAB had been

deferred and were being amortized over 60 months. At December 31, 1984 all costs had been amortized. Such costs consisted of legal and advisory fees.

Income Taxes: Amounts provided for income tax expense are based on earnings reported for financial statement purposes, rather than on the taxable income shown on the corporate income tax return. These amounts may differ because certain items are recorded as income or expense in different years for financial statement and tax return purposes.

CFAB uses the flow-through method of accounting for investment tax credits, which results in a reduction of income taxes in the year credits are utilized.

Reclassifications: Certain reclassifications have been made to the 1983 financial statements to conform with the classifications used in 1984.

Note B — Income Taxes:

Income tax expense consists of the following for the year ended December 31, 1985:

Income tax expense calculated	
at statutory rates	\$122,108
Tax effect of:	
Distribution of allocated	
patronage earnings	(100,308)
Investment tax credit	(21,800)
	<u>\$ -</u>

There was no income tax benefit from the unallocated undistributed patronage loss for the year ended December 31, 1984.

Note C — Related Party Transactions:

In the ordinary course of business, CFAB makes loans to members who serve on CFAB's Board of Directors. Loans to members who serve on the Board of Directors must be approved by the SBC. Total loans to these members at December 31, 1984 and 1983 were \$3,182,794 and \$6,234,394, respectively.

Note D — Loans:

The following represents a classification of CFAB's loan portfolio by major category:

	December 31,	
	1984	1983
Vessels	\$46,450,679	\$50,520,974
Fish processors	29,506,571	30,248,447
Agriculture and timber	19,110,057	24,421,884
Gear, entry permits, and other	9,257,056	8,798,907
	<u>104,324,363</u>	<u>113,990,212</u>
Less: Loans receivable on Class B preferred stock	(9,517,700)	(10,383,200)
	94,806,663	103,607,012
Less: Allowance for loan losses	(5,317,621)	(4,139,536)
	<u>\$89,489,042</u>	<u>\$99,467,476</u>

As this is only the fifth year of lending activity for CFAB, loan loss experience has been limited and no similar lending institution exists on which to base an allowance for expected loan losses. Management has established the allowance for loan losses based on a specific provision for loans identified as a potential loss. Additionally, management has included an allowance of 1.5% for loans not specifically identified as a potential loss. A summary of the activity in the allowance for loan losses is as follows:

	December 31,	
	1984	1983
Balance at beginning of year	\$4,139,536	\$2,000,000
Charge to expense	11,241,619	3,890,135
Recoveries on loans previously charged off	470,093	107,539
	15,851,248	5,997,674
Loans charged off	(10,533,627)	(1,858,138)
Balance at end of year	<u>\$ 5,317,621</u>	<u>\$ 4,139,536</u>

The following represents a classification of CFAB's nonaccrual loans by major category:

	December 31,	
	1984	1983
Fish processors	\$15,069,775	\$2,913,520
Timber	8,934,494	
Vessels and other fishing related activity	7,975,177	3,440,990
	<u>\$31,979,446</u>	<u>\$ 6,354,510</u>

If interest on these loans had been accrued, such income would have approximated \$4,380,000 for 1984.

Nonperforming loans, but not in the opinion of management considered to be nonaccrual loans, totaled \$1,487,920.

CFAB serves the financial needs of the commercial fishing and agricultural industries in the State of Alaska. These industries are subject to seasonal and cyclical fluctuations which could effect the borrowers' ability to repay loans on a timely basis.

Note E — Bank Premises, Furniture, and Equipment:

The following represents a classification of bank premises, furniture and equipment by major category:

	December 31,	
	1984	1983
Furniture, fixtures and equipment	\$ 976,203	\$ 916,083
Leasehold improvements	147,202	125,130
	1,123,405	1,041,213
Less: Accumulated depreciation and amortization	(475,174)	(333,452)
	<u>\$648,231</u>	<u>\$707,761</u>

Note F — Lease Obligations:

CFAB has entered into certain long-term operating lease agreements for buildings and equipment. Rental expense under these leases totaled \$234,076 and \$252,144 for the years ended December 31, 1984 and 1983, respectively. Minimum annual lease payments are as follows:

Year ending December 31,	Amount
1985	\$90,000
1986	35,000
1987	30,000
1988	12,000

Note G — Notes Payable:

Notes payable consisted of the following:

	<u>December 31,</u>	
	1984	1983
Borrowings against lines of credit with Spokane Bank for Cooperatives (SBC); current agreement provides for quarterly interest payments based upon floating rates: Seasonal loan - credit line of \$60,000,000 expiring on March 1, 1985, bearing interest at 11.75% at December 31, 1984	\$ 15,535,000	\$ 49,300,000
SBC matched funds short-term notes with interest rates ranging from 9% to 9.55% maturing at various dates in 1985	35,000,000	
SBC matched funds long-term notes:		
Interest at 10.655%, due July 22, 1985	5,000,000	5,000,000
Interest at 10.544%, due January 20, 1987	5,000,000	5,000,000
Interest at 11.193%, due June 1, 1987	5,000,000	5,000,000
Interest at 10.768%, due September 1, 1987	5,000,000	5,000,000
Interest at 11.28%, due January 20, 1993	5,000,000	5,000,000
Interest at 11.232%, due October 21, 1991	5,000,000	5,000,000
Other notes payable and capitalized equipment leases with various interest rates and maturity dates	39,285	106,368
	<u>\$80,574,285</u>	<u>\$79,406,368</u>

Principal payments required on notes payable are as follows:

<u>Year ending December 31,</u>	<u>Amount</u>
1985	\$55,574,825
1986	
1987	15,000,000
1988	
1989 and beyond	10,000,000

CFAB entered into SBC's matched funding loan program in November, 1982 whereby CFAB may borrow both short-term and long-term funds under its established line of credit at fixed rates of interest, generally providing CFAB with a lower cost of funds.

CFAB must invest in SBC's Class C stock in an amount equal to at least 5% of the cumulative average loan balance maintained with SBC. The amount of CFAB's investment in SBC's Class C stock and equity in allocated surplus was \$4,738,734 and \$3,708,643 at December 31, 1984 and 1983, respectively. The maximum amount due SBC during 1984 was \$94,955,000. These loans are secured by substantially all CFAB assets.

CFAB maintains an unsecured line of credit with a local bank of \$2,000,000. At December 31, 1984 there were no draws outstanding.

Note H — Share Capital:

Shares purchased by the State of Alaska must be repurchased within twenty years by CFAB.

Preferential shareholders rights on dissolution are attached in the order of Class C, Class B and Class A.

Upon issue, the following rights will attach to the three categories of stock:

Class C — No voting or dividend rights. May only be issued to the State of Alaska.

Class B — No voting rights. Class B stock may only be held by members of CFAB, and dividends paid shall not exceed \$10 per share annually. Borrowers must purchase and maintain Class B stock in an amount equal to 10% of their loan proceeds. This amount is added to the loan proceeds in determining the loan balance.

Class A — No dividend rights. Each member of CFAB must own one share of Class A stock. Each share of stock carries one vote. To vote, a member must be engaged in commercial fishing or agriculture and must be a current borrower or have borrowed from CFAB during the preceding two years or have retained patronage earnings with CFAB of at least \$2,500.

Note I — Pension Plans:

CFAB has two pension plans. Benefits for employees were provided through contributions of \$56,881 and \$50,810 in 1984 and 1983, respectively, for the defined contribution plan.

CFAB also has a noncontributory defined benefit plan. Total pension costs for 1984 and 1983 were \$25,855 and \$23,095, respectively. A comparison of accumulated benefits based upon a weighted average rate of return of 8% and plan net assets adjusted for balance sheet accruals as of December 31, 1983 is presented below:

Actuarial present value of accumulated plan benefits:	
Vested	\$ 1,617
Nonvested	
	<u>\$ 1,617</u>
Net assets available for benefits	<u>\$12,000</u>

Information with respect to the actuarial computed value of vested benefits and pension fund assets as of December 31, 1984 is not available.

Note J — Class C Stock Repurchase Plan:

In accordance with AS 44.81.010(b), on or before July 18, 2000, CFAB is required to repurchase its Class C stock issued to the State of Alaska. On November 10, 1982 a contract was signed with the State of Alaska outlining the principles of a plan which calls for the repurchase of outstanding Class C stock with CFAB capital funds to be provided by CFAB's member-borrowers over a period of future operations. On December 12, 1983, CFAB implemented its Class C Stock Redemption Program.

Note K — Commitments and Contingent Liabilities:

In the normal course of business, CFAB makes various commitments and incurs certain contingent liabilities. The commitments include obligations to extend credit. At December 31, 1984, outstanding loan commitments aggregated \$12,173,024.

CFAB is a defendant in legal actions arising from normal business activities. Management believes that those actions are without merit or that the ultimate liability, if any, resulting from them will not materially affect CFAB's financial position.

Note L — Accounting Changes:

In 1984 CFAB adopted the policy of reporting loans receivable applicable to Class B preferred stock purchases as a reduction to Class B preferred stock equity. CFAB believes that reporting in this manner more accurately reflects the economic substance of the Class B stock purchases. There is no effect of the change to current or prior years income. The financial statements for the year ended December 31, 1983 have been restated to include the change.

Also, loans contractually past due more than 90 days will no longer be reflected as earning assets. Accrual of interest on non-performing loans in years prior to 1984 was allowed if, in management's opinion, collectibility of such income was assured. The new method of recognizing income was adopted to follow a consistent, conservative approach to accrual of interest income. The effect of the change in 1984 was to decrease interest income by approximately \$2,007,000. There is no material effect on income in the years prior to 1984.

Robert B. Atwood
President and Publisher

Elaine Atwood
Assistant Publisher

William J. Tobin
Vice President, Editor-in-Chief

Missing the benefits

THE MESSAGE is sharp and clear when Jim Campbell, chairman of the North Pacific Fishery Management Council, talks about bottom fishing in Alaska.

He says Alaskans "are doing a good job of promotion but we are falling on our face when it comes to reaping the benefits."

In the past 10 years, bottom fishing has grown from a production of 1,000 tons a year to a projected two million tons in 1987. That reflects the action of the council last December in making the water from three miles to 200 miles offshore an exclusive fishing area for American fishermen.

The growth has been phenomenal, with investments surging as world markets showed a need for more and more bottom fish. American fishermen were skeptical about the new fishery in the beginning, but they have gone all out for it recently.

Under the council's new rules, the Americans will catch 94 per cent of all the fish in that exclusive zone.

THE DISMAYING part of the development is the fact that 53 percent of the individuals in the fish business receive no dividend checks from the state. They are non-residents who come north for the quick buck and head back home as soon as they get it.

Campbell said estimates show that 1986 gross ex-vessel revenue from bottom fishing in 1986 was \$300 million. Of this, only \$40 million went to Alaska fishermen.

It is equally disturbing that the shoreside processors, mostly in Kodiak, Akutan and Dutch Harbor, took

only 3 percent of the total value of landings of groundfish off Alaska. This estimate was exclusive of \$62 million in halibut landings, the majority of which was landed in Alaska.

These figures show anew the fact that Alaska's biggest industry in point of employment is one of the worst offenders in its failure to hire Alaskans and in its patronizing of local processors.

THE REMEDY suggested by the council chairman requires cooperation:

He said the state should take a position of leadership in bringing it about. The combined efforts, concern and talents of state government and private enterprise, along with active participation by the university and the federal government, must plan it together.

The plan must resolve questions involving the factors that limit development efforts, stem from limited entry law and allocations. There is need for diversification to include provisions for pen-reared salmon, improved service support, transportation and marketing.

Probably the most surprising disclosure in Campbell's report, which he made to the Chamber of Commerce, was that Gov. Steve Cowper has told fishing interests that the state has no policy in regard to development, and will not have one for at least a year and a half.

This is a shocking disclosure. Fisheries are too important to too many Alaskans as well as the markets of the world to wait a year and a half for the state to develop a policy.

ALASKA STATE LEGISLATURE · SENATE

SENATOR RICHARD I. ELIASON

RULES COMMITTEE, CHAIRMAN
LABOR & COMMERCE COMMITTEE, VICE-CHAIRMAN
LEGISLATIVE COUNCIL
RESOURCES COMMITTEE
FISHERIES SUBCOMMITTEE, CHAIRMAN



P O BOX 143
SITKA, ALASKA 99835
P O BOX V
JUNEAU, ALASKA 99811
(907) 465-4916

M E M O R A N D U M

TO: Senator Jack Coghill, Chair
Senate Resources Committee

FROM: Senate Resources Fisheries Subcommittee

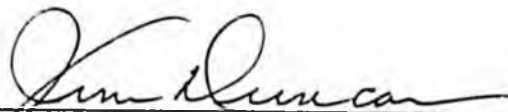
DATE: March 20, 1987

RE: S.B. 8 and S.B. 9 -- legislation relating to the
Commercial Fish and Agriculture Bank (CFAB)

The fisheries subcommittee reports back the above mentioned legislation to the Senate Resources Committee and recommends that S.B. 8 and S.B. 9 be considered by the Committee as soon as possible.



Senator Dick Eliason, Chair



Senator Jim Duncan, Member



Senator Fred Zharoff, Member

SENATE COMMITTEE REPORT

FURTHER:

FINANCE

3/16/87

DATE TURNED INTO OFFICE _____

Mr. President:

RESOURCES _____ Committee considered _____ SB 8

Commercial Fishing and Agricultural Bank.

and recommended:

replace with CS FOR SB 8 Resources) [] same title
[] or adopt _____ CS FOR _____) new title

[] attached amendment(s) and

do pass

[] do not pass

[] no recommendation

[] individual recommendations

[] further referral to _____

[] letter of intent adopted _____

Committee attached or [] adopted fiscal note(s)

[] new [] updated or [] previous

zero [] fiscal impact

MEMBERS SIGNING DO PASS

OTHER RECOMMENDATIONS

Al Glason
Cedric Stupulinski
James ...
Paul ...
Lloyd ...

[Signature]
Chairman signature and recommendation

[] Committee Backup Attached

A PERFORMANCE REVIEW
OF THE
ALASKA COMMERCIAL FISHING
AND AGRICULTURE BANK

May 22, 1981

Audit Control Number
04-101-1035-S

Board of Directors of the:
ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK

Chairperson
Vice Chairperson
Secretary/Treasurer
Member
Member
Member
Member

Roseleen Moore
Paul Huppert
Bob Waldrop
Dale Pihlman
Harvey Samuelsen
William Sutton
Frank Homan

STATE OF ALASKA

AUDIT DIVISION:
POUCH W—ALASKA OFFICE BUILDING

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

JUNEAU, ALASKA 99811

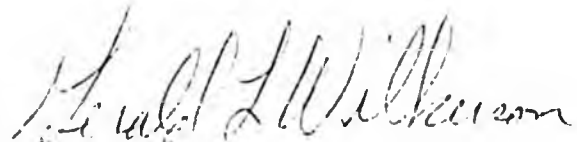
May 22, 1981

Members of the
Legislative Budget and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

A PERFORMANCE REVIEW
OF THE
ALASKA COMMERCIAL FISHING
AND AGRICULTURE BANK

May 22, 1981



Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit

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PURPOSE AND SCOPE OF THE REVIEW

The purpose of our review was to determine if the performance of the Alaska Commercial Fishing and Agriculture Bank (CFAB) is efficient, effective, and economical. Our scope included a review of the Board of Directors' proceedings, operating expenditures, and the loan portfolio. CFAB's financial statements for the year ended December 31, 1980 were audited by a certified public accounting firm.

ORGANIZATION AND FUNCTION

The Alaska Commercial Fishing and Agriculture Bank (CFAB) was created by Chapter 159, SLA 1978 (AS 44.81.010) as a public corporation and government instrumentality of the State, but with a legal existence independent of and separate from the State. Its purpose is to provide financing for the commercial fishing and agricultural industries in Alaska.

In Fiscal Year 1979, the Commissioner of the Department of Revenue purchased \$2,000,000 (200 shares) of special preferred class C stock in accordance with AS 44.81.010(c). Then in March 1980, the Department of Revenue loaned CFAB \$30,000,000 at 9 1/2% per annum. In July 1980, the loan agreements were cancelled through the issuance of an additional 3,000 shares of class C stock to the State and the payment of interest from March 1980, totalling \$480,205. The class C stock receives no voting or dividend rights. CFAB must repurchase the class C stock from the State within 20 years.

CFAB made 136 loans from April 2, 1980 through March 13, 1981. As of March 13, 1981, there were 130 outstanding loans, totalling \$24,287,687 (see Appendix A).

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

CFAB should require that inventories used as collateral be insured, naming CFAB as the loss payee.

CFAB has developed procedural manuals for the processing and accounting of loans and for collateral control. These manuals are well written and are useful management tools.

We reviewed 67 (49%) of the 136 loans made from April 1980 through March 13, 1981. The loan files, in general, were well organized and contained required information. However, we did note an area of weakness in collateral control that needs to be addressed.

Our test included eight loans for which CFAB has a secured interest in the inventories as collateral for the loan advances. Five of these loans did not have insurance on the inventories, naming CFAB as the loss payee.

CFAB could lose its security on the loan advances through spoilage, accident, fire, etc. Therefore, CFAB should require that insurance be obtained by the borrower, naming it as the loss payee, on inventories in transit and inventories not held in bonded warehouses.

Recommendation No. 2

CFAB should compensate members of the Board of Directors for travel expenses in compliance with Alaska Statutes.

CFAB reimburses members of the Board for actual travel expenses rather than a fixed per diem rate established by the Commissioner of Administration. During Fiscal Year 1980, Board members were reimbursed for \$33,807 in actual travel expenses.

AS 44.81.110 states the Board members are to receive compensation at a rate determined by the Board for each day the Board meets if they attend the meeting. In addition, they are entitled to per diem and travel allowances as provided by law for members of State boards and commissions. AS 39.20.180(2) states the members of boards and commissions are entitled, for expenses other than transportation, to a per diem allowance prescribed by the Commissioner of Administration.

Recommendation No. 3

CFAB should give public notice of its Board and membership meetings in accordance with Alaska Statutes.

CFAB has not given public notice of the dates and places of its Board and membership meetings.

A memorandum dated May 13, 1981 from the office of the Attorney General states the Open Meetings Act (AS 44.62.310 - 44.62.312) is applicable to CFAB. AS 44.62.310(e) requires reasonable public notice be given for all meetings required to be open under the Act. Since action taken at meetings held contrary to the Act may be void, it would be prudent of CFAB to comply with the public notice requirement for future meetings.

Other Information

This section of the report addresses the results of our review of CFAB expenditures from inception through April 30, 1981. We have included this information because a significant number of the expenditures may be inappropriate for an entity subsidized by public funds.

Throughout the audit CFAB management has maintained it is a private cooperative entity. They believe they are responsible only to their members, each of whom has purchased a single share of class A common stock for \$100, and class B common stock in an amount equal to ten percent of the member's loans (the amount necessary to purchase the B stock is added to the loan amount requested, deducted from loan proceeds by CFAB at closing, and capitalized.)

CFAB is primarily capitalized through a purchase of nonvoting class C stock by the State of Alaska. Paid-in capital at April 30, 1981 is shown as follows on CFAB financial statements:

Class A Common Stock	\$ 1,770
Class B Common Stock	2,534,900
Class C Common Stock	32,000,000
Capital in Excess of Par Value	<u>15,300</u>
<u>Total Paid-In Capital</u>	<u>\$34,551,970</u>

Each Alaskan has an interest in the manner in which public funds are spent. CFAB has been given a specific mission by the Legislature; that of enhancing commercial fishing and agricultural activities in Alaska. They have been provided with the authority and the wherewithal to accomplish this mission.

As an entity that receives a large State subsidy, we believe it is incumbent upon CFAB management to exercise a higher degree of prudence with their spending habits than if they were completely privately funded.

The following items represent a sampling of CFAB expenditures from inception through April 30, 1981, some of which are questionable:

A. Furniture, Fixtures, and Leasehold Improvements

The balance of CFAB's furniture and fixtures account as of December 31, 1980, CFAB's fiscal year end, totalled \$313,966. Of this amount, \$246,835 was for expenditures for the Anchorage office. The total expended for leasehold improvements as of the same date was \$65,850, which was for purchases of carpet, wallpaper, etc. The following is an example of the type of furnishings purchased for the Anchorage office.

1. President's Office

Sofa	\$ 3,631
Five swivel upholstered chairs	7,717
Teak bookcase/cabinet units with refrigerator and liquor cabinet	4,232

2. Executive Assistant's Office

Natural oak desk	\$ 2,302
Natural oak credenza	3,150

3. Senior Vice-Presidents' Offices

Two teak executive desks	\$ 2,903
Two teak coffee tables	1,812
Two teak bookcase/cabinet units	5,453

4. Executive Conference Room

Rosewood conference table	\$16,225
Conference chairs (14)	10,470
Soapstone carving of a land otter with a crab	2,000

In addition, CFAB maintains an apartment in Juneau for which \$4,218 in furnishings were purchased, such as two beds, dresser, color television, dinette set, desk, etc. Leasehold improvements were made totalling approximately \$2,254, including new carpet and wallpaper.

