

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

**(A COMPONENT UNIT OF THE FEDERATED STATES
OF MICRONESIA NATIONAL GOVERNMENT)**

**FINANCIAL STATEMENTS, ADDITIONAL
INFORMATION AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2008 AND 2007

FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION
(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)

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Years Ended September 30, 2008 and 2007

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INDEPENDENT AUDITORS' REPORT

Chairman
Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

We have audited the accompanying statements of net assets of the Federated States of Micronesia (FSM) Telecommunications Corporation (the Corporation), a component unit of the FSM National Government, as of September 30, 2008 and 2007, and the related statements of revenue, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

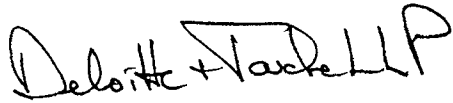
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Corporation as of September 30, 2008 and 2007, and its changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Corporation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audits were conducted for the purpose of forming an opinion on the Corporation's basic financial statements. The accompanying schedule of operating expenses (page 23) is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the Corporation. Such information has been subjected to the auditing procedures applied by us in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2008, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, slightly stylized font.

December 19, 2008

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**
(A COMPONENT UNIT OF THE FEDERATED STATES OF MICRONESIA NATIONAL GOVERNMENT)

Management Discussion and Analysis
Year Ended September 30, 2008

The following discussion and analysis of the financial performance and activity of the Federated States of Micronesia Telecommunications Corporation (FSMTC) is to provide an introduction and understanding of the basic financial statements of the FSMTC for the year ended September 30, 2008. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The FSMTC is a public corporation of the Federated States of Micronesia National Government and is the primary provider of telecommunications services throughout the Federated States of Micronesia (FSM) and to points outside of the FSM. The FSMTC also provides Cable TV in the State of Kosrae and a wireless TV broadcasting system in the State of Yap.

It is under the governance of an appointed 5-member Board of Directors by the President of the FSM and the Governor of each State, which has oversight over both the FSMTC, Cable TV in Kosrae and wireless TV broadcasting in Yap. The General Manager, who is the President and Chief Executive Officer, is also an ex-officio non-voting member of the Board.

The FSMTC provides telecommunications services, which include Plain Old Telephone Services (POTS), to 8,915 active subscribers. Other telecommunications services provided are National and International Overseas Calls, Internet Services, Mobile Cellular Services, Cable Television in State of Kosrae, and Wireless TV in State of Yap.

The FSMTC relies on calls made to and from outside of the FSM and calls within the FSM, which account for approximately 42% of FSMTC revenues. During FY08, FSMTC realized a decrease in Call Revenues of 3% or \$154,314 as compared to FY07. Management believes that the decrease was caused by the increase in internet usage.

During FY2008, internet services account for \$3,142,487 or 25% of FSMTC revenues, an increase of \$527,110 as compared to FY07. As of September 30, 2008, total Internet subscribers were 1,209.

The mobile services account for \$2,129,708 or 17% of FSMTC generated revenues in FY2008. In FY08, FSMTC invested an additional \$6,398,493 as an upgrade to its mobile network system. The upgrade took almost a year, and during that time, mobile services were not functioning properly, which caused a decrease of \$62,612 in mobile revenues as compared to FY07. At September 30, 2008, total mobile subscribers were 33,057, broken down as follows: Pohnpei 15,459, Chuuk 8,761, Yap 6,049 and Kosrae 2,788.

The following table summarizes the financial condition and operations of the FSMTC as of and for the years ended September 30, 2008, 2007 and 2006:

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Year Ended September 30, 2008

Assets:	<u>2008</u>	<u>2007</u>	<u>2006</u>
Cash and cash equivalents	\$ 774,009	\$ 1,260,460	\$ 2,276,011
TCD's and investments in securities	7,692,779	10,308,656	13,840,866
Receivables, prepayments and other assets	2,122,049	2,412,470	1,728,573
Inventory	657,118	642,886	355,316
Property, plant and equipment	<u>44,435,621</u>	<u>45,123,969</u>	<u>41,008,133</u>
	<u>\$ 55,681,576</u>	<u>\$ 59,748,441</u>	<u>\$ 59,208,899</u>
Current liabilities	\$ 2,608,621	\$ 2,774,620	\$ 1,576,947
Noncurrent liabilities	21,937,145	22,824,013	23,686,864
Net assets	<u>31,135,810</u>	<u>34,149,808</u>	<u>33,945,088</u>
	<u>\$ 55,681,576</u>	<u>\$ 59,748,441</u>	<u>\$ 59,208,899</u>
Operating revenues	\$ 12,464,669	\$ 12,823,174	\$ 12,848,046
Operating expenses	<u>(13,500,363)</u>	<u>(13,030,683)</u>	<u>(12,076,681)</u>
(Loss) earnings from operations	<u>(1,035,694)</u>	<u>(207,509)</u>	<u>771,365</u>
Investment (loss) income and others	(1,207,233)	1,547,017	915,247
Interest expense	<u>(771,071)</u>	<u>(1,134,788)</u>	<u>(1,204,370)</u>
(Decrease) increase in net assets	(3,013,998)	204,720	482,242
Net assets at beginning of year	<u>34,149,808</u>	<u>33,945,088</u>	<u>33,462,846</u>
Net assets at end of year	<u>\$ 31,135,810</u>	<u>\$ 34,149,808</u>	<u>\$ 33,945,088</u>

During FY2008, total amount received from telecommunication services exceeded the amount paid to vendors and employees for goods and services. This resulted in net cash provided by operating activities of \$2,690,079.

Total cash and cash equivalent at the end of FY08 is \$774,009 as compared to \$1,260,460 in FY07. The net cash used during FY08 exceeded the net cash provided from operations by \$486,451, mainly due to the acquisition of new capital assets of \$2,577,380. The Corporation withdrew \$1,412,495 from its marketable securities with Solomon Smith Barney to support its cash flow requirements in FY08.

Total revenue in FY2008 decreased by \$358,505 as compared to FY2007. Most were contributed from the decrease in recovery of bad debts. Operating expenses in FY08 increased by \$469,680 in comparison with FY07 operating expenses. Most of the increases were from internet service expenses and plant operation service expenses.

The FSMTC investments in property, plant, and equipment, net of accumulated depreciation, amounted to \$44,435,621 in FY2008 and \$45,123,969 in FY2007.

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Management Discussion and Analysis
Year Ended September 30, 2008

FSMTC's notes payable to the U.S. Department of Agriculture (Rural Utility Services) amounted to \$22,824,414 of which, \$887,269 is classified as the current portion. Interest on funded debts paid during FY2008 was \$771,071, net of capitalized interest of \$393,540 in accordance with FASB 34, associated with construction projects that exceed one year. The principal amount repaid during FY2008 was \$843,683.

Please see the accompanying footnotes to the financial statements for additional information on FSMTC's capital assets and long-term debt.

Management's Discussion and Analysis for the year ended September 30, 2007 is set forth in FSMTC's report on the audit of financial statements, which is dated December 27, 2007. That Discussion and Analysis explains the major factors impacting the 2007 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmpublicauditor.fm.

On November 1, 2005, the FSMTC Board of Directors approved a comprehensive Strategic Plan to direct the Corporation for the next 5 years from 2006 to 2011. The purpose of this Plan is for management directional tool for policy development as well as program delivery. It will guide the Board, management, and staff in dealing with the challenges due to the continuous changes in technology.

Based on the plan, FSMTC is committed to spend \$104,225,504 for the next 5 years with expected revenues of \$87,217,204, the aggregate shortfall is \$17 million. As a result, FSMTC may end up having to borrow from international financial markets to cover the shortfall or tap into cash reserves.

Following are the expected revenues and expenditures for the next three years:

<u>Revenue Source:</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Total</u>
Toll Revenue	\$ 3,751,013	\$ 3,863,543	\$ 3,979,449	\$ 11,594,005
Internet	1,951,604	1,951,604	2,010,152	5,913,360
Net Access	1,508,364	1,523,447	1,538,682	4,570,493
Mobile	4,863,219	5,106,380	5,361,699	15,331,298
External Carriers	134,520	134,520	134,520	403,560
Non-Operating Revenue	1,000,000	1,000,000	1,000,000	3,000,000
Miscellaneous	<u>361,361</u>	<u>368,589</u>	<u>375,960</u>	<u>1,105,910</u>
Total	\$ <u>13,570,081</u>	\$ <u>13,948,083</u>	\$ <u>14,400,462</u>	\$ <u>41,918,626</u>

<u>Expenditure Categories:</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Total</u>
On-Going Expenses:				
Operating expenses	\$ 11,430,712	\$ 12,116,554	\$ 12,843,548	\$ 36,390,814
Capital expenditures	700,000	700,000	700,000	2,100,000

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Management Discussion and Analysis
Year Ended September 30, 2008

Expenditure Categories,
Continued:

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Total</u>
Program Expenditures:				
Board of Directors	27,634	29,015	30,466	87,115
International; Relations	152,869	160,512	168,538	481,919
Government Relations	18,522	19,448	20,421	58,391
Public Relations	137,757	144,645	151,878	434,280
Annual Report	50,000	50,000	50,000	150,000
Community Relations	1,000	1,000	502,855	504,855
Back-up System	2,500	2,500	2,500	7,500
Critical Spare Parts	20,000	20,000	20,000	60,000
Research and Development	420,218	441,229	463,290	1,324,737
Training and Development	115,763	121,551	127,628	364,942
Educational programs	17,364	18,233	19,144	54,741
Website improvement	5,000	5,000	5,000	15,000
Manual Updates	55,566	58,344	61,262	175,172
Strategic Plan Update	5,000	5,000	5,000	15,000
Maintenance and Upgrades	329,923	346,419	463,740	1,140,082
Disaster Recovery Plan	2,500	2,500	2,500	7,500
Fiber Optic	1,121,846	1,121,846	1,121,846	3,365,538
Outer Island Project	1,077,000	1,106,000	116,000	2,299,000
Pricing and Tariffs	5,000	5,000	5,000	15,000
	<hr/>	<hr/>	<hr/>	<hr/>
Total	<u>\$ 15,696,174</u>	<u>\$ 16,474,796</u>	<u>\$ 16,880,616</u>	<u>\$ 49,051,586</u>

On November 19, 2008, the United States Department of Agriculture Rural Development Program notified FSMTC that based on the preliminary review of its "B" loan application, the Corporation is qualified to borrow \$13,120,000. The loan is expected to be approved sometime in January 2009. The loan proceeds of \$3,708,000 are to purchase 8 wavelengths of the fiber capacity from two fibers of the Kwajalein Cable System (KCS) as a capital lease for 25 years. The remaining balance of the loan is for electronics, engineering, and construction of the undersea facilities between Pohnpei and the KCS network branching unit.

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Statements of Net Assets
September 30, 2008 and 2007

	2008	2007
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 774,009	\$ 1,260,460
Time certificates of deposit	112,617	111,142
Investment in securities	7,580,162	10,197,514
Accounts receivable, net of an allowance for doubtful accounts of \$547,612 and \$380,355 in 2008 and 2007, respectively	1,063,877	976,951
Receivables from carriers	312,732	465,586
Advances to employees	20,227	10,184
Inventory	657,118	642,886
Accrued interest and other accrued earnings	317,232	184,602
Other receivables and prepaid expenses	407,981	775,147
Total current assets	11,245,955	14,624,472
Property, plant and equipment, net	44,435,621	45,123,969
	\$ 55,681,576	\$ 59,748,441
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current maturities of long-term debt	\$ 887,269	\$ 844,084
Accounts payable, trade	134,849	272,115
Accounts payable, construction	377,445	661,009
Deferred revenue-debit cards	179,788	196,243
Accrued leave payable	114,063	112,906
Other accrued liabilities	915,207	688,263
Total current liabilities	2,608,621	2,774,620
Long-term debt, net of current portion	21,937,145	22,824,013
Total liabilities	24,545,766	25,598,633
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	21,611,207	21,455,872
Unrestricted	9,524,603	12,693,936
Total net assets	31,135,810	34,149,808
	\$ 55,681,576	\$ 59,748,441