B. Art Work

As of December 31, 1980, the balance of the non-depreciable assets account totalled \$13,353. This represents purchases of prints and paintings for the Anchorage office. A sample of the paintings are:

Custom ordered original paintings by Charlen Jeffery

1. "Brown Bear" watercolor	\$ 3,400
2. "Musk Ox" watercolor	1,750
3. "Cows" watercolor	1,850
4. Six additional watercolors on rice paper, subject matters are fishing and agriculture	2,150
5. "Alaska Fisherman and Farmer"	800
6. "Toast of Alaskan Holiday"	800
7. "Alaskan Logger"	950

C. Automobiles

1. 1980 Chevrolet Citation for a branch office	\$ 7,918
2. 1981 Chevrolet Malibu for a branch office	8,874
3. 1980 Subaru 4x4 Station Wagon for the Anchorage office	7,842
4. 1981 Subaru 4x4 Station Wagon for the Senior Vice-President/ Administration	<u>9,350</u>
<u>Total</u>	<u>\$33,984</u>

In addition to the bank owned vehicles, CFAB pays the \$168 per month lease charge for the President's vehicle. Maintenance and repair costs for the leased and bank owned vehicles totalled \$4,543 during Fiscal Years 1980 and 1981, through April 30. Gasoline expense is paid for the leased vehicle, the bank owned vehicles, and the personal vehicle of the Senior Vice-President/Credit, including gasoline consumed for personal use. The staff employees are reimbursed for the business use of their personal vehicles at a rate of 25 cents per mile.

D. Salaries and Benefits

1. Salaries, Bonuses, and State Benefits

Salary and benefit expenditures totalled \$996,692 for Fiscal Year 1980. Included in this amount was \$108,192 for year-end bonuses. In addition, two CFAB employees received a total of \$1,565 in cash bonuses during the year and \$2,390 was paid directly to a travel agency for a bonus trip to Hong Kong for the Senior Vice-President/ Administration and his spouse.

CFAB is presently accruing \$22,000 to \$24,000 per month for bonus expense. The Fiscal Year 1981 total budgeted bonus accrual is \$282,356.

CFAB officers and employees are in the exempt service of the State personnel system. They are covered by the State insurance and retirement programs. They are also exempted from the Social Security Act, as are other State employees, and instead participate in the State Supplemental Benefit Program. Employer contributions for these benefits are paid from CFAB's operating funds. Officers receive four weeks annual leave and employees receive three weeks. In addition, both officers and employees accrue sick leave at a rate of one day per month.

2. Other Benefits, Fiscal Year 1980

Staff room costs (coffee, hot chocolate, tea, sugar, dish soap, etc.) \$2,943

Season tickets to the Alaska Repertory Theatre \$ 376

Staff Christmas party at the Anchorage Westward Hilton:

Food	\$2,353	
Liquor	2,197	
Entertainment	600	
Floral centerpieces	<u>211</u>	
		\$5,361

Turkeys for CFAB officers and employees \$ 415

Banquet for a staff meeting at the Sheraton Hotel \$ 773

The President, Senior Vice-President/ Administration, a prospective employee and their spouses had dinner at the Captain Cook Hotel in Anchorage. \$ 245

A branch manager and his spouse had two dinners with two CFAB employees at the Mecca Lounge in Kodiak. \$ 320

The total charged to the other employee benefit and the other personnel expense accounts in Fiscal Year 1980 was \$6,076 and \$13,810, respectively.

E. Office Space

The Anchorage office is approximately 7,000 square feet which includes two kitchens each equipped with oak cabinets, microwave oven, dishwasher, and refrigerator. Also, one kitchen has a built-in stove top. CFAB purchased a dinette set for \$1,108 and a natural oak conference table and upholstered chairs for \$4,360 for kitchen/staff room furnishings. In addition, the President's office includes a bathroom with a shower stall.

F. Directors' Fees

In Fiscal Year 1980, \$32,479 was paid to members of CFAB's Board of Directors. Originally in March 1979 the Board set its rate of compensation at \$100 per day during Board meetings in addition to per diem and travel expenses set forth by State law. In April 1979 the Board voted to increase the compensation rate to \$250 per day for the Chairperson and \$200 per day for the members. Again, in February 1980 the rate of compensation was increased to \$500 and \$400 per day for the Chairperson and members, respectively. In addition, CFAB has reimbursed Board members for actual expenses rather than paying a per diem rate, see Recommendation No. 2.

In May 1980 the Board voted to compensate members for work concerning CFAB, other than attendance at meetings, at a rate of \$62 per hour for the Chairperson and \$50 per hour for the members. During the period November 1979 through April 1981, a Board member has been paid \$12,438 for organization and consultation services.

G. Travel, Lodging, and Meals

During a review of Board and staff members' monthly expense reports for the period October 1979 through March 1981, we noted the following:

1. President's Foreign Travel

- a. A European tour, from October 24 through November 17, 1980, to Denmark, England, Rome, and Paris: the purpose of the trip was to tour the Danish fishing industry, visit the British banks and the White Fish Authority, examine the British dairy industry, attend the International Fisheries Conference, and the Fisheries Products Exposition. (Cost includes airfare, totalling \$1,881, for the President's spouse, as well as an undetermined amount for her meals and lodging expense.)

\$8,805

- b. An agriculture tour from January 28 through February 12, 1981, to Denmark, Norway, Sweden, and Finland: (Cost includes International Fisheries Conference fees for the President's spouse and the spouse of the Chairperson of the Board, totalling \$376.) \$6,088
- c. At the November 25, 1980 Board meeting, the President apprised the Board of his tentatively scheduled trips for 1981:
- January - Denmark
(Same as b. above)
Spring or Summer - Japan
October - Munich
2. Senior Vice President/Administration - Foreign Travel
- a. A trip to London, England in January, 1981 \$2,681
3. Dinners
- a. The following dinners were reported on the expense reports of the President and Senior Vice-President/Administration:
- 1) A dinner at the Corsair in Anchorage attended by four CFAB employees and their spouses. \$256
- 2) Three CFAB officers and their spouses had dinner at Simon & Seafort's Saloon & Grill in Anchorage. \$191
- 3) The President and Senior Vice-President/Administration and spouses had dinner with a local businessman and spouse at the Corsair in Anchorage. \$210
- 4) The President, Senior Vice-President/Administration, and a prospective employee had dinner. \$164

5)	Two legislators, CFAB's attorney, and a consultant had dinner in Juneau with the President, Senior Vice-President/Administration and a secretary.	\$213
6)	A dinner at Yancey Derringer's in Juneau with four Board members and the Senior Vice-President/Administration.	\$343
7)	Five members of the Board, the three senior executive officers, the Vice-President/Branch Management, and CFAB's attorney had dinner at Josephine's Restaurant in Anchorage.	\$281
8)	Three dinners at Josephine's Restaurant for the five members of the Board and the Senior Vice-President/Administration.	\$534 400 449
9)	The Senior Vice-President/Administration and the Chairman of the Board had dinner at the Captain Cook Hotel in Anchorage.	\$125
10)	The two Senior Vice-Presidents had dinner at Josephine's Restaurant in Anchorage.	\$157

All told, there were 48 dinners on the expense reports of the President and Senior Vice-President/Administration each costing in excess of \$100 during the period October 1979 through March 1981.

b. Cost of dinners or lunches noted on other persons monthly expense reports:

1)	Branch Manager took Branch Assistant to lunch on five occasions.	\$137
2)	The two Seattle branch office employees and six employees from offices in Alaska dined in Seattle.	\$127
3)	The two Seattle branch office employees and seven employees from the offices in Alaska dined in Seattle.	\$448
4)	Staff lunch at Clinkerdagger, Bickerstaff & Petts Public House in Anchorage.	\$172

c. Banquets held in March 1981 at the Sheraton Hotel in Anchorage. Costs include \$398 for liquor.	\$1,331
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4. Miscellaneous Expenditures

a. Alaska Airlines Board Room, United Airlines Red Carpet and University Club (San Francisco) membership dues on the expense reports of the President or Senior Vice-President/Administration.	\$400
b. Tuxedo rental.	\$40
c. Liquor and mixes for the bar in the President's office.	\$243
d. Glassware and cutlery purchased at Design Craft Ltd. in Anchorage.	\$158
e. Towels and accessories for the executive bathroom purchased at Nordstrom in Anchorage.	\$100
f. Two gift certificates for dinner at Josephine's Restaurant in Anchorage.	\$200
g. Gift certificate at Stephan Fine Arts gallery.	\$100

H. Promotional Costs

1. Anchorage Pre-opening Party at the Sheraton Hotel

64 dinners	\$1,325	
19 bottles Chenin Blanc	186	
18 bottles Pinot Noir	124	
Hosted bar - 283 drink tickets	814	
Flowers	180	
		\$2,629

Meals and lodging for: three members of the Board, two CFAB employees, three business associates, and five spouses.	1,153
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Total Anchorage Costs	3,782
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2. Pre-opening Parties at Branch Offices

a. Kodiak:

Party room rental and permit	\$ 160
Food	450
Bar	621
Gratuity	<u>130</u>
Total food and bar costs	1,361
Air charter for CFAB employees	<u>2,711</u>

Total Kodiak Costs 4,072

b. Cordova:

Elks Club 7,610

c. Homer:

Finger food for 200 persons	\$ 900
Bar	934
Tax	<u>18</u>

Total Homer Costs 1,852

d. Air charter for CFAB employees to Cordova and Homer pre-opening parties.

2,541

e. Seattle (costs are based on an estimate prepared by the Branch Manager):

Invitations	\$ 89
Seafood:	
Crab legs	160
Prawns	90
Caterer	1,100
Liquor and mix	<u>600</u>

Total estimated Seattle Costs 2,039

Total Cost of Pre-opening Parties \$21,896

3.	Legislative Cocktail Party at the Baranof Hotel in Juneau (100 guests)		
	Food	\$1,770	
	Liquor	<u>982</u>	
			\$2,752
4.	Sixty-six Eddie Bauer Gortex mountain parkas with CFAB logo purchased for employees and members of the Board.		\$5,064
5.	Gift packs of Blake's Fancy Smoked Salmon for customers.		\$555
6.	5,750 Dot's Tide Table books printed with CFAB logo for customers.		\$4,573
7.	Cookbooks.		\$1,984
8.	1,000 1980 Annual Reports (ccst includes color setups, slides, printing, design work, etc.)		\$27,466

APPENDIXES

APPENDIX A

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK
SUMMARY SCHEDULE OF LOANS

For the period 04/02/80 - 03/13/81

<u>Purpose of Loan</u>	<u>Total Number of Loans Made</u>	<u>Total Original Amounts</u> (See Notes 1 & 2)	<u>Total Outstanding Balance as of 3/13/81</u> (See Note 3)
Entry Permit Purchase	4	\$ 184,800	\$ 176,600
Entry Permit Refinance	7	217,200	217,200
Used Vessel Purchase	34	3,587,155	3,492,258
New Vessel Purchase	20	3,918,596	1,968,703
Vessel Refinance	35	8,708,721	8,427,605
Vessel Repair	2	40,900	40,900
Gear Purchase	8	443,300	408,339
New or Used Vessel Equipment Purchase	8	327,820	311,615
Miscellaneous Debt Refinance	6	409,877	409,859
Fisherman Working Capital	2	10,750	10,750
Fish Processor Working Capital	<u>10</u>	<u>37,757,000</u>	<u>8,823,857</u>
Totals	<u>136</u>	<u>\$55,606,119</u>	<u>\$24,287,686</u>

See Accompanying Notes to the Summary Schedule of Loans

APPENDIX B

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK
NOTES TO THE SUMMARY SCHEDULE OF LOANS
For the period 04/02/80 - 03/13/81

Note 1

Borrowers are required to purchase CFAB class B stock in an amount equal to 10% of the loan proceeds. The original loan amount listed includes the amount loaned for the purchase of the class B stock.

Note 2

Certain portions of the Fish Processor Working Capital loans are guaranteed by the State of Alaska under the authority of SLA 1980, Chapter 32.

Note 3

On May 14, 1980, CFAB signed a loan agreement with the Spokane Bank for Cooperatives (SBC) which established a line of credit to finance CFAB's current lending activity. As amended on June 18, 1980, CFAB may borrow up to \$30,000,000. The agreement is for a one-year term from June 1, 1980, bearing interest at a floating rate prescribed by SBC. Interest is payable the last day of each quarter. The loan is secured by all CFAB notes evidencing loans to members. The loan agreement is to be renegotiated annually. The outstanding loan balance at March 13, 1981 totalled \$1,000,000.

Further, CFAB is required, in accordance with the Farm Credit Act to purchase SBC class C stock in an amount equal to 15% or a lesser amount prescribed by SBC of the quarterly interest payable. The amount of CFAB's investment in SBC class C stock at March 13, 1981 totalled \$47,784.

APPENDIX C

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK
 SCHEDULE OF LOANS BY BRANCH OFFICE (See Note 1)
 for the Period 04/02/80 - 03/13/81
 (UNAUDITED)

Purpose of Loan	Anchorage			Cordova			Kodiak			Homer		
	Number of Loans Made	Original Loan Amount	Outstanding Balance as of 03/13/81	Number of Loans Made	Original Loan Amount	Outstanding Balance as of 03/13/81	Number of Loans Made	Original Loan Amount	Outstanding Balance as of 03/13/81	Number of Loans Made	Original Loan Amount	Outstanding Balance as of 03/13/81
Entry Permit Purchase	-0-	\$ -0-	\$ -0-	-0-	\$ -0-	\$ -0-	1	\$ 39,600	\$ 39,600	3	\$ 145,200	\$ 137,000
Entry Permit Refinance	2	49,500	49,500	3	74,200	74,200	-0-	-0-	-0-	2	93,500	93,500
Used Vessel Purchase	13	1,974,795	1,890,982	9	461,530	450,446	6	397,330	397,330	6	753,500	753,500
New Vessel Purchase	10	1,756,488	1,279,453	5	399,600	231,844	3	1,592,008	286,905	2	170,500	170,500
Vessel Refinance	15	5,686,750	5,516,936	7	346,510	310,426	4	1,519,450	1,444,306	9	1,156,011	1,155,937
Vessel Repair	1	5,000	5,000	-0-	-0-	-0-	-0-	-0-	-0-	1	35,900	35,900
Gear Purchase	4	277,200	260,506	1	33,000	33,000	-0-	-0-	-0-	3	133,100	114,833
New or Used Vessel Equipment Purchase	2	65,070	64,485	3	89,450	73,368	1	24,200	24,200	2	149,100	149,562
Miscellaneous Debt Refinance	2	165,000	165,000	2	192,227	192,209	-0-	-0-	-0-	2	52,650	52,650
Fisherman Working Capital	1	7,950	7,950	1	2,300	2,800	-0-	-0-	-0-	-0-	-0-	-0-
Fish Processor Working Capital	10	37,757,000	8,823,857	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Totals	60	\$47,744,753	\$18,063,669	31	\$1,599,317	\$1,368,293	15	\$3,572,588	\$2,192,342	30	\$2,689,461	\$2,663,382

See Accompanying Notes to the Schedule of Loans by Branch Office.

APPENDIX D

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK
NOTES TO THE SCHEDULE OF LOANS BY BRANCH OFFICE
For the period 04/02/80 - 03/13/81

Note 1

CFAB has two additional branch offices; one in Seattle and another located in Ketchikan. The Seattle office does not process loans. The Ketchikan office opened in November 1980 and as of March 13, 1981 had not made any loans.



2550 Denali Street, Suite 1201
P.O. Box 4-2070
Anchorage, Alaska 99509
(907) 276-2007

SRA 90-B
Homer, Alaska 99603
(907) 235-8234

Roseleen "Snooks" Moore
RECEIVED
August 31 1981
**LEGISLATIVE
AUDIT**

August 27, 1981

Mr. Paul V. Harris, CPA
Anchorage Office Manager
State of Alaska
Division of Legislative Audit
P.O. Box 1231
Anchorage, Alaska 99510

Dear Mr. Harris:

The report entitled, A Performance Review of the Commercial Fishing and Agriculture Bank dated May 22, 1981, to which you have requested our reply, is essentially the same as that submitted to us by the auditors themselves. We are, therefore, submitting our reply to that original submission. It remains applicable with the following modifications.

1. The reference to open board meetings is new to this report, and
2. The auditors have removed references to actions taken by the board of directors.

Since the completion of the audit, legislation has been passed clarifying CFAB's status and its relationship to the State. That legislation causes the majority of points covered in the audit, and indeed, the focus of the audit itself, to be currently moot.

The Board of Directors and the Management of CFAB look forward to working with the Committee in the future.

Sincerely,

Roseleen "Snooks" Moore

sd



2550 Denali Street, Suite 1201
P.O. Box 4-2070
Anchorage, Alaska 99509
(907) 276-2007

June 12, 1981

Mr. Paul V. Harris, CPA
Anchorage Office Manager
State of Alaska
Division of Legislative Audit
P. O. Box 1231
Anchorage, Alaska 99510

Dear Mr. Harris:

It is apparent from your letter that the audit has failed to grasp the mandate given to CFAB by the Legislature. It has also been unable to properly evaluate the complexities and intricacies of operation demanded of a private company operating in the private market. These standards are imposed upon CFAB in order to fulfill the mission spelled out in the enabling legislation.

The fundamental concept of the Alaska Commercial Fishing and Agriculture Bank (CFAB) is that it is a private, cooperatively owned and managed financial institution. This design was mandated by the Legislature for the purpose of linking with the national cooperative banking system to bring outside capital to Alaskan fishermen and farmers. The designers of CFAB recognized that it must be a private corporation in order to qualify for participation in the national system. The Banks for Cooperatives are prohibited by law from affiliating with or lending money to a government organization. If CFAB had not been organized to operate as a private organization, it would not have been able to lend, in 16 short months of operation, over \$30,000,000 to its over 225 member stockholders who are Alaska fishermen and farmers, and over \$50,000,000 to its member stockholders who are processors, as required by the Legislature. Nor could we have provided employment opportunities to Alaskan workers who crew the vessels, till the land, or process Alaska's fish and farm products.

Even in CFAB's short history, it has fulfilled the intent of bringing in outside capital to finance our fishermen, farmers and processors. Today, the commitment of the Banks for Cooperatives far exceeds that of the original State commitment. Additionally, we have increased the net worth of the Cooperative by more than \$4 million during that same short period. We have in excess of \$40 million in pending loan applications and fully expect to exceed \$300 million in loans to fishermen, farmers and processors by the year 1985.

Alaska Commercial Fishing and Agriculture Bank

In testimony before the State Legislature on several occasions, the Spokane Bank for Cooperatives has testified that they have an excellent relationship with CFAB and hold its management and operations in high regard. They have remarked that the progress made by the Cooperative during its brief period of operation has exceeded their expectations for us at the end of five years. In that testimony, they plainly stated that they would not be able to lend to CFAB if we were not a private cooperative. If CFAB were not a private cooperative, it would cease to be part of the national cooperative banking system and hundreds of millions of dollars would be lost to Alaskan fishermen and farmers. In their place, the Legislature would have to fund the operations of CFAB in the annual budget document and allocate those millions for the same loans, thus reducing the funds available to the people of the state for other purposes and costing them millions of dollars in subsidies.

Our basic instructions from the Governor, the Legislature, and the consultants at the time of CFAB's creation were to form a private, cooperative financial institution. If that is not the case, as you suggest by your comments and the standards apparently used in formulating your audit, then the intent of the legislation cannot be carried out, outside funds cannot be brought in to benefit farmers and fishermen through CFAB, and the Legislature will be forced to appropriate necessary funds from the General Fund. This will, of course, place the State directly back into the loan business against the wishes of the Legislature and the financial community.

The Legislature also intended that CFAB be audited and required in the original legislation that the board of directors have an annual audit performed by outside, independent auditors, and that the audit report be made available to the Governor, members of the Legislature, and the general public. CFAB has employed the national firm of Price Waterhouse & Co. for that purpose. They have completed audits for the years 1979 and 1980. A copy of the 1980 report is attached. This audit clearly shows CFAB to be following proper practices and procedures.

In determining performance, one must look at achievements toward a stated goal. In its brief history, CFAB's achievements are many. Among them are:

1. Establishment of a well organized, systematically run business which is managed according to generally accepted management practices, including:
 - a. Stated mission, goals, objectives, and action plans;
 - b. Complete and accurate accounting systems;
 - c. Detailed, written policies and procedures covering the whole of our operation;
 - d. Complete budgeting and financial reporting system;
 - e. Employee policies, pay scales, job descriptions, and evaluation systems;

- f. Printed documentation for loans bearing the approval of both general and specialized legal counsels of the Cooperative.
2. Active involvement of the members of the Board of Directors in the policy development and control of the organization, plus a high level of attendance by those members at meetings.
3. Development of a full and professional cadre of accounting, legal, insurance, tax, and management advisors of national stature.
4. Completion of a procedural audit by a national firm of CPAs using both their auditors and management advisory groups to insure the continuity of our procedural and control systems. This form of audit is scheduled to be performed on an annual basis.
5. Development of 32 specialists in various aspects of fisheries finance. These add to an extremely limited, if not almost non-existent, field of expertise.
6. Opening five branch offices, offering the full services of the Cooperative, in key areas throughout the state. Branches are now located in Kodiak, Homer, Cordova, Ketchikan, and Seattle.
7. Maintenance of an active calling program to areas outside of the loactions of our established offices.
8. Attracting and financing nearly 250 member shareholders from geographically dispersed areas within the state.
9. Development of a full range of loan programs to serve the fishing and agriculture industries, adding appreciably to those previously available.
10. Development of credit lines necessary to meet CFAB's financial needs and its commitments to members.
11. Achievement of more rapid turnaround of loan applications.
12. Achievement of profits in each of its accounting periods despite expensing all opening and operating costs. Profits for the first quarter of this fiscal year are \$800,000.
13. Return of patronage dividends equal to $9\frac{1}{2}$ percent of the interest paid by members during 1980.
14. The first installment in the return of the State's initial capital investment was made.

15. Support of agriculture and fisheries development through:
 - a. support of 4-H and FFA;
 - b. creation of the Young Alaska Farmers Financing Cooperative to provide financing for youth agricultural projects;
 - c. development of financial planning manuals for use by fishermen and farmers;
 - d. support and initiation of research projects;
 - e. participation in policy development.

16. Enhancing other financial agencies' abilities and opportunities to finance both fisheries and agriculture. CFAB is currently financing the customers of the Agriculture Revolving Loan fund during a period in which it is out of funds, enabling farmers to plant crops and advance projects in the critical summer months.

We have also provided the necessary additional funds and controls of credit to allow other Alaska banks to safely become involved with or continue their involvement with Alaska processors.

17. Adding a point of financial professionalism to the Alaska fishing and agriculture industries to which foreign and "Lower 48" financial institutions can relate and on which they can rely.

In the formulation of your letter, you have failed to relate to specific key points about CFAB's operation. It is owned and operated by private shareholders who bear the full risk of its operation and whose investments are subordinated to those of the State. It is these shareholders who, by law, have the management and control of the Cooperative. Moneys expended by the Cooperative in the achievement of its business purposes are not those of the State. Unlike a State or other public body, CFAB's expenditures do not represent an irrevocable loss of those funds to the people of the state. Expenses are paid by the income of the Cooperative derived from its operations which, by definition and federal tax law, are the property of the member stockholders. CFAB is governed not only by the specific statute creating it, but also the cooperative laws of the state and the federal tax law specifically dealing with lending cooperatives. CFAB pays full federal taxes, unlike a State agency or department.

We appreciate that performance of an audit of CFAB has posed a difficult problem for you. While somewhat unique to Alaska, organizations such as CFAB are widespread in the lower states. They are certainly the business of the Bank for Cooperatives and are among the clients of our CPA firm, Price Waterhouse & Co. In fact, Price Waterhouse is considered to be among the

best in the practice of cooperative accounting, management and tax practice. It lists among its clients some of larger cooperatives in the United States. Using their experience, and with a number of comparisons to draw from, they have audited CFAB and found everything to be in order and within the context of proper operation.

Being a CPA yourself, you are well aware of the Generally Accepted Auditing Standards imposed upon members of your profession. Among these are the matters of relevance, materiality, and context. It appears that items reported in your letter have been taken out of context and included without review and full understanding of the circumstances surrounding them. There is no stated standard of comparison used in the determination of significance.

Development of your report on the basis of inadequate understanding of CFAB, its purposes, and the requirements of operation imposed upon it causes the Board of Directors of CFAB tremendous concern. Presented in the fashion of your letter, without standards of acceptable comparison, provides the public reader no basis upon which to draw judgment. This may unjustly tarnish the reputation of Management and of the members of the Board, as well as diminish the willingness of some borrowers to do business with the Cooperative. In turn, the private stockholders of CFAB will be injured.

We will comment on each of the items raised in your letter.

Recommendation No. 1 is a good point and one previously raised by our CPA's in the course of completing their procedural audit. That point has been corrected both by requirement of borrower-provided insurance and by CFAB obtaining a blanket policy.

Recommendation No. 2 regards the compensation of Board members for per diem expenses. There is an alternate to fixed per diem provided for in the regulations pursuant to which CFAB has established its policies for board reimbursement. We have asked our attorneys to review that section in the case we have misinterpreted the details of application. If we find that we have, we will, naturally, correct procedures in the future.

In the evaluation of expenses, one must relate them to the mission, goals, objectives, and the business framework in which CFAB operates. While CFAB has initial investment funds from the State, it receives no other support and must repay the State within a specified period of time. Viewed as a benefit on the one side, it is a large financial obligation on the other. CFAB must develop an operation capable of attracting the hundreds of millions of dollars from outside lenders necessary to fulfill its mission and purpose. While the mission of providing loans to fishing and agriculture may appear the same as those given to a State loan program, or to AIDA, the road to their accomplishment is much more complex given the lack of State funding or State guarantees.

In addressing the mission imposed by the Legislature and in creating the organization to meet that mission, the Board of Directors has established policies, philosophies, and procedures which insure the long term viability of the organization. This same organization is established to meet the standards and the expectations of the national and international financial communities upon which we must rely now and into the future. It should be noted that CFAB now has correspondent relationships with Denmark, Danish banks, and Norwegian financial institutions, and is opening negotiations with Japanese and Canadian banks, as well as large commercial banks in the "Lower 48."

To establish its standards of operation, the board has closely examined the standards of other similar institutions. We have determined that CFAB's standards are in all cases within comparable standards, as are its expenses. All expenses are deemed necessary to CFAB's business purpose and are according to budgets established in conjunction with Management.

With regard to the items specified in your letter:

A. Furniture, Fixtures and Leasehold Improvements

The expenses of furnishing the executive offices of the Cooperative are in line with similar expenses at the Spokane Bank for Cooperatives and other financial institutions. Neither the cost nor the decor is inconsistent with the standards of other institutions in Anchorage of comparable size.

They are intended to establish the proper decorum and to relate to the type of visitor frequenting the offices. These include trade missions, ambassadors, presidents of large corporations, and executives from among the international financial community. While Steel Case desks may well serve the necessary business environment of a public agency, they do not serve the demands of this Cooperative. Decor of that nature would only serve to reinforce a "poor country cousin" image. In creating the office environment, CFAB took great care in its design and decoration to meet the needs of its many categories of users. It is designed to be a comfortable place to work for those who spend the majority of their days here; a relaxing, warm place to visit for the borrower who is normally intimidated by banks and bankers; and a tasteful, professional environment for the executive businessman.

A careful watch was made of expenses, and a great deal was achieved by the use of highly qualified decorators with experience in office decor.

The conference area you have mistakenly inferred to be restricted to executive personnel is a general conference area decorated to fit the general office decor and serve the purposes previously described, while accommodating the larger meetings regularly held at the office.

The Juneau apartment is widely used by the Board and staff of the Bank. It was originally rented during the formation stages of the Cooperative during which time the Board and the staff were spending large amount of time on a continuing basis in Juneau. It provided a meeting place and proved cost beneficial against the use of hotels. Retention of the apartment has been reviewed periodically and will be again in the future. Having decided to open our Southeastern office in Ketchikan, but having need to conduct business in Juneau on a regular basis, it has been determined that CFAB requires some form of permanent location from which to operate and hold meetings while in that town. The combination of apartment and office showed clearly to be the most economical alternative versus renting an office on a per square foot basis and using hotels. The wallpaper itself was hung by staff and various items of sparse decoration have been contributed by the Board and the staff.

B. Artwork

It should be noted that you have listed all, not a sample, of the artwork purchased by CFAB. The use of the word "Sample" is editorially misleading.

The artwork in the Anchorage office was purchased or commissioned from local artists to fit both the decor and the operation of the office. The expenses of the works are consistent with the art and are under the value of the pieces in the present market. The cost of the individual works does not come close to the cost of the works contained in the State collection, some of which adorn the walls of legislative offices, nor in the collections of other private businesses in Alaska. All pieces in our offices depict agriculture or fishing, with Alaska overtones.

C. Automobiles

Transportation is a necessary part of our business, as it is with most. Not being a State agency, CFAB does not have access to State pool vehicles, nor was such access intended.

It will be noted that the cars purchased by the Cooperative are small, economy vehicles which meet the demands of Alaska conditions.

Provision of automobiles to members of the executive staff, both for business and personal use, is a normal business practice and one necessary to CFAB if it is to attract the personnel needed. You will note that the car provided to the President is not the high priced, luxury vehicle customary to presidents of other Anchorage financial institutions, but rather a Chevrolet with a monthly lease payment far below comparable costs. The automobile provided for the use of the Senior Vice President-Administration is also available for general Bank use and is assigned to him in lieu of other compensation. The gasoline provided to the Senior Vice

President-Credit only partially offsets the luxury vehicle provided by his previous employer, another Anchorage bank.

The decision to purchase automobiles was made after considering the life cycle costs and discounted cash outflows of purchased vehicles over locally available leases or reimbursement for personally provided automobiles.

D. Salary and Benefits

The attraction and retention of the best people is deemed to be of vital importance to the business of the Cooperative. It is a highly accepted business principal that people capital is more important than dollar capital. To attract and retain these people requires that the Cooperative provide competitive salaries, benefits, working conditions, and opportunities. In establishing these benefits, the Board annually reviews the market, both in Alaska and in the "Lower 48", to determine levels and trends.

It should be noted that CFAB pays the full cost of the PERS coverage, including an allocation for administration. No cost is borne by the State. CFAB's involvement with PERS and other State benefit programs will be deleted with passage of current legislation supported by the Board.

The bonus program has been widely covered and explained in detail, not only to the Budget and Audit Committee of the Legislature, but also to all Senators and House members. It has proven to be an effective tool resulting in rapid accomplishment of goals and objectives. Bonuses are paid for productivity, not for the mere occupation of space. In widely read coverage of CFAB pay and bonus programs, the Anchorage Times reported that CFAB's remuneration to employees, including bonuses, was not out of line with industry standards.

Staff room expenses for coffee, tea, etc. are common for business and a common courtesy extended to visitors and staff of most businesses and even some State offices. The figures quoted include stocking of cups, plates, and other necessary kitchen items.

Tickets to the Repertory Theatre were erroneously listed under benefits and should have been posted to entertainment. While listed under one employee name, they are used by other members of the staff to entertain customers, consultants, and other vendors, as well as support the theatre. If you will check the list of donors and ticket holders to the Rep and other performing arts, you will find a large portion of patronage comes from businesses.

A Christmas party is also a normal event in the private sector. CFAB also uses the occasion to thank particular vendors, consultants, and suppliers, as well as the spouses of employees

whom we feel contribute to the organization. Facilities available to accommodate groups of any size are limited in Anchorage and never inexpensive. The cost of these Christmas parties is part of the overall employee relations program which has provided the Cooperative with measurable and high levels of achievement. Comparison with other financial institutions would reveal that neither the function nor the per person cost is out of line.

In the last paragraph of this section, you have listed other staff benefits of \$6,076 and other personnel expenses of \$13,810. In the former figure, you have double counted an accrual of \$4,551 for the previously listed Christmas dinner and \$345 for tickets to the Repertory Theatre, also previously mentioned. Of the latter, the majority does not represent dinners with interviewees and staff, but rather the expenses of bringing people to Anchorage for interviews; including hotel, meals, car rentals, etc. Naturally, some of the names appearing in those postings will now appear as employees. Also included are a few dinners including employees and primarily involve our branch staffs while in Anchorage for loan presentations, training, etc. If you would have the opportunity to examine the expenses of other businesses, you would find that it is common to carry on business over lunch if it involves something better discussed away from the office or the press of the day's schedule allows only that time.

E. Rent

Here, too, you have failed completely to draw comparisons or to consider the full costs of an office. In commenting upon the cost of the office space (also mentioned in our annual report) you have not mentioned the cost of comparable space in Anchorage or within the same building. In making that comparison, one must also consider a number of factors. First is the cost of making necessary tenant improvements such as walls and wiring. Second are the inducements offered by the landlord to obtain the lease. Third is the extra cost of occupancy such as escalator clauses, utilities, and services. And of equal importance is the availability of expansion space during the course of the lease.

After looking at a number of buildings in Anchorage and receiving bids from several, the actual cost of our present location was not only cheaper than the alternatives, but also offered many side benefits, such as central location to staff; adequate, free parking for staff and members; close proximity to our CPAs, attorneys, and insurance brokers who are contacted on a frequent basis; and ease of finding the location for our members and other visitors. Even some State agencies, such as Fish and Game, pay much higher rent. The forecasted cost of a State office building is considerably higher than the figure quoted. One should caution that the disclosure of this rent figure is a violation of our agreement with the landlord, as rents in the building are not the same for all tenants.

In describing the quarters and appointments, particularly in our kitchenettes, you have forgotten to ask questions that would have put many points into perspective. For example, we have doubled the office space since opening and, in so doing, took over the office space previously occupied next to us. That tenant had a kitchenette also, which we have converted into a much needed second conference room. The cost to remove the previously installed appliances exceeded the cost of retaining them. Due to the cost benefit and the convenience of the facility to the staff and clients on that side of the building, they were left. Additionally, the table in that conference room is not natural oak, but rather formica in an oak pattern, as are all of the desks in the area.

If you had surveyed the building, you would have found the kitchenettes to be common in the building and equipped similarly to ours. As can be seen from the one taken over and now used as a conference room, many are larger than the one mistakenly listed as the executive kitchen. Furthermore, if you had observed other floors of the building during the last three and one half months, it would have been noticed, even casually, that oak is the standard material used in all trim, elevators, cabinetry, and other wood surfaces in the building. It is a standard established architecturally.

The kitchenette is used often for preparation of lunches for luncheon meetings, saving not only the expense of eating out, but also time during busy days.

F. Directors Fees

Directors fees are, by law, left to the discretion of the Board of Directors. CFAB's Board compared compensation paid for other private boards and even some State boards, such as the Permanent Fund. Also, in the consideration was the amount of time necessary to complete the Board function (two days each month for regular meetings) and the lost travel time of one day each way for the majority of members. You should have also found that the Board spends considerable time outside the regular board meetings on behalf of the Cooperative. Rates for this time were compared to consultant time rates and the daily meeting rate. Closer questioning would have revealed that individual Board members bill only a fraction of the time they spend.

You have listed as significant the fact that one member received \$12,438 in consulting and organization fees during an 18 month period. You are referring to the previous Chairman of the Board. During the early organization period of the Cooperative, the Bank had limited staff and those it did have were unfamiliar with much of the workings of the Alaska business system. This individual, at the request of the Board, devoted countless hours to the organizational efforts and brought to the task knowledge and experience not elsewhere available in the organization. His regular business is that of a consultant, together with other

partners, and his income dependent upon hourly billings. He could not afford to devote the time required without proper billing nor would his business partners have allowed it. The time billed was substantially below that applied and the rates below those charged by other consultants and professionals employed by the organization.

G. Travel, Lodging and Meals

Foreign travel is a necessary part of CFAB's business. We deal with internationally traded commodities, both in fisheries and agriculture. Likewise, our members have internationally related financial transactions. Markets and practices in other parts of the world have direct impact upon the financial well being of our stockholders.

CFAB has correspondent relationships in Scandanavia, has purchased equipment to aid Alaska's farming community from Denmark, and is beginning negotiations with other foreign banks. These relationships are used not only to provide necessary credit information on receivables financed, but are expected to result in lines of credit enhancing our lending abilities. Provision of knowledgeable and complete lending services to Alaskan fishermen and farmers cannot be accomplished without development of a wide range of international contacts.

You will find that others on the trips listed included representatives of State government and private enterprise. You should also note that the agriculture trip to Denmark was at Denmark's invitation and most were expenses for their account. Further examination of other private and government departments will reveal a wide range of foreign travel. The significance of international markets to Alaska is evidenced, in part, by the fact that the State itself keeps two fully staffed offices overseas, and is considering a third.

It is the policy of the Cooperative to allow travel expenses for spouses if the functions attended normally include spouses as a part of the activities. You will find this to be a similar practice among most Anchorage banks, other businesses, and the Bank for Cooperatives.

You have mistakenly listed a minor amount of \$376 as an expense of a former trip. It is a prepayment of the Munich International Fisheries Conference to be held this October. That conference will be attended by various of our processing members, as well as the Alaska Seafood Marketing Institute. You might also be interested to know that the Alaskans attending the previous conference were highly appreciative of our attendance and remarked that CFAB was the first Alaska financial institution to show sufficient interest in becoming fully involved in learning the industry.

The Senior Vice President-Administration made only one trip to England. He was accompanied by the Vice President of Branch

Administration who is also a vessel surveyor. They were in London to visit the various departments of Lloyds of London, which is the major insurer of vessels in Alaska. In addition to learning about the intricacies of vessel insurance, they also investigated possible criteria for certifying vessel surveyors, as well as ways in which the risk of Alaska fisheries as perceived by Lloyds might be diminished. This would result in substantial savings to our fisheries members. Competence in both insurance and vessel valuation is a vital part of our business.

Dinners

In listing 48 dinners over \$100, you have not considered the number of people involved, the purposes of the dinners, or the relationship of those entertained to the business. You also seem to miss the prices charged by the average dinner house in Anchorage that is conducive to a business discussion. In fact, it is one of the items that ranks among the more substantial cost of living differences between Anchorage and elsewhere.

All dinners you have listed were in the normal course of business and involved a defined business purpose. Most of the ten dinners you have listed should be self explanatory given the people attending. Without more detailed reference to dates, it is impossible to describe each one. However, since such dinners are not that common an occurrence, I can clarify specific occasions to help you further understand our business. I will refer to them by the number you have ascribed.

1. This was a dinner that involved the Vice President-Branch Administration who had been offered the job in Anchorage, but had not yet accepted. He was in Anchorage to look over the area with his spouse and look for available housing. Raised in Cordova, both he and his wife were unsure of the move and wanted to become more comfortable with the business climate of the Anchorage office. The dinner was to allow his spouse to become acquainted with other spouses and gain assurances of help and availability of necessary family services. It is common for businesses to have such dinners. They are a selling function necessary to have the right people in the right positions.
6. This bill also included cocktails and dessert for an assortment of legislators, UFA representatives, and CFAB consultants.
8. These dinners also included other members of the staff and possibly their spouses. They were held in conjunction with the normal board meetings. It has been the practice of the Board to continue business through the dinner hours and to use this time to obtain more general and informal information about the operation. They often invite staff members and their wives to learn

about particular jobs within the Cooperative and to give the staff members wider exposure to the business.

10. This dinner included the Senior Vice President-Administration and the prospective Senior Vice President-Credit and their wives. The occasion gave these two people, who are key officers of the Cooperative and who must interface directly on almost every matter, a chance to become better acquainted and form the grounds for needed communication. Again, this is a necessary part of a business operation and normal to private business.

Members of the Board and the Executive staff are professionals in upper income brackets and educational backgrounds. The level of entertainment done is consistent with industry standards.

You have further listed four occasions of other staff dinners. We fail to understand their inclusion. Of the first, you mention several lunches totaling \$137. It is difficult to draw any conclusions from that statement since the context, purpose, and applicability elements are missing from your statement.

The dinners listed for the staff in Seattle were most likely for our participation in the Fish Exposition in Seattle during which we had several employees in Seattle to man our booth. The dinners and their prices are normal.

The lunch costing \$172 was a going away luncheon for one of the staff and quite insignificant when compared to the contribution to the Cooperative of the departing member.

The items included in the \$1,331 listed as "Banquets" include the annual meeting of shareholders, a board meeting, the Agriculture Symposium, and a trade delegation.

Miscellaneous expenses listed are for stocking of the office facilities in most cases. Tuxedo rental was for an affair requiring both attendance of the employee and formal wear.

The use of the Alaska Airline Board room is also a necessary part of the business and is used for meetings at the airport with clients and others passing through. It provides private accommodations for such meetings at insignificant annual cost.

H. Promotional Costs

Opening parties are a normal part of business and provide a significant show of interest in both the community and the members of the markets served. The opening Anchorage party was attended by close to 100 people, not all of whom had dinner. Both the cost of the affair and the attendance was reasonable by Anchorage business standards. Reference should be made to the recent opening of the Anchorage office of Alaska Pacific Bank, as well as several professional firms entering the Anchorage market. That comparison will show the cost of CFAB's opening dinner to be normal and the affairs to be equally frequent among those

companies.

Similar receptions were deemed essential to each branch office location listed and were structured to fit the norm for such affairs in each area. It is difficult to envision an opening reception in an area to introduce a new company and new services without representatives of the company present. It would be particularly insulting to CFAB members and potential members for the members of the Board and senior officers not to be present. Additionally, the occasions provide opportunity to the Board and Management to become quickly familiar with the people in the communities they will be serving. Use of charter aircraft when transporting a larger number of people offers a large cost benefit.

As a private company with legislative needs, good governmental relations is a normal and necessary function. The legislative reception, which was well attended, provided the staff and the Board the opportunity to discuss CFAB's needs and operation with legislators who would be unavailable in another form. Such receptions and dinners are also normal to the legislative process and Juneau experiences them on a regular basis.