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
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Statements of Revenue, Expenses, and Changes in Net Assets
Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Overseas tolls	\$ 3,482,269	\$ 3,628,642
Internet	3,142,488	2,615,378
Net access	1,810,585	1,818,526
Mobile charges	2,129,708	2,192,320
External carriers	1,770,930	1,712,418
ICTV Kosrae cable charges	89,908	104,553
ICTV Yap cable charges	75,246	78,971
Uncollectible	(156,472)	385,774
Miscellaneous	<u>120,007</u>	<u>286,592</u>
Total operating revenues	<u>12,464,669</u>	<u>12,823,174</u>
Operating expenses:		
Consumer operations	1,948,088	1,955,795
Corporate operations	2,565,602	2,540,281
Plant operations	1,916,624	1,757,805
Cable and wire	1,275,801	1,218,882
General support	1,185,954	1,162,137
Earth station	1,024,713	956,672
Internet expense	1,505,823	1,303,803
Central office	735,330	752,736
Wireless telephone	626,632	567,309
Terminal equipment	471,815	518,564
ICTV expense	<u>243,981</u>	<u>296,699</u>
Total operating expenses	<u>13,500,363</u>	<u>13,030,683</u>
Loss from operations	<u>(1,035,694)</u>	<u>(207,509)</u>
Nonoperating revenues (expenses):		
Interest income - general	10,120	62,402
Interest expense	(771,071)	(1,134,788)
Investment (loss) income	<u>(1,217,353)</u>	<u>1,484,615</u>
Total nonoperating revenues (expenses), net	<u>(1,978,304)</u>	<u>412,229</u>
Change in net assets	(3,013,998)	204,720
Total net assets at beginning of year	<u>34,149,808</u>	<u>33,945,088</u>
Total net assets at end of year	<u>\$ 31,135,810</u>	<u>\$ 34,149,808</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
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Statements of Cash Flows
Years Ended September 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash received from subscribers, long distance carriers and other customers	\$ 12,355,748	\$ 12,391,097
Cash paid to suppliers for goods and services	(5,883,749)	(6,092,777)
Cash paid to employees	(3,781,920)	(3,705,211)
Net cash provided by operating activities	2,690,079	2,593,109
Cash flows from capital and related financing activities:		
Additions to property, plant and equipment	(2,577,380)	(6,679,567)
Repayments of long-term debt	(843,683)	(803,507)
Interest paid on long-term debt	(1,164,111)	(1,204,813)
Net cash used for capital and related financing activities	(4,585,174)	(8,687,887)
Cash flows from investing activities:		
Net purchases, sales and maturities of investments	(105,518)	(263,897)
Withdrawals from investments	1,412,495	5,017,066
Interest and dividends received on investment securities	93,022	266,832
Interest received on time certificate of deposit	8,645	59,226
Net cash provided by investing activities	1,408,644	5,079,227
Net change in cash and cash equivalents	(486,451)	(1,015,551)
Cash and cash equivalents at beginning of year	1,260,460	2,276,011
Cash and cash equivalents at end of year	\$ 774,009	\$ 1,260,460
Reconciliation of loss from operations to net cash provided by operating activities:		
Loss from operations	\$ (1,035,694)	\$ (207,509)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation	3,375,204	3,294,765
Bad debts	167,257	-
(Increase) decrease in assets:		
Accounts receivable	(254,183)	(389,446)
Receivable from carriers	152,854	(307,627)
Advances to employees	(10,043)	25,450
Inventory	(14,232)	(287,570)
Accrued interest and other accrued earnings	(132,630)	172,112
Other receivables and prepaid expenses	367,166	(184,386)
Increase (decrease) in liabilities:		
Accounts payable, trade	(137,266)	175,983
Deferred revenue-debit cards	(16,455)	58,596
Accrued leave payable	1,157	(13,776)
Other payables and accrued expenses	226,944	256,517
Net cash provided by operating activities	\$ 2,690,079	\$ 2,593,109

See accompanying notes to financial statements.

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Notes to Financial Statements
September 30, 2008 and 2007

(1) Summary of Significant Accounting Policies

Nature of Operations

The Federated States of Micronesia (FSM) Telecommunications Corporation (the Corporation), a component unit of the FSM National Government, is a local exchange carrier (LEC) and an international exchange carrier providing local telephone service, cellular service, Internet access, long distance telecommunication services, and digital wireless TV. The Corporation serves commercial and residential customers in the four states that comprise the FSM - Chuuk, Kosrae, Pohnpei and Yap.

Organization

The Corporation was established as a public corporation under the laws of the Federated States of Micronesia, the purpose of which is to provide telecommunications services, except radio and television broadcasting, throughout the FSM and to points outside the FSM and began its operations in October 1983.

Basis of Accounting

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Corporation implemented all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989.

The Corporation maintains a chart of accounts in accordance with the Uniform System of Accounts for telephone companies of the United States Federal Communications Commission's Rules, and in conformity with accounting principles generally accepted in the United States of America (GAAP). Additionally, the Corporation utilizes the accrual basis of accounting.

The Corporation has adopted GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No.'s 37 and 38, which establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following three net asset categories:

- Invested in capital assets, net of related debt:

Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted:

➤ Nonexpendable - Net assets subject to externally imposed stipulations that require the Corporation to maintain them permanently.

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Notes to Financial Statements
September 30, 2008 and 2007

(1) Summary of Significant Accounting Policies

Basis of Accounting, Continued

- Expendable - Net assets whose use by the Corporation is subject to externally imposed stipulations that can be fulfilled by actions of the Corporation pursuant to those stipulations or that expire by the passage of time.

The Corporation has no restricted net assets at September 30, 2008 and 2007.

- Unrestricted:

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity date within three months of the date acquired by the Corporation. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified in the statements of net assets. Certificate of deposit investment accounts established and set aside for future capital expenditure projects are classified within investment in securities.

Investments

Investments and related investment earnings are reported at fair value using quoted market prices. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Accounts Receivable

Accounts receivable are due from businesses and individuals located within the FSM and are interest free and uncollateralized. Receivables from international carriers are due from entities within the United States and Japan.

Accounts receivable are stated at the amount management expects to collect on outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection effects are written off through a charge to the valuation allowance and a credit to accounts receivable.

Inventory

Materials and supplies are valued at cost, which approximates market, using the first-in-first-out (FIFO) method.