Gortex jackets were given to the staff as both a traveling uniform providing quick and easy identification and as a functional garment for the conditions in which they travel. Provision of garments is not at all uncommon in the fishing industry. The price you have quoted included 1000 patches costing \$1,200 to be used on hats and other promotions. Your attention is drawn to a feature story in a recent edition of the Fishermens Journal specifying the importance of these hats and logos within the fishing and agriculture industries, both in Alaska and the "Lower 48."

Tide books are an essential item to all fishermen and are used by all our members and potential member stockholders. Constantly referred to by the fishermen, they are an extremely effective media through which to provide facts about CFAB and its available services.

The cookbooks are a part of a visual program on the use of the microwave in cooking fish. It is part of a national promotional campaign produced by the National Fisheries Institute of which CFAB is a member. The campaign has been participated in by numerous processors and marketers. CFAB makes its slide presentation and cookbooks available to home economics groups, businessmen selling microwaves, and cooking classes. It was recently prominently used by the Alaska Seafood Marketing Institute in a show promoting Alaska fisheries products in the Mid-West and will be used again by the same group in Germany. Development of these types of programs falls clearly within the legislative mandate.

The annual reports ordered by the Cooperative were 1000, not 500. The cost of producing that report was above that planned

because of a number of reasons, including the original photographer leaving the state with the pictures, requiring them to be reshot by another photographer; special, quick turnaround time by the printer and separator due to the time constraint of legislatively imposed March membership meeting which left only two weeks between completion of the audit and the meeting. These unusual costs associated with our first annual report should not occur again with future reports. However, the expense of an annual report is an absolutely necessary expense of our business. It is the primary publication supplied by us to our members, legislators, the Governor, the public, as well as our creditors and vendors, and is considered by members of the financial community as an essential communications tool. Put together as CFAB's was, the vehicle provides not only the opportunity to present a company's financial picture, but the entire framework of the business.

I. Review of Board Minutes

Your remarks in this section are truly out of context and without precedent. We can find no reason or justification for their inclusion in your report. Even given the consideration of the inappropriate standards used in your audit of CFAB, it is particularly unique to include two items on which the Board of Directors has taken negative action.

The items presented include no reference to the decision making process involved, the cost to benefit relationships derived, or the purpose of the discussions. Foreign travel for education in the fisheries -- the predominant market we serve -- is a viable item to review. The availability of an extremely low airfare opened an otherwise costly opportunity for discussion. An aircraft in a state dependent upon air travel and for an organization traveling to all parts of the state is also an item one would expect a board to discuss.

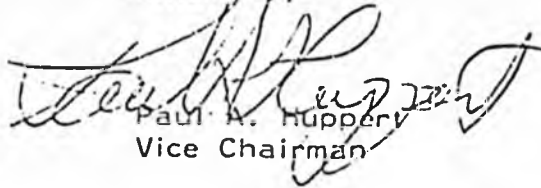
Are you suggesting that there are items forbidden to the Board for discussion and review in the interest of the corporation they are responsible for? Are you further implying that a board should stand in criticism for reviewing all the alternatives open to their business? Or are you suggesting that the board minutes reflect only those items which you, a staff employee of the State, consider to be proper, palatable and in keeping with your particular personal standards? I am sure you are aware that foreign travel is extensive among Alaskans and is a subject reflected in the minutes of many boards. Additionally, the State of Alaska itself has considered purchase or lease of a State plane on several occasions.

Mr. Harris, we appreciate the efforts that you and your staff put into the audit. Danna worked hard and fit in well with the office staff. We are sorry that your understanding was not more complete, enabling your audit to be of a more meaningful nature. Your report only proves that a private business operating

Paul V. Harris
June 12, 1981
Page 16

under the standards required by the private market cannot be audited against standards commonly used by the Legislative Auditor.

Sincerely,



Paul A. Huppert
Vice Chairman

sd

Alaska State Legislature



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SENATOR
ARLISS STURGULEWSKI

COMMITTEES
CHAIRMAN
Legislative Budget & Audit

Community & Regional Affairs
Finance
Resources

W.P. [unclear]
Comm. Fed.

Senate RECEIVED

02 SEP 1981

LEGISLATIVE
AUDIT

MEMORANDUM

02 September 1981

TO: Glen Svendsen
Special Assistant

FROM: Senator Arliss Sturgulewski *AS*
Chairman, Legislative Budget & Audit Committee

RE: Commercial Fishing & Agriculture Bank

Enclosed please find the letter sent by Roseleen Moore in response to my earlier question regarding issues raised by individual Legislative Budget & Audit Committee members. Will you have Betty send out a copy of my original letter plus this response to all committee members?

I am sending a copy of Roseleen Moore's response as well as a copy of this memo to Jerry Wilkerson.



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Roseleen "Snooks" Moore
Chairman

August 27, 1981

The Honorable Arliss Sturgulewski
2957 Sheldon Jackson Street
Anchorage, Alaska 99504

Dear Senator Sturgulewski:

We appreciate the findings on management expenditures and the Board has taken steps to reevaluate and correct our current budget and will definitely take these findings into account in the budget preparation for the coming year.

As you can well appreciate, the repayment of the State is a multi-faceted problem that must be approached carefully. The impact upon CFAB and its ability to meet its mission, its goals, and the expectations of the communities it serves will be significantly affected by the course taken. There should be no doubt in the minds of the legislators that CFAB takes the responsibility of meeting its obligation seriously. Repayment of the State is of paramount importance to the Board and Management of CFAB and is of significance in established policies, budgets, and plans.

We are in the process of examining all the alternative means to accomplish the legislative imperative that the Class C stock be repaid by the end of 20 years. Our decision will be reached as part of the planning process at the December board meeting. You can be assured that our direction will be based upon our judgment and will best serve the two industries we serve as well as the original intent of the legislation.

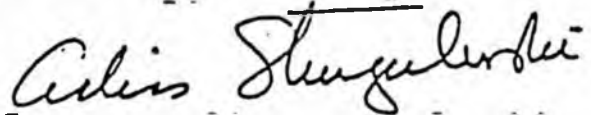
Sincerely,

Roseleen "Snooks" Moore

sd

Your timely response to these two requests will be appreciated by the Committee. Any questions or clarification of these requests can be directed to me.

Sincerely,

A handwritten signature in cursive script, reading "Arliss Sturgulewski".

Senator Arliss Sturgulewski
Chairman, Legislative Budget &
Audit Committee

cc: All members - Legislative
Budget & Audit Committee



State fishing loan bank makes recovery

By JIM ERICKSON
Daily News reporter

The Alaska Commercial Fishing and Agriculture Bank, its decks awash in red ink and in danger of being scuttled two years ago, has manned the pumps.

Rebounding from a near-fatal \$10 million loss in 1984, the lending cooperative posted a \$535,780 profit last year, according to figures released Wednesday. The organization's financial picture had brightened enough to justify the April 1 mailing of dividend checks to CFAB's 577 members, most of them Alaska fishermen.

The company made \$114,187 in 1985.

Ed Crane, president of CFAB, attributed the recovery to several factors. The most significant was a 31 percent reduction in overhead compared to the previous year. Operating expenses totaled \$1.9 million last year, the lowest annual outlay in the cooperative's six-year history.

Crane said much of the savings resulted from the closing of four regional offices in late 1985.

Larger fish harvests and higher prices in the Alaska fishing industry had little ef-

fect on CFAB's bottom line last year, Crane said. Interest income from loans, CFAB's main source of income, declined to \$6.1 million in 1986 from \$10.1 million in 1985. Total loans dropped to \$41.1 million last year from \$62.4 million.

"We've shrunk in (loan) volume really more than we're comfortable with," Crane said. Industry growth has been centered in areas that CFAB cannot participate in, such as joint ventures between Alaska fishermen and Outside companies, he said.

The cooperative, which the Alaska Legislature established with a \$32 million capital infusion in 1981, can make loans only to Alaskans or Alaska companies.

"We've had numerous deals, particularly recently, where people have approached us for a loan to refurbish a processing plant, and we had to say no" because the company was not Alaska-based, Crane said. Despite efforts last year and this year to get law changed to allow CFAB to make out-of-state loans, lawmakers have shown little interest, he said.

CFAB is owned by members and by the state.

"The biggest frustration I feel personally is the lack of

flexibility and the orphan-like existence we live."

Commercial banks, which in the past have shown little interest in lending money to fishermen, now are competing on a small scale with CFAB, he said.

Crane said CFAB has "turned around" runaway loan losses and delinquencies that threatened to ruin the organization two years ago.

CFAB's non-earning loans increased slightly last year to \$17 million. But that amount was still far less than the \$32 million in delinquent loans CFAB carried in 1984.

Ten delinquent borrowers accounted for more than \$13 million of CFAB's current delinquencies.

Continuing problems with bad loans mean the organization must charge higher interest rates on new loans, Crane said.

Partly to provide a "rate rebate," CFAB's board of directors decided to pay members a 1986 dividend. The total amount paid was \$214,309, or 40 percent of CFAB's net income last year. The average check was for \$371, although the amounts varied from \$1.18 to \$29,282.

Despite CFAB's return to modest profitability, it remains unclear whether the

cooperative will be able to repay all of the state's \$32 million investment when it comes due at the turn of the century, Crane said.

"Somehow, we've got to get \$32 million in liquidity built in there" in the next 13 years, he said. "I'm skeptical we can do that."

CFAB now has \$17 million in "solid assets," Crane said. Two years ago, if CFAB had been liquidated, "the state would have lost the whole \$32 million."

The cooperative also faces another at CFAB borrows money to lend to members from the Spokane Bank for Cooperatives, and has \$5.4 million invested in that organization. The Spokane bank is one of 37 banks in the troubled Farm Credit System, which holds nearly one-third of the nation's farm debt.

If the condition of the system worsens or if proposed federal help does not come, CFAB could have trouble borrowing what it needs for members, and borrowing costs could remain "at a relatively high level," CFAB's annual report states.

CFAB ultimately could suffer a paper loss of \$5.4 million if the system collapses, Crane said.

Capital-reared bank is having hard time standing on its own

An auditor's note in the State of Alaska Financial Report announces that the state may lose all or part of \$31.8 million invested in the Alaska Commercial Fishing and Agriculture Bank.

Those who are scrambling to get a few thousand dollars from the state this year are entitled to ask the government how \$30 million was cast to the winds without even the minor formality of a legislative appropriation.

Among the many strange creatures to evolve from Juneau's mad-cap hatchery, the Alaska Commercial Fishing and Agriculture Bank (CFAB) is one of the most curious. It's not a bank and it's not even a state agency, yet it's a creation of the Legislature, financed with state money. It's a sort of bureaucratic platypus.

The CFAB was created by the 1978 Legislature as a public corporation within the Department of Commerce and Economic Development. The original intent was to raise lending capital from the tax-exempt bond market, but the Internal Revenue Service declined to endorse the scheme.

Instead of letting this miscreant die, the Hammond administration devised a roundabout plan to establish the CFAB as a private cooperative bank financed by \$32 million in government money.

In Fiscal Year 1979 the Department of Revenue bought 200 shares of CFAB stock for \$2 million. The stock was special preferred Class C,



Fred Pratt

having no voting or dividend rights. A 1979 act of the Legislature authorized the stock purchase and appropriated \$2 million for stock purchases to finance the bank's start-up costs.

In March 1980 the Department of Revenue loaned CFAB another \$30 million at 9 1/2 percent interest. The bank opened its doors for business April 2, 1980. In July 1980 the loan was canceled by an agreement in which the bank issued the state another 3,000 shares of Class C stock at 1 paid \$480,205 in interest.

I'm unable to find anywhere in the Legislature's records where this \$30 million was appropriated. I checked with Deputy Commissioner of Revenue Mill Barker and he confirmed this after a short search of the department's records and consulting a former Revenue official.

The bank's only obligation to the state for the \$32 million is to buy back the stock at the same price within 20 years. The governor also gets to appoint two members of the seven person board of directors.

The bank's major source of operating capital is the Spokane Bank

for Cooperatives, a member of the federal government's Farm Credit System. The stockholders of CFAB are the borrowers themselves. If you get a loan you must buy one share of Class A stock for \$10, giving you one vote but no dividends, and enough shares of \$100 Class B stock to make up five or 10 percent of your loan amount.

The bank loans you the money to buy the Class B stock by tacking it onto your loan request. If the bank should ever pay dividends, it would be paid out on the Class B stock.

Since it doesn't take deposits, the bank is not chartered by the state and it's specifically exempted by law from the Alaska Banking Code.

The CFAB went right to work, with a panache that quickly caught the eye of the Legislature's financial watchdogs. An audit of the bank's books in May 1981 focused public attention on how the state's "investment" in CFAB was spent.

The legislative auditor noted that the bank president's office in Anchorage was furnished with a \$3,631 sofa, a teak bookcase and cabinet that included a refrigerator and liquor cabinet (\$4,232), and five swivel upholstered chairs (\$7,717). The two senior vice presidents had teak desks, teak coffee tables and teak bookcases. The executive conference room boasted a rosewood conference table (\$16,225), 14 chairs (\$10,470) and a \$2,000 soapstone carving.

They decorated the office with (See PRATT, Page C-5)

Fairbanks Daily News-Miner, Fairbanks, Alaska, Sunday, February 15, 1987—C-5

PRATT

(Continued from Page C-1)

\$13,353 in artwork, the auditors reported. The 7,000 square feet of leased office space in Anchorage included two kitchens, each equipped with oak cabinets, microwave oven, dishwasher and refrigerator. The employee lunch room had an oak conference table and upholstered chairs (\$4,360).

Oddly enough, the staff seems to prefer other places to eat. The bank records included 48 dinners of more than \$100 each on the expense report of its two top officials for an 18-month period. The bank paid \$215 for dinner for two bank officers, a prospective employee and their spouses at the Captain Cook. It cost \$256 for a dinner at the Corsair in Anchorage for four bank employees and their spouses, and the president ran up a \$210 tab taking his wife, a senior vice president, a local businessman and their spouses out to dinner at the Corsair.

The bank's 1980 Christmas party at the Anchorage Westward Hilton cost \$2,353 for food, \$2,197 for liquor and \$600 for entertainment. The bank also spent \$415 for holiday turkeys for its employees.

A pre-opening party at the Sheraton Hotel cost \$1,325 for 64 dinners, \$186 for 19 bottles of Chenin Blanc wine, \$124 for 18 bottles of Pinot Noir and \$814 to pay the tab for 283 drink tickets at the hosted bar. The bank said about 100 people attended this affair, and the total cost came to \$3,782 when travel and hotel expenses were added in.

The bank also held pre-opening parties at the branch offices in Kodiak (\$4,072), Cordova (\$7,610), Homer (\$1,852) and Seattle (\$2,039).

Another \$5,064 was paid for 66 Eddie Bauer Gortex mountain parkas with CFAB logos, given to employees and board members.

The bank responded by saying it wanted to avoid giving a "poor country cousin" image and its spending was in line with that of private sector banks. It claimed the furniture described as "natural oak" was Formica in an oak pattern.

The president was quite a jet-setter. In the fall of 1980 he and his wife toured Denmark, England, Rome and Paris at a cost of \$8,805, and they returned to visit Denmark, Norway, Sweden and Finland the following spring (\$6,068).

The audit reported that in 1981 he anticipated a spring or summer trip to Japan and an October trip to Munich.

The auditor also found the bank was not requiring insurance of inventories used as collateral, which is odd when your collateral might include sensitive inventories like frozen fish. In a sample of eight loans the auditor found five were unsecured, and the bank was listed as the loss payee.

Most of the bank's operations seemed aimed toward commercial fishing, with a major portion going to operating financing for fish processors. Farmers could find much cheaper money with the state's special agriculture loan programs.

I reviewed the bank's annual reports for 1983, 1984 and 1985. In the first of those years, the bank had 828 shares of Class A membership stock outstanding and slightly more than \$100 million in loans. Its interest and investment income was \$14,624,765, but it faced \$7.2 million in interest payments for the capital it borrowed, \$3.9 million in loan loss provisions and its other operating expenses reduced its "profit" to \$309,473.

A note on related party transactions revealed that \$6.2 million of

the bank's loans were to members of the board or directors or bank employees.

The bank reported a ten-fold increase in loans charged off that year, from \$176,121 in 1982 to \$1,858,138 in 1983.

The 1984 report showed a dramatic reversal. The bank lost \$10 million, mostly because it had to add \$11.2 million to loan loss reserves.

"Clearly, the exuberance associated with building, or patronizing, a new entity created a climate conducive to speculative lending relationships," the new bank president reported. The loan interest income dropped to below \$12 million while the interest expense for capital was up to \$8.4 million. The CFAB essentially had a negative net worth.

That year the bank notified the state that it might not be able to buy back the \$31.8 million in stock by the year 2000. There was some fear then that the CFAB might have to be taken over by the Spokane Bank for Cooperatives, Barker told me.

Things improved in 1985, the latest year for which a financial report is available. Loans were trimmed to \$62.5 million, the obligations

to the Spokane bank were cut by \$32.3 million through a reduction in the line of credit extended to CFAB. The year showed a small profit of \$114,187.

The offices in Cordova, Homer, Ketchikan and Kodiak were closed. The bank adopted a policy of recognizing non-performing loans if they were more than 90 days overdue, instead of letting the decision go by a manager's judgement. It also recognized that the Class B stock can't be simultaneously an asset and a loan receivable.

The bank management has done an excellent job in adjusting to its problems, but it's easy to see that the much smaller asset base is unlikely to produce the \$2 million a year in net profits needed to pay back the state by 2000, especially when the bank still shows a loss of \$6.8 million in operations over its seven-year life.

That's the price we'll pay for just one more lesson in how government schemes to promote business turn out to be more promotion than business.

Fred Pratt is a free lance journalist who covers Alaska business and politics.

ALASKA COMMERCIAL FISHING
AND AGRICULTURE BANK

- - -

REPORT ON EXAMINATION OF
FINANCIAL STATEMENTS

- - -

YEARS ENDED DECEMBER 31, 1986 AND 1985

Touche Ross & Co.
550 West Seventh Avenue
Suite 1500
Anchorage, AK 99501-3567
Telephone: 907 272-8462



Board of Directors
Alaska Commercial Fishing and
Agriculture Bank
Anchorage, Alaska

We have examined the balance sheets of Alaska Commercial Fishing and Agriculture Bank as of December 31, 1986 and 1985, and the related statements of earnings, changes in capital and allocated/unallocated undistributed patronage earnings (loss), and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Alaska Commercial Fishing and Agriculture Bank as of December 31, 1986 and 1985, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Certified Public Accountants
January 23, 1987
(March 2, 1987 as to Note I)

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK

BALANCE SHEETS

ASSETS

	<u>December 31,</u>	
	<u>1986</u>	<u>1985</u>
CASH	\$ 147,410	\$ 106,773
TEMPORARY INVESTMENTS	4,150,000	3,200,000
LOANS AND OTHER RECEIVABLES, net of allowance for loan losses of \$3,291,026 and \$3,441,130	41,130,799	62,495,806
ACCRUED INTEREST RECEIVABLE:		
Temporary investments	4,700	44,144
Loans and other receivables	<u>1,302,252</u>	<u>2,071,202</u>
	1,306,952	2,115,346
INVESTMENT IN SPOKANE BANK FOR COOPERATIVES	5,390,548	5,252,423
BANK PREMISES, FURNITURE AND EQUIPMENT, net	351,874	471,503
ACQUIRED ASSETS HELD FOR SALE	83,007	1,606,164
OTHER ASSETS	28,997	90,563
	<u>\$52,589,587</u>	<u>\$75,338,578</u>

See notes to financial statements.

LIABILITIES, CAPITAL AND PATRONAGE EARNINGS

December 31,

1986 1985

LIABILITIES:

Accounts payable and accrued expenses	\$ 191,979	\$ 308,016
Accrued interest payable	233,634	416,780
Class B preferred stock subscriptions	60,163	
Notes payable	<u>25,002,539</u>	<u>48,268,294</u>

25,488,315 48,993,090

COMMITMENTS AND CONTINGENT
LIABILITIES (Note H)

CAPITAL AND PATRONAGE EARNINGS:

Share capital -		
Class C special preferred stock, \$10,000 par value, authorized 4,000 shares, outstanding 3,180 shares	31,800,000	31,800,000
Class B preferred stock, \$100 par value, authorized 400,000 shares, outstanding 40,410 and 65,845 shares	4,041,000	6,584,500
Loans receivable on Class B preferred stock	(3,698,500)	(6,584,500)
Class A membership stock, \$10 par value, authorized 10,000 shares, outstanding 975 and 931 shares	<u>9,750</u>	<u>9,310</u>

32,152,250 31,809,310

C stock retirement pool 184,930 92,152

Capital in excess of par value 86,940 82,980

Contributed capital 144,626 144,626

32,568,746 32,129,068

Allocated undistributed
patronage earnings 825,691 1,045,365

Unallocated undistributed
patronage earnings 535,780

Unallocated undistributed
patronage loss (6,828,945) (6,828,945)

27,101,272 26,345,488

\$52,589,587 \$75,338,578

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK

STATEMENTS OF EARNINGS

	<u>Year ended December 31,</u>	
	<u>1986</u>	<u>1985</u>
INTEREST INCOME:		
Interest on loans and other receivables	\$6,119,445	\$10,141,090
Interest on temporary investments	<u>165,143</u>	<u>362,767</u>
	6,284,588	10,503,857
INTEREST EXPENSE	3,765,900	6,267,003
LOSS ON ASSETS HELD FOR SALE	1,347	91,127
PROVISION FOR LOAN LOSSES	<u>50,470</u>	<u>1,234,930</u>
	<u>3,817,717</u>	<u>7,593,060</u>
	2,466,871	2,910,797
OTHER EXPENSES:		
Salaries and benefits	1,184,760	1,705,780
Occupancy expense	203,379	252,300
Depreciation and amortization	131,789	160,279
Professional fees	110,181	150,191
Advertising and promotion	67,861	79,922
Travel, lodging and meals	66,219	136,675
Office operations	62,722	126,717
Telephone and postage	40,484	87,238
Miscellaneous	36,522	50,554
Director's fees	<u>27,174</u>	<u>46,954</u>
	<u>1,931,091</u>	<u>2,796,610</u>
UNALLOCATED UNDISTRIBUTED PATRONAGE EARNINGS BEFORE INCOME TAX EXPENSE AND EXTRAORDINARY CREDIT	535,780	114,187
INCOME TAX EXPENSE	<u>226,300</u>	<u>32,200</u>
UNALLOCATED UNDISTRIBUTED PATRONAGE EARNINGS BEFORE EXTRAORDINARY CREDIT	309,480	81,987
EXTRAORDINARY CREDIT - UTILIZATION OF NET OPERATING LOSS CARRYFORWARD	<u>226,300</u>	<u>32,200</u>
UNALLOCATED UNDISTRIBUTED PATRONAGE EARNINGS	<u>\$ 535,780</u>	<u>\$ 114,187</u>

See notes to financial statements.

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK

STATEMENTS OF CHANGES IN CAPITAL
AND ALLOCATED/UNALLOCATED
UNDISTRIBUTED PATRONAGE EARNINGS (LOSS)

	<u>Share capital</u>	<u>C stock retirement pool</u>
Balance, January 1, 1985	\$31,808,880	\$ 10,260
Issuance (redemption) of stock during the year:		
Class B preferred stock, 29,332 shares, net	(2,933,200)	
Class A stock, 43 shares	430	
C stock retirement pool:		
Class B preferred stock assessments		171,398
Assessments receivable		(89,506)
Reduction in loan receivable on Class B preferred stock redemption	2,933,200	
Loan principal charged against allocated undistributed patronage earnings		
Unallocated undistributed patronage earnings		
Allocation to unallocated undistributed patronage loss		
	<hr/>	<hr/>
Balance, December 31, 1985	31,809,310	92,152
Issuance (redemption) of stock during the year:		
Class B preferred stock, 25,435 shares, net	(2,543,500)	
Class A stock, 44 shares	440	
Reduction in loans receivable on Class B preferred stock redemption	2,886,000	
C stock retirement pool:		
Class B preferred stock assessments		70,966
Assessments receivable		21,812
Loan principal charged against allocated undistributed patronage earnings		
Unallocated undistributed patronage earnings		
	<hr/>	<hr/>
Balance, December 31, 1986	<u>\$32,152,250</u>	<u>\$184,930</u>

See notes to financial statements.

<u>Capital in excess of par value</u>	<u>Contributed capital</u>	<u>Allocated undistributed patronage earnings</u>	<u>Unallocated undistributed patronage earnings</u>	<u>Unallocated undistributed patronage loss</u>	<u>Total</u>
\$79,110	\$144,626	\$4,514,237	\$ -	\$(9,977,776)	\$26,579,337
					(2,933,200)
3,870					4,300
					171,398
					(89,506)
					2,933,200
		(434,228)			(434,228)
			114,187		114,187
		<u>(3,034,644)</u>	<u>(114,187)</u>	<u>3,148,831</u>	
82,980	144,626	1,045,365		(6,828,945)	26,345,488
					(2,543,500)
3,960					4,400
					2,886,000
					70,966
					21,812
		(219,674)			(219,674)
			535,780		535,780
<u>\$86,940</u>	<u>\$144,626</u>	<u>\$ 825,691</u>	<u>\$535,780</u>	<u>\$(6,828,945)</u>	<u>\$27,101,272</u>

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	<u>Year ended December 31,</u>	
	<u>1986</u>	<u>1985</u>
SOURCE OF FUNDS:		
From operations -		
Unallocated undistributed patronage earnings	\$ 535,780	\$ 114,187
Items not requiring the use of funds:		
Depreciation and amortization	131,789	160,279
Provision for loan loss	50,470	1,234,930
Loss (gain) on sale of assets	683	(839)
	<hr/>	<hr/>
Funds provided from operations	718,722	1,508,557
Net proceeds from sale of assets	2,032	20,924
Net proceeds from stock issuance	4,400	4,300
Decrease in cash		16,558
Decrease in temporary investments		5,627,865
Decrease in acquired assets held for sale	1,523,157	755,141
Decrease in loans	21,515,111	28,869,727
Decrease in other assets	61,566	411,485
Decrease in accrued interest receivable	808,394	1,089,589
Increase in stock subscription payable	60,163	
Increase in Class B preferred stock assessments, net	92,778	81,892
Increase in Class B preferred stock	342,500	
	<hr/>	<hr/>
	<u>\$25,128,823</u>	<u>\$38,386,038</u>

See notes to financial statements.

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK

STATEMENTS OF CHANGES IN FINANCIAL POSITION
(continued)

	<u>Year ended December 31,</u>	
	<u>1986</u>	<u>1985</u>
USE OF FUNDS:		
Loans charged off, net of recoveries	\$ 200,574	\$ 3,111,420
Loan principal charged against allocated undistributed patronage earnings	219,674	434,228
Increase in cash	40,637	
Increase in temporary investments	950,000	
Increase in investment in Spokane Bank for Cooperatives	138,125	513,689
Increase in bank premises, furniture and equipment	14,874	3,637
Decrease in accounts payable and accrued expenses	116,038	64,000
Decrease in accrued interest payable	183,146	1,953,073
Decrease in notes payable	<u>23,265,755</u>	<u>32,305,991</u>
	<u>\$25,128,823</u>	<u>\$38,386,038</u>

See notes to financial statements.

ALASKA COMMERCIAL FISHING AND AGRICULTURE BANK

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 1986 AND 1985

NOTE A - SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES:

Operations -

The Alaska Commercial Fishing and Agriculture Bank (CFAB) was incorporated on May 4, 1979 to promote growth of Alaska agriculture and fishing by providing debt financing to resident-owned businesses engaged in harvesting, processing or marketing, and to promote its own growth as a strong user-oriented institution through cooperative ownership and self-governance.

CFAB is a cooperative corporation and intends to refund any allocated undistributed patronage earnings at such time as the Board of Directors finds that the financial condition of CFAB will so permit.

Interest on loans -

The accrual of income on loans is discontinued when interest or principal is contractually past due more than 90 days.

Patronage dividends -

Patronage dividends received from Spokane Bank for Cooperatives (SBC), of which CFAB is a member, reduce interest expense to SBC in the year declared.

Allowance for loan losses -

The allowance for loan losses is based upon specific identification of uncollectible loans and a general reserve for those loans not specifically identified.

Acquired assets held for sale -

Acquired assets held for sale include those assets acquired through foreclosure. These assets are carried at the lower of fair market value or the recorded investment in the related loan. Holding costs are expensed when incurred unless such costs increase the fair market value of the asset.

Bank premises, furniture and equipment -

Bank premises, furniture and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are charged to operations by use of the straight-line method over estimated useful lives of three to ten years. Expenditures for maintenance and repairs are charged to operating expense as incurred. Expenditures for renewals or improvements which extend the life of an asset are capitalized at cost and depreciated as stated above. Upon sale, retirement or other dispositions of property, the cost and accumulated depreciation are removed from the respective accounts and the resulting gain or loss recorded.

Income taxes -

Amounts provided for income tax expense are based on earnings reported for financial statement purposes, rather than on the taxable income shown on the corporate income tax return. These amounts may differ because certain items are recorded as income or expense in different years for financial statement and tax return purposes.

NOTE B - LOANS:

CFAB's loan portfolio by major category is as follows -

	<u>December 31,</u>	
	<u>1986</u>	<u>1985</u>
Vessels	\$25,623,250	\$34,135,387
Fish processors	8,702,504	14,172,810
Agriculture and timber	7,596,991	16,221,453
Gear, entry permits and other	4,371,442	7,697,386
Other receivables	<u>1,826,138</u>	<u>294,400</u>
	48,120,325	72,521,436
Less loans receivable on Class B preferred stock	<u>(3,698,500)</u>	<u>(6,584,500)</u>
	44,421,825	65,936,936
Less allowance for loan losses	<u>(3,291,026)</u>	<u>(3,441,130)</u>
	<u>\$41,130,799</u>	<u>\$62,495,806</u>

The loan portfolio includes loans which have been classified as nonaccrual. Nonaccrual loans by major category are as follows -

	<u>December 31,</u>	
	<u>1986</u>	<u>1985</u>
Fish processors	\$ 4,441,655	\$ 5,246,914
Vessels	3,025,085	4,480,381
Agriculture and timber	7,569,743	3,740,558
Gear, entry permits and other	2,286,902	2,185,492
	<u>\$17,323,385</u>	<u>\$15,653,345</u>

Activity in the allowance for loan losses is as follows -

	<u>December 31,</u>	
	<u>1986</u>	<u>1985</u>
Balance at beginning of year	\$3,441,130	\$5,317,621
Charged to expense	50,470	1,234,929
Recoveries on loans previously charged off	688,266	374,889
	<u>4,179,866</u>	<u>6,927,439</u>
Loans charged off	<u>(888,840)</u>	<u>(3,486,309)</u>
Balance at end of year	<u>\$3,291,026</u>	<u>\$3,441,130</u>

CFAB serves the financial needs of the commercial fishing and agricultural industries in the State of Alaska. These industries are subject to seasonal and cyclical fluctuations which could affect the borrowers' ability to repay loans on a timely basis.

Loans to directors -

To qualify for election to the CFAB Board of Directors, an individual must be a borrowing member. Loans to members who serve on the Board of Directors must be approved by the SBC. Total loans to these members were \$141,247 and \$1,613,378 in 1986 and 1985, respectively.

NOTE C - TEMPORARY INVESTMENTS:

Temporary investments consisted of \$4,150,000 of farm credit bonds maturing at various dates in 1987, with interest rates ranging from 5.99% to 8.50% and certificates of deposit of \$3,200,000 with interest rates ranging from 8.45% to 8.52% at December 31, 1986 and 1985, respectively.

NOTE D - BANK PREMISES, FURNITURE
AND EQUIPMENT:

The following represents a classification of bank premises,
furniture and equipment by major category -

	<u>December 31,</u>	
	<u>1986</u>	<u>1985</u>
Furniture, fixtures and equipment	\$ 893,365	\$ 889,432
Leasehold improvements	<u>147,202</u>	<u>147,202</u>
	1,040,567	1,036,634
Less accumulated depreciation and amortization	<u>(688,693)</u>	<u>(565,131)</u>
	<u>\$ 351,874</u>	<u>\$ 471,503</u>

NOTE E - NOTES PAYABLE:

Notes payable consisted of -

	<u>December 31,</u>	
	<u>1986</u>	<u>1985</u>
SBC long-term notes with interest rates ranging from 10.54% to 11.75% maturing at various dates to January, 1993	\$25,000,000	\$28,000,000
SBC short-term notes and seasonal loan with interest rates ranging from 8.7% to 10.25% maturing at various dates in 1986		20,220,081
Other notes payable and capitalized equipment leases with various interest rates and maturity dates	<u>2,539</u>	<u>48,213</u>
	<u>\$25,002,539</u>	<u>\$48,268,294</u>

The loans are secured by substantially all CFAB assets.

Principal payments required on notes payable are as follows -

<u>Year ending December 31,</u>	<u>Amount</u>
1987	\$ -
1988	10,000,000
1989	10,000,000
1990	5,000,000

CFAB must invest in SBC's Class C stock in an amount equal to at least 5% of the cumulative average loan balance maintained with SBC. The amount of CFAB's investment in SBC's Class C stock and equity in allocated surplus was \$5,390,548 and \$5,252,423 at December 31, 1986 and 1985, respectively.

NOTE F - PENSION PLANS:

CFAB has pension plans covering substantially all employees. The total cost charged to operations for 1986 and 1985 was \$57,422 and \$58,372, respectively. The Board of Directors voted to terminate the floor retirement pension plan during 1986. The floor retirement plan provided for payments in the event the remaining pension plan was not sufficiently funded to meet actuarially computed retirement funding. As of December 31, 1985, the net assets available for benefits under the floor retirement plan was \$28,244. This amount will be refunded to CFAB upon the approval of termination by regulatory agencies. In accordance with generally accepted accounting principles, no gain will be recorded until the regulatory approval of the termination is obtained.

NOTE G - CAPITAL AND PATRONAGE EARNINGS:

Share capital -

Shares purchased by the State of Alaska must be repurchased by CFAB on or before July 20, 2000.

Preferential shareholders' rights on dissolution are attached in the order of Class C, Class B and Class A.

The following rights apply to the three categories of stock -

Class C - No voting or dividend rights. May only be issued to the State of Alaska.

Class B - No voting rights. Class B stock may only be held by members of CFAB. Prior to December 31, 1985, all loans required a purchase of Class B stock in an amount equal to 10% of the loan balance; however, this purchase was not funded but was evidenced by notes. On loans made subsequent to December 31, 1985, each borrower is required to make a cash purchase of Class B stock in an amount equal to 5% of the total loan. This investment will remain in place until retired by the Board of Directors.

Class A - No dividend rights. Each member of CFAB must own one share of Class A stock. Each share of stock carries one vote. To vote, a member must be engaged in commercial fishing or agriculture and must be a current borrower or have borrowed from CFAB during the preceding two years or have a minimum retained patronage earnings with CFAB of \$2,500.

Unallocated undistributed patronage loss -

In accordance with Alaska Commercial Fishing and Agriculture Bank bylaws, the Board of Directors acted to reduce an unallocated undistributed patronage loss in the amount of \$9,977,776 as follows: 1) by allocating \$3,034,644 to allocated undistributed patronage earnings of prior years in 1985; and 2) by charging \$114,187 to 1985 unallocated undistributed patronage earnings. At December 31, 1986, the remaining unallocated undistributed patronage loss amount was \$6,828,945 (see Note I).

Class C stock repurchase plan -

In accordance with AS 44.81.010(b), on or before July 20, 2000, CFAB is required to repurchase its Class C stock issued to the State of Alaska. CFAB implemented a program requiring borrowers originating loans after December 12, 1983 to make an additional purchase of Class B stock for the assumed purpose of ultimately funding the repurchase of Class C stock. This plan was in effect until December 31, 1985. Notes originated after December 31, 1985, are not subject to this program but, are subject to new Class B stock requirements.

NOTE H - CONTINGENCIES AND COMMITMENTS:

Contingencies -

CFAB is a defendant in several legal actions arising from normal business activities including actions related to delinquent loans and foreclosures. CFAB reserves for potential losses on delinquent loans as described in Note A. As to litigation outside of delinquencies and foreclosures, management believes that those actions are without merit or that the ultimate liability, if any, resulting from them will not materially affect CFAB's financial position or its results of operations.

Commitments -

CFAB has entered into certain noncancelable long-term operating lease agreements for buildings. Rental expense under these leases totaled \$192,450 and \$231,549 for the years ended December 31, 1986 and 1985, respectively. Minimum annual lease payments are as follows -

<u>Year ending December 31,</u>	<u>Amount</u>
1987	\$201,000
1988	182,000
1989	174,000
1990	43,000

NOTE I - SUBSEQUENT EVENT:

On March 2, 1987, in accordance with Alaska Commercial Fishing and Agriculture Bank bylaws, the Board of Directors acted to reduce the unallocated undistributed patronage loss by charging \$321,468 to 1986 unallocated undistributed patronage earnings. The remaining unallocated undistributed patronage loss is \$6,507,477.

In addition, the Board of Directors approved an allocation of 1986 patronage earnings totaling \$214,312 to 1986 patrons. This allocation is to be distributed in cash on or before April 1, 1987.

APR 13 1987

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 Board of Directors and Staff Inside Back Cover

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As we review the developments and results of CFAB's 1986 operations, and prepare to discuss them with members, we are reminded of the question, "Is the glass half-empty or is it half-full?"

For CFAB, the question must be, "Was 1986 a partial success or was it a partial failure?" Many objectives were attained or exceeded in 1986, and there is no doubt that by any conventional measurement CFAB is financially stronger today than a year ago. However, some goals were not met, and the effort to provide financing and services to members at a currently reasonable cost remains a difficult challenge. In these next few pages, we will share with you the major events and developments of the past year.

PMS 561
"The Board of Directors has concluded to return 40 percent of the 1986 margins to its 1986 patrons in the form of a cash patronage refund."

A particular point of satisfaction is the 1986 net operating results — a margin of \$535,780. While that is not a large amount, it compares favorably with the disastrous 1984 loss of \$100 million and the modest \$114,000 margin of 1985. Because CFAB is a cooperative and its net margins are applied to the benefit of the borrower-owners whose patronage produces those margins, we do not operate CFAB toward an objective of large net margins; nevertheless, it is critical that policies established and implemented throughout the entire year be directed toward assuring that there be some net margin, however modest, remaining at December 31.

Consistent with the foregoing and with CFAB's Bylaws, the Board of Directors has concluded to return 40 percent of the 1986 margins to its 1986 patrons in the form of a cash patronage refund. Checks totaling \$214,312 and equal to about 3-1/2 percent of the 1986 interest paid will be mailed to affected borrower-owners by April 1, 1987. The remainder of the 1986 margins has been applied to reduce the unallocated and undistributed patronage loss remaining from 1984 operations.

PMS 561
"Actual operating expenses totaled \$1,931,000, the lowest of any of the six full years of operations."

It is not possible to identify single and specific events or circumstances which created the 1986 margin. It is the result of many interrelated developments. However, it is possible and rational to identify many factors without which the margin would not have been achieved. One such factor is CFAB's operating expenses, or "overhead." A year ago we reported that those expenses for 1985 had been reduced by nearly \$400,000 from CFAB's four-year average of \$3.2 million, and said that for 1986, "...we are striving for a further reduction of \$500,000 to \$600,000..." Our objective was \$2.2 to \$2.3 million — actual operating expenses totaled \$1,931,000, the lowest of any of the six full years of operations. While the Board of Directors and management of CFAB provide basic direction and leadership in pursuit of such objectives, they cannot be achieved or exceeded without the constant and committed efforts of every CFAB staff member. We applaud the performance of CFAB's employees; they are worthy of high regard by all borrower-owners.

PMS 561
"There is no more pervasive and negative influence on CFAB and on the demands it must make of its performing, interest-paying, borrowers than the level of non-performing loans."

A major 1986 disappointment was CFAB's inability to significantly reduce the dollar level of non-earning loans. (A non-earning loan is one on which a contractual payment is delinquent by 90 days or more and/or which CFAB's management has reason to believe represents a continuing and serious problem.) Non-earning loans totaled \$15,653,345 at December 31, 1985, and \$17,321,385 a year later. The relative closeness of those numbers suggests inactivity and is somewhat misleading. The actual changes which occurred are better illustrated by the following reconciliation:

\$15,653,345	Non-earning loans at December 31, 1985
6,909,019	Balances which became non-earning during 1986
(594,663)	Balances charged off during 1986
(4,644,316)	Balances collected or restructured during 1986
<u>\$17,321,385</u>	Non-earning loans at December 31, 1986

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There is no more pervasive and negative influence on CFAB and on the demands it must make of its performing, interest-paying, borrowers than the level of non-performing loans. That aggregate balance effectively represents funds which CFAB has borrowed and on which it must pay monthly interest in cash — since CFAB's only source of cash income is interest on performing loans, there is no alternative but to maintain interest rates at a level which is perceived by many borrowers as excessive. Whether or not that perception is realistic, it is a cause for many difficult discussions between CFAB and its members.

PNIS 561

"The single greatest concern of CFAB's borrower-owners is its interest requirement."

We characterize those discussions as "difficult" because first, we understand and are totally sympathetic to members' points of view. On the other hand, we are unable to offer a response other than to say that CFAB is totally committed to correcting the problems which impose the current burdens on its operations. There are no external sources of relief to which CFAB can turn, or which it can share with its members. Rehabilitation of CFAB can only be achieved through the liquidation or restructuring of its non-earning assets. While that purpose receives constant attention, a frustrating reality is that, in general, results cannot be obtained through CFAB's efforts alone; other parties or processes hold a great deal of control. The \$17.3 million of non-performing balances involves a total of 67 loans, but over \$13.1 million of it is in 23 loans to only ten individual borrowers! In most of the cases, the borrowers are currently under the protection of a Bankruptcy Court or are otherwise embroiled in complex litigation. CFAB's attention to these accounts is both necessary and costly; but that attention by itself cannot force the resolution of the matters involved.