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Notes to Financial Statements
September 30, 2008 and 2007

(1) Summary of Significant Accounting Policies, Continued

Property, Plant and Equipment

Property, plant and equipment are stated at cost. The Corporation capitalizes buildings, land improvements and equipment that have a cost of \$2,000 or more and an estimated useful life of at least five years. The cost of maintenance and repairs is charged to operating expenses. Depreciation is calculated on the straight-line method over the estimated useful lives of the respective assets.

Plant Under Construction

Plant under construction represents the accumulated costs of unfinished capital projects. These costs are capitalized as property, plant and equipment upon completion of each project.

Valuation of Long-Lived Assets

The Corporation, using its best estimates based on reasonable and supportable assumptions and projections, reviews assets for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable. Impaired assets are reported at the lower of cost or fair value. At September 30, 2008 and 2007, no assets had been written down.

Compensated Absences

It is the Corporation's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. No liability is reported for unpaid accumulated sick leave. Vacation pay is accrued when incurred.

Advertising Cost

Advertising costs are charged to operations when incurred.

Income Taxes

Corporate profits are not subject to income tax in the FSM. The FSM National Government imposes a gross revenue tax of 3% on revenues. The Corporation is specifically exempt from any taxes except import taxes in accordance with its enabling legislation.

Revenue Recognition and Classification

Billings for local service revenue and basic internet service are rendered monthly in advance. Advance billings are recorded as a liability and are subsequently transferred to income in the period earned. Prepaid card revenues are recorded when the cards are sold.

Long distance network services revenues and usage-sensitive internet service revenues are based on a per-minute charge paid by the end user or other telecommunications service providers. These revenues are billed in arrears, but are recognized in the month that service is provided.

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Notes to Financial Statements
September 30, 2008 and 2007

(1) Summary of Significant Accounting Policies, Continued

Revenue Recognition and Classification, Continued

The Corporation records all revenue generated from providing telecommunications services as operating revenue, including local service, long distance, internet, and cellular services.

Non-operating revenues and expenses consist of investment earnings, interest paid on long-term debt, and grant funds received.

Reclassifications

Certain reclassifications have been made to the 2007 financial statements in order to conform to the 2008 presentation.

New Accounting Standards

During fiscal year 2008, the Corporation implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*, and GASB Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments and GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing, and includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

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(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

Management Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(2) Investment – Island Cable Television

On December 8, 1998, the Corporation acquired a 50% ownership in Island Cable Television - Pohnpei for \$450,000. The Corporation recorded this investment under the equity method of accounting. Goodwill of \$383,062 resulting from the purchase was being amortized over a period of fifteen (15) years. The remaining goodwill balance of \$325,603 as of September 30, 2002 was written-off.

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(3) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The deposit and investment policies of the Corporation are governed by the Board of Directors. As such, the Board of Directors is authorized to delegate certain responsibilities to third parties. Investment managers have discretion to purchase, sell, or hold the specific securities to meet the objectives set forth in the investment policy.

Generally, the Corporation can invest in bonds and other indebtedness of the U.S. and in preferred or common stock of any corporation created or existing under the laws of the U.S. or any U.S. state, territory, or commonwealth. Additionally, a maximum of 20% of the total portfolio may be invested in non-U.S. equities.

A. Deposits

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by the Corporation or its agent in the Corporation's name;
- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Corporation's name; or
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Corporation's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Corporation's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution but not in the Corporation's name. The Corporation does not have a deposit policy for custodial credit risk.

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Notes to Financial Statements
September 30, 2008 and 2007

(3) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2008 and 2007, the carrying amount of the Corporation's total cash and cash equivalents and time certificates of deposit were \$886,626 and \$1,371,602, respectively, and the corresponding bank balances were \$1,095,171 and \$1,457,437, respectively, all of which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008 and 2007, bank deposits in the amount of \$300,000 were FDIC insured. Accordingly, these deposits are exposed to custodial credit risk. The Corporation does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. The Corporation has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on its deposits.

B. Investments

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by the Corporation or its agent in the Corporation's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the Corporation's name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Corporation's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the elements of custodial credit risk in GASB Statement No. 3.

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the Corporation's investment policy.

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Corporation will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. As of September 30, 2008 and 2007, the Corporation's investments are held in the name of the Corporation and are administered by investment managers subject to Securities Investor Protection Corporation insurance in accordance with the Corporation's investment policy.

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(3) Deposits and Investments, Continued

B. Investments, Continued

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Corporation's investment policy limits investment maturities to no more than one year to manage its exposure to fair value losses arising from increasing interest rates.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Corporation. As of September 30, 2008 and 2007, there were no investments in any one issuer that exceeded 5% of total investments.