This aspect of CFAB's circumstances is addressed at some length because it is clear that the single greatest concern of CFAB's borrower-owners is its interest requirement. That interest requirement is directly related to the amount and status of non-earning loans. For example, if only half of the \$13.1 million in the 23 loans mentioned above were restored to an earning status, CFAB's interest requirement on an annualized basis could be translated into an overall rate reduction of as much as 2-1/2 percent! There is no mystery or complexity involved, and there is no other response we can offer to borrower-owners' concerns.

"At December 31, 1986, CFAB's investment in SBC totaled nearly \$5.4 million dollars."

Another serious and unforeseen threat to CFAB's recovery efforts appeared during 1986, related to circumstances far from Alaska and not at all associated with CFAB's own markets. It relates to the trends and developments in U.S. agriculture generally and, in particular, within the Federal Farm Credit System which has provided credit to agriculture for 70 years. CFAB was established and structured specifically to seek its financing from that System. Since 1980, CFAB has obtained a major part of its loanable funds through borrowings from the Spokane Bank for Cooperatives (SBC), one of 37 banks of the System. SBC is itself a cooperative, and CFAB has been required to invest capital in SBC in the same manner as borrowing members invest in CFAB.

At December 31, 1986, CFAB's investment in SBC totaled nearly \$5.4 million dollars. Under the circumstances which have prevailed in the past, CFAB would expect that amount to be returned to it in cash in the years subsequent to 1988. However, the dramatic and rapid deterioration of the Farm Credit System as a whole during 1984 to 1986, coupled with the effects of legislation passed by the U.S. Congress in December 1985, suggests that the liquidity of the Spokane Bank for Cooperatives has been or soon will be drastically affected. This will not only affect SBC's ability to retire capital as in the past, but will also tend to force it to maintain interest rates — and therefore CFAB's costs — at a relatively high level.

"...The first investment of true equity by members."

1986 also brought more satisfying and promising developments to discuss with members. Effective January 1, 1986, CFAB's revised Class B Preferred Stock program was established and has been well received. Borrower-owners actually purchased \$342,500 of Class B Preferred Stock during 1986. That is perhaps a modest amount in total, but it is the first investment of true equity by members; and the amount will increase substantially as CFAB grows over the next few years.

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Another new program for 1986 which has proven especially useful and attractive is that which involves a modified level payment plan for term loans. In the past, repayment of term loans was usually structured to involve equal annual increments of principal plus an interest payment. It was difficult for the borrower to project an annual payment amount more than a year ahead, and it also resulted in the highest payments required in the earliest years of what was often a new venture. Under the modified level payment plan, payments are fixed in three-year increments throughout the life of the loan. The resulting ease of budgeting for the borrower has made this program even more successful than was contemplated at its introduction.

CFAB also in 1986 introduced and refined a differential interest rate program. This program incorporates a careful and objective analysis of each individual applicant's creditworthiness within the context of his specific loan request. Every applicant is evaluated against identical standards: to the extent that an applicant's history and circumstances clearly represent a better-than-average credit risk, he is offered an interest rate somewhat lower than CFAB's normal rate. This program is available to, and has been applied to, existing loan accounts as well as to new applicants.

Effective June 1, 1986, CFAB's base interest rate — and therefore the interest rate on most CFAB loans — was reduced by 1/2 percent. Coupled with the cash patronage refund mentioned earlier, 1986 patrons' net costs of borrowing were reduced in a meaningful way from those of 1985.

PMS 561
"The 1987 Annual Meeting will be held in three sessions, also, in October — at Sitka, Anchorage, and Kodiak. We urge your attendance!"

CFAB's 1986 Annual Meeting was held in three sessions — one each in Ketchikan, Anchorage, and Cordova. The basic purpose of that format was to permit and encour-

age attendance by a broader range of members than is possible with a single meeting date and location. The meeting sessions themselves were relatively informal and the members in attendance were able to participate with constructive and challenging questions and observations to the Board of Directors and CFAB's management. Although it was clear that many members (relative to CFAB's total membership) are not yet inclined to take advantage of this unique opportunity to exercise the rights and privileges of their ownership of CFAB, we were encouraged by the participation. The 1987 Annual Meeting will be held in three sessions, also, in October — at Sitka, Anchorage, and Kodiak. We urge your attendance!

One of the important items of business transacted in the 1986 Annual Meeting was the adoption of amendments to CFAB's Articles of Incorporation. The most significant part of that was a re-expression of the powers and authorities of CFAB. The original language of that section was essentially a repetition of the provisions of CFAB's statute (AS44.811); this created, or had the potential for creating, inconsistencies if and as that statute is amended. The revised language now provides for CFAB to engage in essentially "whatever businesses and activities the law permits."

"In terms of numbers, there was also a significant change to CFAB's Board of Directors in 1986:"

In terms of numbers, there was also a significant change to CFAB's Board of Directors in 1986. In February, Governor Sheffield appointed Anchorage businessman Henry Klin to fill the longstanding vacancy in one of the two appointed seats. In April, the Governor also appointed Gil Cunderson of Juneau to replace Bob Waldrop of Ketchikan, whose term had expired. Also in April, Founding Director and former Chairperson Roseleen Moore of Homer resigned from her elected seat. The Board appointed Mr. Waldrop to serve in Mrs. Moore's position until the Annual Meeting. Due to coincidental circumstances, all five of the elected Director positions were subject to contest at the 1986 Annual Meeting: Director Tommy Thompson, Sitka, and Founding Director

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Dale Pihlman of Ketchikan had declined nomination for re-election to their seats. At the Annual Meeting, Mr. Waldrop and Harvey Samuelsen, Dillingham, were elected to three-year terms; Dean Paddock of Juneau and Paul Huppert, Palmer, were elected to two-year terms; and Alan Olness of Petersburg was elected to a one-year term. The stature and total number of candidates were gratifying. The net effect is the loss to members of the experience and commitment of Mrs. Moore, Mr. Pihlman, and Mr. Thompson, with the gain of the dedication and new perspectives of Messrs. Kim, Gunderson, Paddock, and Olness. In its own annual organizational process, the Board elected Mr. Gunderson Secretary-Treasurer of CFAB, Mr. Waldrop to the position of Vice Chairman, and Mr. Huppert to once again serve as Chairman.

PMS 561 "One of its critical needs is for...the philosophies and attitudes of 'owners of a business'..."

CFAB is a cooperative. Its owners are its customers, and only its customers can become owners. That structure lends itself to pronouncements and philosophical expressions which are often dismissed as trite. Moreover, because CFAB is a credit cooperative, its relationship with each customer is pervasive, highly subjective, and precise — measured to the last penny! The rights, privileges, and responsibilities of ownership are much more difficult to define and to pursue. There are no immediate and measurable benefits or other results to the exercise of ownership rights. Nevertheless, unless there is a viable and active ownership base in place able and willing to express its directions and expectations to CFAB's Board of Direc-

tors and management with regard to the total operations of the institution, the only guidance available to us is the language of a statute written nine years ago.

CFAB is in a period of change and of accommodating the realities which have become apparent during its brief life; a period of recovering from adversity while attempting to generate from within the resources to build for the future. One of its critical needs is for a body of members with the philosophies and attitudes of "owners of a business" rather than of "customers with a vote." Again, we urge you to participate in the election of a director later in 1987, to attend an Annual Meeting session in Sitka, Anchorage, or Kodiak, and to seek and take advantage of opportunities to communicate with your directors and management about CFAB as a business. Whether or not you are personally acquainted with one or more of CFAB's Directors, please do not hesitate to contact any of them to discuss your concerns, questions, or observations about CFAB.

Paul A. Huppert

Paul A. Huppert - PMS 561

Chairman, Board of Directors

Edward E. Crane

Edward E. Crane - 561

President

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CFAB's only significant business activity is the extension and administration of loans to Alaska's fishing, farming, and timber industries. Each of CFAB's resources is committed to support that primary activity.

Over the past two years, the liquidation, restructuring, or other resolution of non-performing loans have absorbed a great deal of CFAB energy. Also, the very existence of such loans has created and imposed unusual requirements on performing borrowers. Those requirements have in turn resulted in the loss of loan accounts and opportunities in those instances in which the borrowers or applicants have alternative financing available. Those circumstances are discussed more comprehensively in the Executive Message of this Annual Report. The principal effect has been a sharp decline in CFAB's gross loan volume from \$94.8 million at December 31, 1984, to \$65.9 million a year later, and to \$44.4 million at the end of 1986.

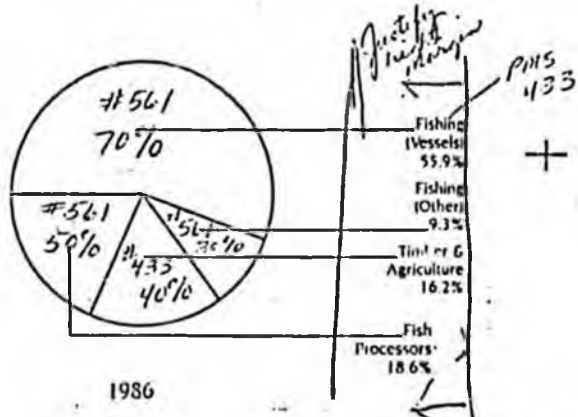
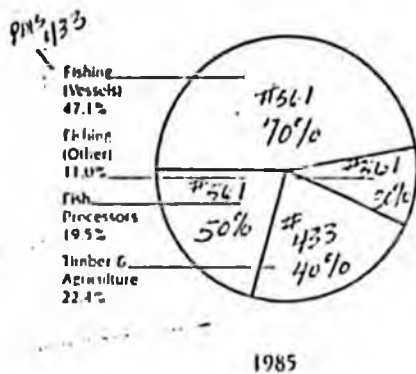
That net reduction is only part of the story, however. CFAB's new loan actions continued in 1986 at a pace much like that of 1985. There were 105 new loans made, totaling \$11,508,000. Of that amount, \$7,825,000 was "new" money, with the remainder being refinancing of loan balances already outstanding on CFAB's books. Slightly less than half, or 46, of the new loans were to new CFAB members; the other 59 new loans were to borrowers who already were, or had been, active CFAB members.

The graphics below show the relative composition of CFAB's loan portfolio at the two most recent year-ends. It continues to be clear that CFAB is an important source of

vessel financing for Alaska fishermen. There is also a noticeable increase in demand for the financing of Limited Entry Permit purchases, particularly for diversification into new fisheries. CFAB is the only private institution which has the legal authority to make such a loan and to accept the permit itself as security. Unfortunately certain restrictions expressed in CFAB's statute and not related to credit considerations have severely limited the range of commercial fishermen to whom CFAB may make such loans.

As discussed in the 1985 Annual Report, CFAB cannot assert that its lending activities have broad effects on the industries it is mandated to serve. The effects tend to be localized and, more specifically, focused on individual borrowers. The most generalized implications of CFAB's presence and ability to offer financing are felt by all fishermen as a result of the competitive pressures imposed on alternative loan sources.

The charts below are somewhat distorted by the consolidation of "Timber & Agriculture" for the sake of simplicity. CFAB has had no new farm loan activity for the past two years. This appears to be the result of two primary factors: (a) The State's own agricultural loan program which offers subsidized financing, particularly for developmental activities; and (b) the relatively strong and stable circumstances of long-established farm operators, whose needs for short-term production financing are also served by the State's programs. The State's posture and capacities appear to be changing, and it seems possible that 1987 will present new agricultural financing opportunities and requirements for CFAB.



See last year



Board of Directors
Alaska Commercial Fishing and
Agriculture Bank
Anchorage, Alaska

We have examined the balance sheets of Alaska Commercial Fishing and Agriculture Bank as of December 31, 1986 and 1985, and the related statements of earnings, changes in capital and allocated/unallocated undistributed patronage earnings (loss), and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Alaska Commercial Fishing and Agriculture Bank as of December 31, 1986 and 1985, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.

Certified Public Accountants
January 23, 1987
(March 2, 1987 as to Note 1)

^{PMS 561}

ALASKA COMMERCIAL FISHING & AGRICULTURE BANK *PM 5/33*
Balance Sheets *561*

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	December 31,	
	1986	1985
Assets		
Cash	\$ 147,410	\$ 106,773
Temporary investments	4,150,000	3,200,000
Loans and other receivables, net of allowance for loan losses of \$3,291,026 and \$1,441,130	41,130,799	62,495,806
Accrued interest receivable:		
Temporary investments	4,700	44,144
Loans and other receivables	1,302,252	2,071,202
	1,306,952	2,115,346
Investment in Spokane Bank for Cooperatives	5,390,548	5,252,423
Bank premises, furniture and equipment, net	351,874	471,503
Acquired assets held for sale	83,007	1,606,164
Other assets	28,797	90,563
	<u>\$52,589,587</u>	<u>\$75,338,578</u>
Liabilities		
Accounts payable and accrued expenses	\$ 191,979	\$ 308,016
Accrued interest payable	233,634	416,780
Class B preferred stock subscriptions	60,163	
Notes payable	25,002,539	48,268,294
	<u>25,488,315</u>	<u>48,993,090</u>
Commitments and Contingent Liabilities (Note H)		
Capital and Patronage Earnings:		
Share capital—		
Class C special preferred stock, \$10,000 par value, authorized 4,000 shares, outstanding 3,180 shares	31,800,000	31,800,000
Class B preferred stock, \$100 par value, authorized 400,000 shares, outstanding 40,410 and 65,845 shares	4,041,000	6,584,500
Loans receivable on Class B preferred stock	(3,698,500)	(6,584,500)
Class A membership stock, \$10 par value, authorized 10,000 shares, outstanding 975 and 931 shares	9,750	9,310
	<u>32,152,250</u>	<u>31,809,310</u>
C Stock retirement pool	184,930	92,152
Capital in excess of par value	86,940	82,980
Contributed capital	144,626	144,626
	32,568,746	32,129,068
Allocated undistributed patronage earnings	825,691	1,045,365
Unallocated undistributed patronage earnings	535,780	
Unallocated undistributed patronage loss	(6,828,945)	(6,828,945)
	<u>27,101,272</u>	<u>26,345,488</u>
	<u>\$52,589,587</u>	<u>\$75,338,578</u>

See notes to financial statements

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ALASKA COMMERCIAL FISHING & AGRICULTURE BANK ^{7/13/83}
Statements of Earnings ^{12/1/83}

^{12/1/83}
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	Year Ended December 31,	
	1986	1985
Interest Income:		
Interest on loans and other receivables	\$ 6,119,445	\$10,141,090
Interest on temporary investments	165,143	362,767
	<u>6,284,588</u>	<u>10,503,857</u>
Interest expense	3,763,900	6,267,003
Loss on assets held for sale	1,347	91,127
Provision for loan losses	50,470	1,234,930
	<u>3,817,717</u>	<u>7,593,060</u>
	<u>2,466,871</u>	<u>2,910,797</u>
Other Expenses:		
Salaries and benefits	1,184,760	1,705,780
Occupancy expense	203,379	252,300
Depreciation and amortization	131,789	160,279
Professional fees	110,181	150,191
Advertising and promotion	67,861	79,922
Travel, lodging and meals	66,219	136,675
Office operations	62,722	126,717
Telephone and postage	40,484	87,238
Miscellaneous	36,522	50,554
Directors' fees	27,174	46,954
	<u>1,931,091</u>	<u>2,796,610</u>
Unallocated undistributed patronage earnings before income tax expense and extraordinary credit	533,780	114,187
Income tax expense	226,300	32,200
Unallocated undistributed patronage earnings before extraordinary credit	309,480	81,987
Extraordinary credit - utilization of net operating loss carry forward	226,300	32,200
Unallocated undistributed patronage earnings	<u>\$ 533,780</u>	<u>\$ 114,187</u>

See notes to financial statements

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Statements of Changes in Capital and Allocated / Unallocated Undistributed ⁷⁻¹³⁻⁸³ 56-1

541 Patronage Earnings (Loss)

Part 1
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Change in
Unallocated
patronage

	Share Capital	C Stock Retirement Pool	Capital In Excess Of Par Value	Contributed Capital	Allocated Undistributed Patronage Earnings	Unallocated Undistributed Patronage Earnings	Unallocated Undistributed Patronage Loss	Total
Balance, January 1, 1985	\$31,808,880	\$ 10,260	\$79,110	\$144,626	\$4,514,237	\$ -	\$ (9,977,776)	\$26,579,337
Issuance (redemption) of stock during the year:								
Class B preferred stock, 29,332 shares, net	(2,933,200)							(2,933,200)
Class A stock, 43 shares	430		3,870					4,300
C stock retirement pool:								
Class B preferred stock assessments		171,398						171,398
Assessments receivable		(89,506)						(89,506)
Reduction in loan receivable on Class B preferred stock redemption	2,933,200							2,933,200
Loan principal charged against allocated undistributed patronage earnings					(434,228)			(434,228)
Unallocated undistributed patronage earnings						114,187		114,187
Allocation to unallocated undistributed patronage loss								
Balance, December 31, 1985	31,809,310	92,152	82,980	144,626	13,034,644	(114,187)	3,148,831	26,345,488
Issuance (redemption) of stock during the year:								
Class B preferred stock, 25,435 shares, net	(2,543,500)							(2,543,500)
Class A stock, 44 shares	440		3,960					4,400
Reduction in loans receivable on Class B preferred stock redemption	2,886,000							2,886,000
C stock retirement pool:								
Class B preferred stock assessments		70,966						70,966
Assessments receivable		21,812						21,812
Loan principal charged against allocated undistributed patronage earnings					(219,674)			(219,674)
Unallocated undistributed patronage earnings						535,780		535,780
Balance, December 31, 1986	\$32,152,250	\$184,930	\$86,940	\$144,626	\$ 825,691	\$535,780	\$ (6,828,945)	\$27,101,272

See notes to financial statements

Statements of Changes in Financial Position ^{>133} _{>541 ✓}

	Year Ended December 31.	
	1986	1985
Source of Funds:		
From Operations:		
Unallocated undistributed patronage earnings	\$ 535,780	\$ 114,187
Items not requiring the use of funds:		
Depreciation and amortization	131,789	160,279
Provision for loan loss	50,470	1,224,930
Loss (gain) on sale of assets	683	(839)
Funds provided from operations	718,722	1,508,557
Net proceeds from sale of assets	2,032	20,924
Net proceeds from stock issuance	4,400	4,300
Decrease in cash		16,558
Decrease in temporary investments		5,627,865
Decrease in acquired assets held for sale	1,523,157	755,141
Decrease in loans	21,515,111	28,869,727
Decrease in other assets	61,566	411,485
Decrease in accrued interest receivable	808,394	1,089,589
Increase in stock subscription payable	60,163	
Increase in Class B preferred stock assessments, net	92,778	81,892
Increase in Class B preferred stock	342,500	
	<u>\$25,128,823</u>	<u>\$38,386,038</u>
Use of Funds:		
Loans charged off, net of recoveries	\$ 200,574	\$ 3,111,420
Loan principal charged against allocated undistributed patronage earnings	219,674	434,228
Increase in cash	40,637	
Increase in temporary investments	950,000	
Increase in investment in Spokane Bank for Cooperatives	138,125	513,689
Increase in bank premises, furniture and equipment	14,874	3,637
Decrease in accounts payable and accrued expenses	116,038	64,000
Decrease in accrued interest payable	183,146	1,953,073
Decrease in notes payable	23,265,755	32,305,991
	<u>\$25,128,823</u>	<u>\$38,386,038</u>

See notes to financial statements

Years Ended December 31, 1986 and 1985

Note A - Summary of Significant Accounting Policies:

Operations: The Alaska Commercial Fishing and Agriculture Bank (CFAB) was incorporated on May 4, 1979 to promote growth of Alaska agriculture and fishing by providing debt financing to resident-owned businesses engaged in harvesting, processing or marketing, and to promote its own growth as a strong user-oriented institution through cooperative ownership and self-governance.

CFAB is a cooperative corporation and intends to refund any allocated undistributed patronage earnings at such time as the Board of Directors finds that the financial condition of CFAB will so permit.

Interest on loans: The accrual of income on loans is discontinued when interest or principal is contractually past due more than 90 days.

Patronage dividends: Patronage dividends received from Spokane Bank for Cooperatives (SBC), of which CFAB is a member, reduce interest expense to SBC in the year declared.

Allowance for loan losses: The allowance for loan losses is based upon specific identification of uncollectible loans and a general reserve for those loans not specifically identified.

Acquired assets held for sale: Acquired assets held for sale include those assets acquired through foreclosure. These assets are carried at the lower of fair market value or the recorded investment in the related loan. Holding costs are expensed when incurred unless such costs increase the fair market value of the asset.

Bank premises, furniture and equipment: Bank premises, furniture and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are charged to operations by use of the straight-line method over estimated useful lives of three to ten years. Expenditures for maintenance and repairs are charged to operating expense as incurred. Expenditures for renewals or improvements which extend the life of an asset are capitalized at cost and depreciated as stated above. Upon sale, retirement or other dispositions of

property, the cost and accumulated depreciation are removed from the respective accounts and the resulting gain or loss recorded.

Income taxes: Amounts provided for income tax expense are based on earnings reported for financial statement purposes, rather than on the taxable income shown on the corporate income tax return. These amounts may differ because certain items are recorded as income or expense in different years for financial statement and tax return purposes.

Note B - Loans:

CFAB's loan portfolio by major category is as follows:

	December 31,	
	1986	1985
Vessels	\$25,623,250	\$34,135,387
Fish processors	8,702,504	14,172,810
Agriculture and timber	7,596,991	16,221,453
Gear, entry permits, and other	4,371,442	7,697,386
Other receivables	1,826,138	294,400
	<u>48,120,325</u>	<u>72,521,436</u>
Less loans receivable on Class B preferred stock	(3,698,500)	(6,584,500)
	<u>44,421,825</u>	<u>65,936,936</u>
Less allowance for loan losses	(3,291,026)	(3,441,130)
	<u>\$41,130,799</u>	<u>\$62,495,806</u>

The loan portfolio includes loans which have been classified as nonaccrual. Nonaccrual loans by major category are as follows:

	December 31,	
	1986	1985
Fish processors	\$ 4,441,655	\$ 5,246,914
Vessels	3,025,085	4,480,781
Agriculture and timber	7,569,743	3,740,558
Gear, entry permits and other	2,286,902	2,185,492
	<u>\$17,323,385</u>	<u>\$15,653,345</u>

133
131

Activity in the allowance for loan losses is as follows:

	December 31,	
	1986	1985
Balance at beginning of year	\$ 3,441,130	\$ 5,317,621
Charged to expense	50,470	1,234,929
Recoveries on loans previously charged off	688,266	374,859
	<u>4,179,866</u>	<u>6,927,439</u>
Loans charged off	(888,840)	(3,486,309)
Balance at end of year	<u>\$ 3,291,026</u>	<u>\$ 3,441,130</u>

CFAB serves the financial needs of the commercial fishing and agricultural industries in the State of Alaska. These industries are subject to seasonal and cyclical fluctuations which could affect the borrowers' ability to repay loans on a timely basis.

Loans to directors: To qualify for election to the CFAB Board of Directors, an individual must be a borrowing member. Loans to members who serve on the Board of Directors must be approved by the SBC. Total loans to these members were \$141,247 and \$1,613,378 in 1986 and 1985, respectively.

Note C — Temporary Investments:

Temporary investments consisted of \$4,150,000 of Farm Credit Bonds maturing at various dates in 1987, with interest rates ranging from 5.99% to 8.50% and certificates of deposit of \$3,200,000 with interest rates ranging from 8.45% to 8.52% at December 31, 1986 and 1985, respectively.

Note D — Bank Premises, Furniture and Equipment:

The following represents a classification of bank premises, furniture and equipment by major category:

	December 31,	
	1986	1985
Furniture, fixtures and equipment	\$ 893,365	\$ 889,432
Leasehold improvements	147,202	147,202
	<u>1,040,567</u>	<u>1,036,634</u>
Less accumulated depreciation and amortization	(688,693)	(565,131)
	<u>\$ 351,874</u>	<u>\$ 471,503</u>

Note E — Notes Payable:

Notes payable consisted of the following:

	December 31,	
	1986	1985
Spokane Bank for Cooperatives (SBC) long-term notes with interest rates ranging from 10.544% to 11.75% maturing at various dates to January, 1993	\$25,000,000	\$28,000,000
SBC short-term notes and seasonal loan with interest rates ranging from 8.7% to 10.25% maturing at various dates in 1986		20,220,081
Other notes payable and capitalized equipment leases with various interest rates and maturity dates	2,539	48,213
	<u>\$25,002,539</u>	<u>\$48,268,294</u>

The loans are secured by substantially all CFAB assets

Principal payments required on notes payable are as follows:

Year Ending December 31,	Amount
1987	\$ -
1988	10,000,000
1989	10,000,000
1990	5,000,000

CFAB must invest in SBC's Class C stock in an amount equal to at least 5% of the cumulative average loan balance maintained with SBC. The amount of CFAB's investment in SBC's Class C stock and equity in allocated surplus was \$5,390,548 and \$5,252,423 at December 31, 1986 and 1985, respectively.

Note F — Pension Plans:

CFAB has pension plans covering substantially all employees. The total cost charged to operations for 1986 and 1985 was \$57,422 and \$58,372, respectively. The Board of Directors voted to terminate the floor retirement pension plan during 1986. The floor retirement pension plan provided for payments in the event the remaining pension plan was not sufficiently funded to meet actuarially computed retirement funding. As of December 31, 1985, the net assets available for benefits under the floor retirement plan was \$28,244. This amount will be refunded to CFAB upon the approval of termination by regulatory agencies. In accordance with generally accepted accounting principles, no gain will be recorded until the regulatory approval of the termination is obtained.

Note G — Capital and Patronage Earnings:

State Capital: Shares purchased by the State of Alaska must be repurchased by CFAB on or before July 20, 2000.

Preferential shareholders' rights on dissolution are attached in the order of Class C, Class B and Class A.

The following rights apply to the three categories of stock:

- Class C** - No voting or dividend rights. May only be issued to the State of Alaska.
- Class B** - No voting rights. Class B stock may only be held by members of CFAB. Prior to December 31, 1985, all loans required a purchase of Class B stock in an amount equal to 10% of the loan balance; however, this purchase was not funded but was evidenced by notes. On loans made subsequent to December 31, 1985, each borrower is required to make a cash purchase of Class B stock in an amount equal to 5% of the total loan. This investment will remain in place until retired by the Board of Directors.
- Class A** - No dividend rights. Each member of CFAB must own one share of Class A stock. Each share of stock carries one vote. To vote a member must be engaged in commercial fishing or agriculture and must be a current borrower or have borrowed from CFAB during the preceding two years or have a minimum retained patronage earnings with CFAB of \$2,500.

*Part 4
4/3/83*

Unallocated Undistributed Patronage Loss: In accordance with Alaska Commercial Fishing and Agriculture Bank bylaws, the Board of Directors acted to reduce an unallocated undistributed patronage loss in the amount of \$9,977,776 as follows: 1) by allocating \$3,034,644 to allocated undistributed patronage earnings of prior years in 1985; and 2) by charging \$114,187 to 1985 unallocated undistributed patronage earnings. At December 31, 1986, the remaining unallocated undistributed patronage loss amount was \$6,828,945 (see Note I).

Class C Stock Repurchase Plan: In accordance with AS 44.81.010(b), on or before July 20, 2000, CFAB is required to repurchase its Class C stock issued to the State of Alaska. CFAB implemented a program requiring borrowers originating loans after December 12, 1983 to make an additional purchase of Class B stock for the assumed purpose of ultimately funding the repurchase of Class C stock. This plan was in effect until December 31, 1985. Notes originated after December 31, 1985, are not subject to this program but are subject to new Class B stock requirements.

Note H — Contingencies and Commitments:

Contingencies: CFAB is a defendant in several legal actions arising from normal business activities including actions related to delinquent loans and foreclosures. CFAB reserves for potential losses on delinquent loans as described in Note A. As to litigation outside of delinquencies and foreclosures, management believes that those

actions are without merit or that the ultimate liability, if any, resulting from them will not materially affect CFAB's financial position or its results of operations.

Commitments: CFAB has entered into certain noncancelable long-term operating lease agreements for buildings. Rental expense under these leases totaled \$192,150 and \$231,549 for the years ended December 31, 1986 and 1985, respectively. Minimum annual lease payments are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
1987	\$201,000
1988	182,000
1989	174,000
1990	43,000

Note I - Subsequent Event:

On March 2, 1987, in accordance with Alaska Commercial Fishing and Agriculture Bank bylaws, the Board of Directors acted to reduce the unallocated undistributed patronage loss by charging \$321,468 to 1986 unallocated undistributed patronage earnings. The remaining unallocated undistributed patronage loss is \$6,507,477.

In addition, the Board of Directors approved an allocation of 1986 patronage earnings totaling \$214,312 to 1986 patrons. This allocation is to be distributed in cash on or before April 1, 1987.

Board of Directors and Staff

W. L. ...

Board of Directors

- Paul A. Huppert
Chairman
- Robert Waldrop
Vice Chairman
- Gilbert Gunderson
Secretary/Treasurer
- Hyoung "Henry" Kim
Director
- Alan D. Otness
Director
- Dean Paddock
Director
- Harvey Samuelson
Director

Staff

- Iver H. Amundsen
Assistant Vice President
- ~~Karol A. Askerman~~
~~Assistant Vice President~~
- Karl D. Barnard
Vice President
- Dan A. Berkshire
Assistant Vice President
- Cynthia D. Blush
Senior Bookkeeper
- Darleen S. Church
Vice President
- Robert H. Clark
Assistant Vice President
- Edward E. Crane
President
- John W. Enge
Fisheries Analyst
- A. W. Hall
Business Development Officer
- Lela F. Hart
Assistant Vice President
- Sharon A. Morgan
Administrative Support Secretary
- Deanne L. Osha
Documentation & Information Specialist
- Daydra R. Presley
Communications Manager
- Judy A. Ouling
Administrative Support Clerk
- David G. Rogers
Senior Vice President
- Chianne G. Sanchez
Executive Secretary
- Douglas W. Sindt
Data Processing Supervisor
- Lora C. Smith
Senior Bookkeeper
- Deborah A. Tosch
Documentation Paralegal
- Godelieve C. Van Lint
Administrative Support Clerk
- DeLories M. vonGemmingen
Executive Secretary

more up →

1-23-86 Anch. Times

CFAB's future brightening

by Mary Scarpinato
Times Writer

Alaska's Commercial Fishing and Agriculture Bank once looked like it was in the bad loan business. But a financial turnaround may now be forthcoming, according to president Ed Crane.

New borrowers will help to push along those recovery prospects out of their own pockets with a requirement that they also purchase stock in the bank.

After reporting a \$9.9 million loss for 1984 (primarily due to bad loans in the fishing and timber industries), the 1985 reckoning for CFAB should show a "dramatic improvement, very close to a break-even position," said Crane.

Crane based this picture on

unaudited figures and preferred to hold back on any specific numbers until the audit is completed sometime in February.

"The only remedy is hard work," he said of past and continuing efforts to get CFAB on the upswing.

Much of this has concentrated on attempting to restructure loans verging on repayment problems, he said.

Only last fall, CFAB was warning that its own \$32 million obligation to the state hardly looked like it could be repaid on schedule.

CFAB was created in 1981 to serve fisherman and farmers unable to secure loans from conventional banks. It was essentially launched when the state bought \$32 million worth of CFAB stock on condition that this be repurchased by the year 2000.

"I've always had hope," Crane said, when asked if CFAB's brightening prospects might bode better for return of the state's investment.

New borrowers, in one sense, will be making investments similar to the state's.

As of Jan. 1, anyone taking out a CFAB loan (including previous borrowers taking out additional loans) must purchase stock with a value equal to 5 percent of the loan.

But, unlike the state, these borrowers have no repurchase arrangement.

"We are asking, we are requiring, that people take a risk if they are going to be borrowers," Crane said, adding that these individuals also have an interest in the financial health of the institution.

Meanwhile, CFAB has been doing its own belt-tightening. Last summer, four of its branch offices were closed. Staff was cut from 39 to 24. No salary levels were reduced for remaining personnel but employees are working to cut overhead in their various departments, Crane said.

"Essentially, it's been the efforts of our staff," he said, "particularly with creditors, dealing with non-performing loans. This was being done in the past, but we're attempting to react sooner now."

During 1984, CFAB had delinquent loans amounting to roughly \$32 million, or more than one-third of its entire loan portfolio. Its interest rates range between 13.5 percent and 14.25 percent, Crane said.

3-4-86 Anch. Daily News

CFAB rebounds from loss with small profit

By JIM ERICKSON
Daily News business reporter

The Commercial Fishing and Agriculture Bank has rebounded from the largest losses in its six-year history and posted a small profit in 1985.

Ed Crane, president of CFAB, said Monday the company made significant strides last year in controlling a slew of bad fishing loans that resulted in a \$10 million loss in 1984 and pushed the bank to the brink of failure.

"As far as non-performing loans are concerned, we really made a lot more progress than I thought we would," Crane said.

Audited financial results for 1985 show CFAB posted operating earnings of \$114,000. The bank lost \$9.97 million the previous year.

Through more aggressive collection action, restructuring of problem loans and foreclosures, CFAB has cut the amount of bad loans by half.

As of Dec. 31, 1984, the bank had \$32 million in loans classified "non-performing," or 90 days past due. That was 36 percent of its \$89 million loan portfolio.

A year later, nearly \$16 million of the bank's \$62 million loan portfolio were non-performing, or 25 percent.

The legislature created CFAB in 1978 to provide loans to farmers, fishermen and the timber industry that traditionally have had trouble getting loans from conventional lenders. About 85 percent of CFAB's loans finance vessels for individual fishermen.

To launch CFAB, the state in 1960 purchased \$32 million worth of the cooperative's stock, essentially providing an interest-free loan due in the year 2000.

Crane informed the state last year that the bank's troubles would make it impossible to repay the state on time.

On Monday, he said the improved financial outlook "enhanced the possibility (of repaying the state), but we've got to do a lot better than \$114,000 a year to realistically project repaying that \$32 million 14 years from now."

Crane said hard work by employees and a good year overall for the fishing industry contributed to the turnaround. The bank also closed four offices and reduced staff from 39

to 24 last year.

"If you look at this as a struggle for survival, I see it as us driving from Anchorage to New York City and we pulled into Edmonton a half day ahead of schedule. That's good, that's satisfying, but we've still got a long way to go."

However, CFAB assets shrunk from about \$110 million in 1984 to \$75 million last year. Crane said that was partly because of fewer borrowers due to uncertainty in the fishing industry.

In addition, CFAB has been forced by its loan problems to keep its interest rates about 2 to 3.5 percentage points higher than competing lenders, Crane said. CFAB's highest rate is about 14.75 percent, he said.

That has resulted in the flight of some of CFAB's most-profitable and less-risky customers to other lenders, he said.

"What I find most troublesome is that we're forced by statute and expectations into such a very narrow corner as far as lending activity is concerned," he said.

ALASKA STATE LEGISLATURE - SENATE

SENATOR RICHARD I. ELIASON

RULES COMMITTEE, CHAIRMAN
LABOR & COMMERCE COMMITTEE, VICE CHAIRMAN
LEGISLATIVE COUNCIL
RESOURCES COMMITTEE
FISHERIES SUBCOMMITTEE, CHAIRMAN



P.O. BOX 143
SITKA, ALASKA 99835
P.O. BOX V
JUNEAU, ALASKA 99811
(907) 465 4916

MEMORANDUM

TO: Senator Jack Coghill, Chair
Senate Resources Committee

FROM: Senate Resources Fisheries Subcommittee

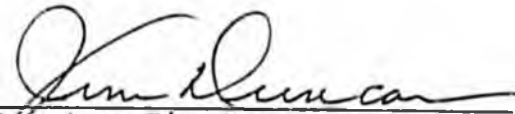
DATE: March 20, 1987

RE: S.B. 8 and S.B. 9 -- legislation relating to the
Commercial Fish and Agriculture Bank (CFAB)

The fisheries subcommittee reports back the above mentioned legislation to the Senate Resources Committee and recommends that S.B. 8 and S.B. 9 be considered by the Committee as soon as possible.



Senator Dick Eliason, Chair



Senator Jim Duncan, Member



Senator Fred Zharoff, Member

Alaska State Legislature

Senate Resources Committee



Sen. John B. (Jack) Coghill, Chairman
Sen. Paul Fischer, Vice Chairman
Sen. Lloyd Jones
Sen. Arliss Sturgulewski
Sen. Jim Duncan
Sen. Fred Zhatoff
Sen. Dick Eliason

Box V
Juneau, Alaska 99811
(907) 465-4907

TO: SENATE RESOURCES COMMITTEE
FROM: COMMITTEE STAFF
DATE: APRIL 15, 1987
RE: CFAB INFORMATION

CONTENTS

1. MEMO FROM FISHERIES SUBCOMMITTEE
2. FRED PRATT ARTICLE ON CFAB
3. ANCHORAGE DAILY NEWS CFAB ARTICLE (4/9/87)
4. 1986 FINANCIAL STATEMENT
5. STATUTES REGARDING CFAB

Alaska State Legislature

Senate Resources Committee



Sen. John B. (Jack) Coqhill, Chairman
Sen. Paul Fischer, Vice-Chairman
Sen. Lloyd Jones
Sen. Arliss Sturgulewski
Sen. Jim Duncan
Sen. Fred Zharoff
Sen. Dick Eliason

Box V
Juneau, Alaska 99811
(907) 465-4907

TO: SENATE RESOURCES COMMITTEE MEMBERS
FROM: COMMITTEE STAFF
DATE: APRIL 15, 1987
RE: SB 8 " An Act Related to the Commercial Fish and
Agricultural Bank"

CONTENTS

1. SPONSOR'S BILL ANALYSIS BY SECTION
2. DEPARTMENT OF REVENUE FISCAL NOTE
3. LETTER TO SENATOR ZHAROFF FROM ED CRANE
4. FOURTEEN POINTS FROM CFAB, GENERAL INFORMATION



SENATOR FRED F. ZHAROFF
ALASKA STATE LEGISLATURE

P.O. BOX 405, KODIAK, ALASKA 99816 (907) 486-6259

DURING SESSION:

P.O. BOX V, JUNEAU, ALASKA 99811 • (907) 485-3473 • 485-3474

DISTRICT N

ALASKA PENINSULA • ALEUTIAN CHAIN • BRISTOL BAY • KODIAK ISLAND • LAKE CLARK/LAKE ILIAMNA • PRIBILOF ISLANDS • SHUMAGIN ISLANDS

SECTIONAL ANALYSIS

Senate Bill No. 8 -- "An Act relating to the Commercial Fishing and Agriculture Bank".

SECTION 1

44.81.010(a): Exempts CFAB from the provisions of the Alaska Cooperative Corporation Act (AS 10.15), since the act was not written to apply to cooperative banking institutions such as CFAB. CFAB is governed by its own separate statute (Title 44, Chapter 81), and should not be subject to possible amendments to AS 10.15. CFAB is already exempt from the Alaska Banking Code (AS 06.05).

SECTION 2

44.81.020(a): Deletes language that at least one of the Alaska farmer members of the board have "at least 10 years of Alaskan farm experience". Requirement is difficult to meet and, based on CFAB's experience, unnecessary. Deletes outdated language pertaining to board appointments.

SECTION 3

44.81.090: Amends statute to allow for removal of members of the board of directors who release confidential information in violation of AS 44.81.260 (Confidentiality of CFAB records), who commit "serious ethical misconduct", or who maintain "a chronically and irredeemably substandard borrowing relationship with the bank". Removal occurs upon a unanimous vote of the remaining members of the board. Deletes outdated language pertaining to board appointments.

SECTION 4

44.81.210(a)(20):

Deletes language duplicated from state loan program statutes requiring loan applicants to have experience in the fishery for which they are applying for a loan. As a private institution, CFAB should be free to evaluate loan applications based on its own objective credit standards.

SECTION 5

44.81.210(a)(22):

Deletes unnecessary language. The conditions regarding the acceptance of a pledge of a limited entry permit as security for a loan are spelled out in Section 6.

SECTION 6

44.81.235:

New section. Expands the purposes for which a limited entry permit may be accepted as collateral. Currently, a permit may be pledged as security on a loan to purchase a permit; on a loan for the repair, restoration, or improvement of a commercial fishing vessel or commercial fishing gear; and on a loan for the construction or purchase of a commercial fishing vessel. Language added to reorganize and expand the provisions to read: (1) "purchase, repair, restoration, or improvement of a commercial fishing vessel or commercial fishing gear;" (2) "construction of a commercial fishing vessel;" (3) "working capital, including insurance premiums, fuel, bait, and boat storage and launching expenses;" and (4) "purchase and improvement of set net sites and associated equipment". Allows a permit to be used as security for more than one loan, and to refinance existing debt on the items listed above. Allows a fisherman to use a permit for one fishery to secure funds to use in another fishery. Expands slightly the exception CFAB was granted to AS 16.43.150, which prevents anyone (except the state or CFAB) from legally seizing a permit-holder's permit. This section would allow fishermen more flexibility in their business plans. Under limited circumstances, they would have a new asset to use to leverage funds for their operations. The circumstances are limited because CFAB -- with its special statutory relationship to the fishing industry -- would still be the only private institution with the ability to accept permits as collateral.

the same

50 no Collateral

*roughly make working capital loans possible
they have working capital loans
CFAB has loans a lot of things over the years
permits for business entry*

SECTION 7

44.81.270:

Adds new subsections.