As of September 30, 2008 and 2007, investments at fair value are as follows:

	<u>2008</u>	<u>2007</u>
Fixed income:		
U.S. Treasury obligations	\$ 585,549	\$ 1,094,980
U.S. Government agencies	664,229	519,633
Corporate notes	<u>1,537,420</u>	<u>1,455,521</u>
	2,787,198	3,070,134
Other investments:		
Domestic and international equities	4,302,600	6,602,383
Money market funds	<u>490,364</u>	<u>524,997</u>
	<u>\$ 7,580,162</u>	<u>\$ 10,197,514</u>

As of September 30, 2008, the Corporation's investments in debt securities were as follows:

	Moody's Credit Rating	<u>Investment Maturities (In Years)</u>				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
U.S. Treasury obligations	Aaa/P-1	\$ -	\$ 513,889	\$ 71,660	\$ -	\$ 585,549
U.S. Government agencies	Aaa/P-1	-	501,629	162,600	-	664,229
Corporate notes	A1/P-1	-	238,486	122,977	-	361,463
Corporate notes	A2/P-1	-	355,188	-	-	355,188
Corporate notes	A3/P-2	-	100,047	-	-	100,047
Corporate notes	Aaa/P-1	-	92,867	-	-	92,867
Corporate notes	Aa1/P-1	-	98,627	-	-	98,627
Corporate notes	Aa2/P-1	-	272,329	-	-	272,329
Corporate notes	Aa3/P-1	-	<u>142,102</u>	<u>114,797</u>	-	<u>256,899</u>
		<u>\$ -</u>	<u>\$ 2,315,164</u>	<u>\$ 472,034</u>	<u>\$ -</u>	<u>\$ 2,787,198</u>

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(3) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2007, the Corporation's investments in debt securities were as follows:

	Moody's Credit Rating	Investment Maturities (In Years)				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
U.S. Treasury obligations	Aaa/P-1	\$ -	\$ 547,042	\$ 547,938	\$ -	\$ 1,094,980
U.S. Government agencies	Aaa/P-1	-	183,613	336,020	-	519,633
Corporate notes	A1/P-1	-	265,038	-	-	265,038
Corporate notes	A2/P-1	-	150,317	-	-	150,317
Corporate notes	A3/P-2	101,037	-	-	-	101,037
Corporate notes	Aaa/P-1	-	99,927	-	-	99,927
Corporate notes	Aa1/P-1	-	245,864	-	-	245,864
Corporate notes	Aa2/P-1	-	74,779	-	-	74,779
Corporate notes	Aa3/P-1	-	518,559	-	-	518,559
		<u>\$ 101,037</u>	<u>\$ 2,085,139</u>	<u>\$ 883,958</u>	<u>\$ -</u>	<u>\$ 3,070,134</u>

(4) Property, Plant and Equipment

Capital asset activities of the Corporation for the years ended September 30, 2008 and 2007 are as follows:

	Estimated Useful Lives	Balance October 1, 2007	Additions	Retirements	Balance September 30, 2008
General support	5-35 years	\$ 14,326,505	\$ 214,807	\$ (35,080)	\$ 14,506,232
Central office	20 years	10,512,166	444,410	-	10,956,576
Earth station	20 years	5,136,009	272,992	-	5,409,001
Terminal equipment	5-20 years	2,587,671	361,335	-	2,949,006
Cellular network	10-20 years	6,427,477	7,365,061	-	13,792,538
Internet equipment	8 years	1,063,452	204,392	-	1,267,844
Pole, cable and wiring	15-20 years	<u>33,701,827</u>	<u>136,071</u>	<u>(35,080)</u>	<u>33,837,898</u>
Total		73,755,107	8,999,068	(35,080)	82,719,095
Accumulated depreciation		<u>(35,771,630)</u>	<u>(3,375,204)</u>	<u>35,080</u>	<u>(39,111,754)</u>
		37,983,477	5,623,864	-	43,607,341
Plant under construction		<u>7,140,492</u>	<u>1,966,783</u>	<u>(8,278,999)</u>	<u>828,276</u>
Property, plant and equipment, net		<u>\$ 45,123,969</u>	<u>\$ 7,590,647</u>	<u>\$(8,278,999)</u>	<u>\$ 44,435,617</u>

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Notes to Financial Statements
September 30, 2008 and 2007

(4) Property, Plant and Equipment, Continued

	<u>Estimated Useful Lives</u>	<u>Balance October 1, 2006</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance September 30, 2007</u>
General support	5-35 years	\$ 15,059,822	\$ 677,309	\$ (1,410,626)	\$ 14,326,505
Central office	20 years	10,516,546	-	(4,380)	10,512,166
Earth station	20 years	5,125,704	10,305	-	5,136,009
Terminal equipment	5-20 years	4,400,828	54,378	(1,867,535)	2,587,671
Cellular network	10-20 years	5,493,570	998,232	(64,325)	6,427,477
Internet equipment	8 years	759,079	304,373	-	1,063,452
Pole, cable and wiring	15-20 years	<u>33,649,369</u>	<u>56,960</u>	<u>(4,502)</u>	<u>33,701,827</u>
Total		75,004,918	2,101,557	(3,351,368)	73,755,107
Accumulated depreciation		<u>(35,828,233)</u>	<u>(3,294,765)</u>	<u>3,351,368</u>	<u>(35,771,630)</u>
		39,176,685	(1,193,208)	-	37,983,477
Plant under construction		<u>1,831,448</u>	<u>6,839,372</u>	<u>(1,530,328)</u>	<u>7,140,492</u>
Property, plant and equipment, net		<u>\$ 41,008,133</u>	<u>\$ 5,646,164</u>	<u>\$ (1,530,328)</u>	<u>\$ 45,123,969</u>

(5) Capitalized Interest

Interest is capitalized on all construction-in-progress pursuant to FASB 34, *Capitalization of Interest Costs*, provided that the construction period exceeds one year. Interest capitalized on qualifying construction-in-progress was \$393,040 and \$70,025 during the years ended September 30, 2008 and 2007, respectively.

(6) Long-term Debt

	<u>2008</u>	<u>2007</u>
Loan payable to Rural Utilities Service (RUS), with a 35 year term, interest at 5%, collateralized by the Corporation's specific ground leases and essentially all other assets. Pursuant to a loan agreement dated August 1, 1990, the Corporation is required to make monthly payments of both principal and interest to RUS.	\$ 22,824,414	\$ 23,668,097
Less: current portion	<u>887,269</u>	<u>844,084</u>
	<u>\$ 21,937,145</u>	<u>\$ 22,824,013</u>

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(6) Long-term Debt, Continued

Future minimum principal and interest payments on notes payable for subsequent years ending September 30, are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 887,269	\$ 1,121,051	\$ 2,008,320
2010	932,664	1,075,656	2,008,320
2011	980,381	1,027,939	2,008,320
2012	1,030,539	977,781	2,008,320
2013	1,083,263	925,057	2,008,320
2014 through 2018	4,916,358	3,116,922	8,033,280
2019 through 2023	7,699,666	2,341,934	10,041,600
2024 through 2025	<u>5,294,274</u>	<u>394,039</u>	<u>5,688,313</u>
	<u>\$ 22,824,414</u>	<u>\$ 10,980,379</u>	<u>\$ 33,804,793</u>

A summary of changes in long-term liabilities for the years ended September 30, 2008 and 2007 are as follows:

	<u>Balance October 1, 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance September 30, 2008</u>	<u>Due Within one Year</u>
Note payable: Rural Utilities Service	\$ <u>23,668,097</u>	\$ <u> -</u>	\$ <u>(843,683)</u>	\$ <u>22,824,414</u>	\$ <u>887,269</u>
	<u>Balance October 1, 2006</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance September 30, 2007</u>	<u>Due Within one Year</u>
Note payable: Rural Utilities Service	\$ <u>24,471,604</u>	\$ <u> -</u>	\$ <u>(803,507)</u>	\$ <u>23,668,097</u>	\$ <u>844,084</u>

(7) Commitments and Contingencies

Leases

The Corporation has sixteen operating leases as of September 30, 2008. Seven are residential real estate leases for contract employees, which have a term of one or two years. Three represent leases for satellite stations of Yap, Pohnpei, and Kosrae with thirty-year leases. Three are for land site for three of state offices with 25-35 year terms beginning in 1988 for Pohnpei and Yap and 1990 for Kosrae. One is for the Pohnpei training center with a 25 year term beginning 1983 and two land site leases for the previous central office and for the southeast remote switch on Pohnpei; both for 15 year terms beginning in 1994. The Corporation has also entered into various circuit leases expiring through 2010 and 2016.

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Notes to Financial Statements
September 30, 2008 and 2007

(7) Commitments and Contingencies, Continued

Leases, Continued

The approximate future minimum annual lease payments payable by the Corporation are as follows:

<u>Year ending September 30:</u>	<u>Total</u>
2009	\$ 1,965,707
2010	1,363,197
2011	536,747
2012	476,447
2013	468,423
2014 through 2018	880,684
2019 through 2023	19,364
2024 through 2026	<u>5,292</u>
	\$ <u>5,715,861</u>

Self Insurance

The Corporation purchases insurance to cover risks associated with its buildings and equipment (\$17,530,500 of coverage) and vehicles (up to \$1 million of coverage and \$500 per vehicle per incident). Additionally, the Corporation purchases fidelity insurance coverage for selected employees (total coverage of \$2,204,000) and workmen's compensation insurance (coverage of up to \$50,000 per employee). The Corporation also purchases general liability insurance in connection with operations (up to \$1 million per occurrence). There have been no significant reductions in coverage, and there have been no settlements in excess of insurance coverage for the past three years. The Corporation does not purchase insurance for its Outside Plant. As most of these items are underground, the Corporation is of the opinion that losses from such, if any, will be minimal. Therefore, the Corporation is self insured for Outside Plant and all other risks not encompassed in the forgoing. Management is of the opinion that no material losses have resulted from this practice.