- (b) Requires an annual independent audit. Legislative auditor may confer with and review the workpapers of the independent auditor. Legislative auditor may only conduct an audit at the direction of the Legislative Budget and Audit Committee (AS 24.20.271).
- (c) Requires state bank examiners to perform "an annual qualitative examination and evaluation of the bank", for the standard fee. Outlines what the examination and evaluation shall include.

STATE OF ALASKA 1987 LEGISLATIVE SESSION
FISCAL NOTE

Bill Version: SB 8
Publish Date: _____

REQUEST: _____

Revision Date: _____
Title: Relating to the Commercial
Fishing & Agriculture Bank
Sponsor: Zharoff & Eliason
Requestor: Senate Labor & commerce

Agency Affected: Department Revenue
BRU: Treasury
Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
OPERATING						
PERSONAL SERVICES	-	-	-	-	-	-
TRAVEL	-	-	-	-	-	-
CONTRACTUAL	-	-	-	-	-	-
SUPPLIES	-	-	-	-	-	-
EQUIPMENT	-	-	-	-	-	-
LANDS & STRUCTURES	-	-	-	-	-	-
GRANTS, CLAIMS	-	-	-	-	-	-
MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	-	-	-	-	-
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Thousands of Dollars)

GENERAL FUND	-	-	-	-	-	-
FEDERAL FUNDS	-	-	-	-	-	-
OTHER	-	-	-	-	-	-
TOTAL	-	-	-	-	-	-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

ANALYSIS: Attach a separate page for analysis.

Prepared By: Milt Barker *MB*
Division: Treasury

Phone: 465-2350
Date: January 26, 1987

Approved by Commissioner: *H. Muloe*
Agency: Department of Revenue

Date: 1/26/87

Distribution (by preparer):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)
- Senate Secretary



2550 Denali Street, Suite 1201
P.O. Box 4-2070
Anchorage, Alaska 99509-2070
(907) 276-2007

March 19, 1986

Senator Fred F. Zharoff
Alaska State Legislature
Box V (M.S. 3100)
Juneau, Alaska 99811

Dear Senator Zharoff:

Thank you for your comments and for the constructive interest in CFAB which you expressed during the recent hearing on SB410.

It is unfortunate that such focused discussions as we had might leave an onlooker with the thoughts that Alaska is populated by only two kinds of fishermen/borrowers, either "good" or "poor"; that if a fisherman isn't one he must be the other; and that the "poors" naturally gravitate to CFAB while the "goods" have more attractive alternatives. Such is not the case. However, if a traditional financial institution with, say, \$50.0 million of loanable funds has made a risk-limiting policy decision to have no more than 10 percent of its loan portfolio invested in the Alaska commercial fishing industry, that institution can (and should) be very selective and competitive in determining which segments or which individual members of the industry it will finance. Its management's basic responsibility is to protect and enhance the interests of the stockholders and depositors rather than to serve the industry.

CFAB's only mission in life, on the other hand, is to serve that industry, along with agriculture. Accordingly, it must attempt to -- at best -- attract and accommodate a broad cross-section of the industry. Its policies and practices must be structured to exclude the lowest percentiles (in terms of creditworthiness) of the industry; conversely, they cannot be designed to allow or encourage a "skimming" off the top. All of us lapse into expressions of qualitative judgments when discussing or contrasting CFAB's activities and performance with those of other institutions. In reality, however, the "competition" is illusory because of the great divergence of objectives, purposes, and resources. As a final thought on that matter, I would argue that perhaps one of CFAB's most significant services is that rendered to the "top of the list" operators who do not borrow from it; were it not for CFAB's existence, there would be no motive for other lenders to offer attractive terms to that group.

A major thought expressed at the Resources Committee hearing was that there may well be other features of CFAB's statute which could be constructively modified, and I was invited to address the matter. That is the primary reason for this letter.

Alaska Commercial Fishing and Agriculture Bank

Senator Fred F. Zharoff
March 19, 1986
Page 2 of 8

In my view, the CFAB statute was a creative and visionary response to a worthy need. It is true that the legislature did not necessarily invent the perfect mousetrap the first time around -- there are some points which can hopefully be addressed -- but my strong personal opinion is that CFAB's basic problems have arisen in the implementation process and are not really evidence of a faulty concept. Some of the most damaging events have involved specific instances of poor judgment, flamboyance and speculative growth policies, etc. The more general and pervasive problems, though, appear to stem from a broadbased failure to recognize the genuine uniqueness of CFAB's combination of origin, structure, limitations, objectives, markets, and pressures. That charge of "failure" is not offered as condemnation of anybody. CFAB is unique -- there was no precedent, no pattern, no body of experience to call upon. There is no real reason to believe that those of us involved with CFAB today are any more insightful than our predecessors; we have the benefit and advantage of experience over five eventful years.

The existing statute does give CFAB broad authorities and powers; broader than we have ever used. The only general restriction which tends to be self-defeating is that which is being addressed in SB410. As CFAB's CEO, whose most fundamental responsibility is to work toward the stability and healthy growth of the institution itself, I would subjectively prefer a total removal of the restrictions addressed by SB410, and would justify that by the argument, "What's good for CFAB is good for the State." However, I am realistic enough to recognize that the business of CFAB must be affected by the politics of its creation and heritage, and I am quite pleased with SB410 and its promise.

Before going further with discussion of specific statute features, I would like to address other points which were raised at the hearing and also to stress that the only thing which would help CFAB to deal with its immediate problems is cash (or an interest-earning cash equivalent). I offer that as a matter of fact - not as a plea for cash. The fundamental problem is illiquidity, manifested by the imbalance between interest-bearing debt and interest-earning assets. We did make great strides during 1985 toward curing that imbalance, principally through the liquidation of non-earning assets. Over that year, CFAB reduced its interest-bearing debt by \$32.3 million, but its interest-earning assets were reduced by only \$19.5 million: Effectively, we created \$12.8 million of liquidity and/or earning ability out of the 12-31-84 non-earning assets. In addition, for 1986 we have reduced our operating budget by about \$1.0 million, which has the same effect as creating about another \$7.0 million of earning assets. We can not, and do not, project improvement at the same rate during 1986 -- "easiest" problems get solved first, and we are working our way into the hard core which is much more difficult to deal with!.

Senator Fred F. Zharoff
March 19, 1986
Page 3 of 8

The easiest solution to the immediate problems (from CFAB's standpoint) would be for the State to invest another \$6.0 to \$8.0 million in CFAB, in return for a long-term commitment from our lender as well as that lender's subordination to the State with respect to the future proceeds from \$10.0 or \$12.0 million of non-earning assets in order to secure repayment to the State. That does not appear to be realistic, and I am not certain it would be best just because it would be easiest. On the other hand, there were concepts embodied in some of the committee discussion -- particularly in Senator Coghill's comments -- which I believe are worthy of exploration and which bear potential benefit to both the State and to CFAB. CFAB has an administrative and operational infrastructure which is presently underutilized. Also, we are continuing to build a professional credit staff which, out of necessity, is primarily oriented to difficult situations. It occurs to me, given the current and projected State budget constraints as well as the frequent (but not universal) expressions of sentiment for limiting or eliminating State-funded direct loan programs, that there may well be opportunities for CFAB to act on an agency or contract basis for the State in administering, modifying, or phasing out particular programs. While this is probably something to be addressed administratively rather than through the legislature, it seems appropriate to acknowledge it as relevant to our recent discussion.

There was also some discussion about the status of, and repayment prospects of, the State's \$31.8 million investment in CFAB. We have from time to time heard expressions from various sources that the State should consider abandoning or "writing off" that investment. My personal view is that that action would be inappropriate, for a variety of reasons:

1) CFAB needs to be held accountable for its actions, policies, and results; and ownership by the State imposes accountability. It is true that the State's stock is non-voting, while the borrower-members have the theoretical authority and ability to influence the institution through exercise of their voting rights. However, CFAB is still a new institution without a "mature" body of members; while those members have a common interest in general, the most significant interest is one which is specific to each individual; and it would be a very costly and time-consuming effort for a small group of members to work toward correction of a perceived problem -- the most effective control element for members is probably through the election of quality directors. Even though we at CFAB might chafe at the frustrations and imperfections of communicating with legislators and administrators, the practical fact is that the accountability imposed by State investment is probably the greatest possible protection for all parties involved.

2) As a citizen, I can think of no reason the state should abandon the investment. The present value may be nominal - that was, of course, known when the investment was made -- but I'm sure the State has made hundreds

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of other capital investments of various kinds "for a public purpose" and which have limited financial value.

3) As discussed earlier, a non-cash transaction would not assist CFAB in dealing with immediate problems; there would simply be a re-classification in the equity portion of our balance sheet. On the other hand, if there should be a dramatic worsening of CFAB's immediate problems and if CFAB were forced into a bankruptcy and/or liquidation, there is every reason to believe the State would ultimately recover a significant part of its investment. The State should not forego that opportunity.

4) While the \$31.8 million does appear to be an investment of capital, it bears at least one of the elements of debt (a due date). In general, an abandonment of capital has no significant tax implications, but a forgiveness of debt creates a taxable gain. Such an action should be carefully analyzed beforehand, in order that CFAB not be confronted with a horrendous Federal tax liability!

Notwithstanding all of the foregoing, it would seem appropriate that this legislature recognize and address the realities of that investment and the prospects for retirement on the present schedule. As I mentioned the other day, we at CFAB view the obligation very soberly and recognize the clock is running. However, we are doing today what any illiquid individual or entity does; we are committing all available cash to those obligations which have the ability to put us out of business today. As a matter of fact, since the Spokane Bank for Cooperatives holds a lien on all cash proceeds (as well as on most other assets) we could not fund a repayment plan. While there may be no compelling and immediate reason to change the requirement today, we do now have the benefit of over five years of experience and can recognize that a requirement which seemed realistic in 1978 and 1979 is no longer achievable. In CFAB's view it would be more reasonable for the legislature to change the retirement date to, perhaps, July 1, 2010. An alternative might be to set the retirement "at the call of the legislature but in no event prior to July 1, 2010." It would not be unreasonable -- at least in theory -- to attach a sinking fund requirement, but that might involve some difficult negotiations with CFAB's lender depending upon how the requirement were structured.

* * * * *

Following are the other specific points in CFAB's statute (AS 44.81) which we believe could be constructively addressed:

Sec. 44.81.010.(a) The reference to AS 10.15.005-10.15.600 (the basic cooperative statute) should be eliminated. CFAB is unique, and AS 44.81 provides a specific and comprehensive organic foundation. AS 10.15 is subject

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to change without regard for its impact on CFAB, and a basic necessity for a credit institution, especially one involved in long-term loans, is stability in every form. There was an abortive effort in 1984-85 to develop sweeping changes in AS 10.15; that effort had merit within its own context, but many of the proposed changes did not recognize the possible existence of a statewide cooperative whose relationship to members is purely financial.

Sec. 44.81.010.(b) & (c) A modified requirement for repurchase of State capital should be addressed here.

Sec. 44.81.020.(a) & (b) The requirement that at least one board member be an Alaska farmer is constructive. However, the proviso that he/she have "at least 10 years of Alaskan farm experience" (whatever that means!) creates a situation which is probably not in the best interests of members. Since each elected director must also be a current or recent CFAB borrower, it appears there are less than five individuals in the entire state eligible for this position. Other directors don't need to be 10-year fishermen, etc., and a second farmer director does not need to meet the 10-year requirement. Why limit the members' choice of directors in this way?

Also, there should be a provision for removal of an elected director as a result of a unanimous finding by the remaining directors of a "serious conflict of interest or a chronically and irremediably substandard borrowing relationship." We have received a legal opinion, based on the existing statute, to the effect that only the members of CFAB can remove or recall an elected director -- however, since the statute elsewhere prohibits disclosure to members (or anyone else) of information regarding a borrower (including directors), a Catch-22 situation exists.

Finally, this section should also make clear that the five elected directors are accountable as individuals to the members only. They should not be subject to the same requirements, standards, etc., as are the gubernatorial appointees. Each director candidate must literally "campaign" for election, and the members have ample opportunity to apply whatever standards they choose.

Secs. 44.81.200, 44.81.260.(b)(1), 44.81.270, & 44.81.280 Section 44.81.200, by implication, requires CFAB to have an annual financial audit by independent outside auditors. That may be sufficient, but it would not hurt for that requirement to be specific. To avoid costly redundancy while retaining opportunity for legislative oversight, it would be well to provide that the Legislative Audit Division is authorized to confer with, and to review the audit workpapers of, CFAB's outside auditors and could make its own audit only after a recommendation to, and direction by, the Budget and Audit Committee.

A far more important and necessary provision, from our viewpoint, would be for an annual qualitative examination and evaluation by the State's

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bank examiners. CFAB's directors and management are greatly desirous of the discipline imposed by an independent and professional examination. More important, and because CFAB's loan portfolio comprises about 84 percent of its total assets, the State should be vitally interested in a periodic qualitative evaluation. We urge that such an examination be statutorily directed, and that the examiners be required to provide both the legislature and the governor (as well as CFAB's board) with a summary report which expresses loan portfolio quality on a statistical basis and which also addressed the appropriateness and effectiveness of the institution's policies, practices, and management within the context of its statutory purpose.

Secs. 44.81.210.(a)(20) & (22) These paragraphs deal with the bases and circumstances under which CFAB may accept the pledge of a limited entry permit as security for a loan. We recognize the matter of limited entry permits in general is subject to diverse political and emotional overtones; CFAB's subjective view, however, relates strictly to the business asset aspects of permits. It is also premised on the concept that a viable loan is one which is structured to meet the reasonable business needs of both lender and borrower and which preserves the relative risk positions of owner and creditor. An all-too-common perception among non-credit people is that lending is some kind of game of wits which creates either "bank wins/borrower loses" or "bank loses/borrower wins" situations!

Paragraph (20) sets forth requirements which are identical to those of the Commercial Fishing Loan Act administered by the State itself. We have no particular concern with the two-year residency requirement expressed in (20) but, since CFAB was created to serve a broader group than the State's own program, we do not understand why CFAB should be limited to the other requirements in (20) -- they are essentially eligibility requirements, and may or may not have any relevance to objective credit standards a lender might apply. Within the context of "service to Alaska fishermen," an entry permit will only be sold by a limited entry permit holder who is presumably motivated to sell. If CFAB can finance a qualified buyer, which party is getting the benefit of CFAB's existence?

Paragraph (22) is much more difficult for CFAB as a lender. We have been advised frequently by counsel that a restrictive provision such as this will always be construed strictly, rather than liberally, by the courts; consequently, we flatly avoid making loans that we would otherwise be willing to make. Again notwithstanding the complex and controversial history of the limited entry program itself, we do not understand why this asset which is a critical and integral element of any fisherman's operation should have such unique status. The restrictions do not necessarily work to a fisherman's advantage. Consider the hypothetical case of an individual who has managed to accumulate \$50,000 in cash but has no other significant resources; he has arranged to lease a vessel and gear if he can buy a \$50,000 permit and have

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\$35,000 of working capital. If he buys the permit for cash and comes to CFAB for a \$35,000 working capital loan, he probably won't get it. On the other hand, if he has presence of mind enough to come to CFAB first, we might very likely finance \$35,000 of the permit purchase (and on a term basis, rather than on a seasonal working capital basis) and let him use his own funds for working capital. Same individual; all other credit factors the same; but, obviously, paragraph (22) affects his ability to fish.

We are told that a major rationale for the sacrosanctity of limited entry permits is that, "foreclosure of a permit takes away the borrower's ability to fish." We would agree with that. We would hasten to add, however, that no responsible lender -- including CFAB -- lends money in anticipation of acquiring the security pledged. There are many, often misunderstood, reasons for requiring collateral to a loan. In the final analysis, it is a stop-loss feature and/or one which permits a degree of leverage. The courts do not permit a lender to acquire collateral without an often costly and time-consuming showing of clear proof that the borrower cannot and/or will not conform to the loan contract to which he agreed. If a borrower is unwilling to risk his/her legal ability to fish in order to have the financial ability to fish, why should CFAB put other people's money (including the State's) at risk?

As a final example of the impact of paragraph (22), we would cite "gear" loans, for which there is frequent demand. Gear is almost valueless for collateral purposes. An applicant for a gear loan is held by CFAB to essentially the same standards as are applied to an unsecured borrower -- this means very few applicants can qualify. Effectively, CFAB is denying credit to a large body of applicants because an unidentifiable, but small, number of them will not perform. If, however, those applicants could put their permits at risk to secure a gear loan, many more gear loans could be made -- and we expect borrowers would take a much more serious approach to servicing those loans!

We believe paragraph (22) should be rewritten to provide:

(1) Loans made should be restricted to enabling the fisherman to better compete in the fishery for which he holds the pledged permit. In other words, a loan to purchase a drag boat should not be secured by a salmon permit; and,

(2) The authorized loan purpose should be expanded to include:

(a) purchase of fishing gear.

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(b) working capital, including insurance premiums, fuel, bait, boat storage and launching expenses.

(c) purchase and improvement of set net sites and associated equipment.


(3) A provision should be added allowing CFAB to take a permit pledge on more than one loan, provided each loan purpose is authorized for such a pledge.

(4) Refinance of existing debt or debts provided the original loan purpose(s) authorized a permit pledge.

* * * * *

Again, we appreciate the constructive interest expressed by you and your colleagues on March 12. All of us at CFAB -- Directors, management, and staff -- are very much aware of the general and specific obligations CFAB holds toward the State, the public at large, and its mandated constituency. We regret the difficult circumstances of the recent past, and we are committed to restoring CFAB to a position of genuine service to Alaska and its citizens.

Sincerely,



Edward E. Crane
President

EEC:1077V

1. Alaska Commercial Fishing and Agriculture Bank (CFAB) was created in 1978 by the Alaska State Legislature. Its purpose is to provide a source of credit to the Alaska fishing and agriculture industries, with emphasis on the development and broadening of those industries.
2. CFAB is structured under its statute as a cooperative. A cooperative is a corporation whose stockholders and customers are the same individuals or entities. A cooperative is subject to the same business and financial considerations as any other corporation.
3. The State of Alaska provided an initial capital base to CFAB through the purchase of stock; the State presently owns \$31.8 million of such stock. CFAB's statute requires that the State stock be repurchased within 20 years from the original investment (1980).
4. CFAB has no organic, structural, operational, or financial relationship with the State except for the capital investment and that two of CFAB's seven directors are appointed by the Governor.
5. CFAB's lending ability is not limited to the amount of the State's investment. CFAB borrows additional funds at "market" rates and terms, pledging its loans and other assets as security. It re-lends those funds to its borrower/owners at rates sufficient to cover its own interest costs, its operating expenses, and to generate capital through earnings. CFAB's outstanding loans to Alaska fishermen and farmers reached a year-end peak of nearly \$104 million at December 31, 1983, and had other assets of about \$19 million; a total nearly \$91 million greater than the State's investment.
6. CFAB's borrowers become owners through a purchase of stock at the time of borrowing and through payment of interest at a level high enough to create retained earnings.
7. Under its statute, CFAB may lend money only to those individuals who are bona fide residents of Alaska. There appears to be no sound and reasonable argument against that limitation.
8. A vast majority of CFAB's loans are to individual fishermen (about 80 to 85 percent by number); most of them are to finance a vessel and/or are secured by a lien on a vessel. This appears to be CFAB's most "natural" market and the credit void which CFAB was most intended to fill.
9. Compared to almost any other type of commercial lending, financing fishing vessels is extremely cumbersome and costly. Alaska geography adds considerable costs. Those factors, in addition to the dangerous concentration of risk, make it extremely difficult for CFAB to maintain a focus on that market without charging interest rates which are unusually burdensome to its borrowers.
10. CFAB has attempted to balance its loan portfolio, and to moderate its total circumstances, through loans to corporations which process seafood and timber. Those loans tend to be relatively large, but do not require servicing costs to a comparable degree. They permit basic operating expenses to be spread over a larger volume of loan dollars, moderating the pressure on smaller individual borrowers.

11. CFAB's statute provides that it can only finance corporations of which the majority ownership and control rests with Alaska residents.
12. A recent survey disclosed that of 22 shorebased Alaska processors having annual sales in excess of \$10 million, 17 are ineligible to borrow from CFAB by reason of ownership identity. CFAB has, or has had, lending relationships with four of the five others.
13. Statutory denial of eligibility by reason of ownership is inconsistent with the facts that these processing corporations own facilities in Alaska, pay local taxes in Alaska, provide employment to Alaskans, purchase and add value to Alaska seafoods, pay fish taxes to the State of Alaska, provide a competitive marketing environment for Alaska fishermen, and purchase supplies and services in Alaska. Interest paid on funds borrowed from CFAB (or any other Alaska entity) would be an additional and beneficial increment of Alaska seafoods proceeds within the Alaska economy.
14. While it is clear that the 1978 State Legislature intended to create an institution to serve Alaska interests exclusively, the requirement that the state investment be repurchased evidences the intent that CFAB be operated, and grow, on sound business principles. Removal of the statutory limitation with regard to shorebased processing corporations is consistent with the first intent and greatly enhances the opportunity for fulfillment of the second.