Construction Commitments

During the year ended September 30, 2008, the Corporation entered into various contracts for construction and expansion of its facilities and services. Approximately \$2,008,667 is outstanding under these contracts as of September 30, 2008.

External Carriers

External carriers located in other countries are subject to oversight policies from their respective regulatory agencies. Currently, U.S. regulatory agencies are contemplating a reduction of the tariff rate used by the Corporation for settlement with certain U.S. carriers. The ultimate outcome of this matter and the related impact on the Corporation cannot be predicted at this time.

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Notes to Financial Statements
September 30, 2008 and 2007

(7) Commitments and Contingencies, Continued

Litigation

In the ordinary course of business, claims have been filed against the Corporation. Management does not believe that the plaintiffs will prevail and the ultimate outcome is currently not determinable. Therefore, no provision has been recorded in the accompanying financial statements for losses, if any, that may result.

(8) Related Party Transactions

The Corporation's services are provided to its affiliates at the same rates as are charged to third parties. The Corporation is a component unit of the Federated States of Micronesia National Government. As of September 30, 2008, the Corporation has receivables from the FSM National Government of approximately \$216,503 (170,139 at September 30, 2007).

(9) Retirement Plan

The Corporation's retirement plan (the Plan) is a self-administered program established to pay retirement, disability and survivor income to employees and their survivors to supplement similar benefits that employees received from the FSM Social Security System. The Plan is a contributory plan in which the Corporation contributes 10 percent of the participant's annual salary, and the participant contributes 3 or more percent from his or her annual salary. Participation is optional. The Corporation's controller is the designated Plan administrator. Contributions to the Plan during the years ended September 30, 2008 and 2007 were \$269,347 and \$251,946, respectively. Management is of the opinion that the plan does not represent an asset or liability of the Corporation. For the years ended September 30, 2008 and 2007, plan assets were \$3,812,923 and \$4,201,774, respectively.

(10) Subsequent Event

On November 19, 2008, United States Department of Agriculture Rural Development, notified FSMTC that based on the preliminary review of its "B" loan application, the Corporation is qualified to loan \$13,120,000. The loan is expected to be approved sometime in January 2009. The loan proceeds of \$3,708,000 are to purchase 8 wave lengths of fiber capacity of the two fibers of the Kwajalein Cable System (KCS) as capital lease for 25 years. The remaining balance of the loan is for electronics, engineering and construction of the undersea facilities between Pohnpei and the KCS network branching unit.

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Schedule of Operating Expenses
Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Salaries and wages	\$ 3,848,896	\$ 3,750,715
Depreciation	3,375,204	3,294,765
Circuit lease	1,919,455	1,657,981
Utilities	1,103,735	909,171
Repairs and maintenance	573,236	746,819
Advertising	548,650	530,280
Cost of sales	386,499	428,683
Travel	374,793	311,942
Contractual services	329,964	143,158
Communications	239,986	284,455
Supplies	142,700	92,788
Petroleum and lubricants	104,361	93,217
ICTV affiliated	78,568	86,976
Representation	75,526	35,519
Insurance	74,061	60,946
Training	58,990	158,936
Freight	53,648	58,265
Rental expenses	52,600	50,658
Professional fees	35,380	80,988
Import tax expense	28,384	78,651
Publications and printing	17,010	35,811
Miscellaneous	78,717	139,959
	<u>\$ 13,500,363</u>	<u>\$ 13,030,683</u>

See Accompanying Independent Auditors' Report.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Chairman
Board of Directors
Federated States of Micronesia
Telecommunications Corporation:

We have audited the financial statements of the Federated States of Micronesia Telecommunications Corporation (the Corporation), as of and for the year ended September 30, 2008, and have issued our report thereon dated December 19, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

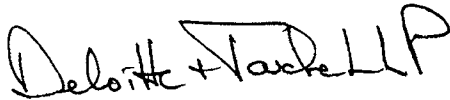
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Corporation in a separate letter dated December 19, 2008.

This report is intended solely for the information and use of the Board of Directors and management of the Corporation, federal awarding agencies, the Rural Utilities Service, supplemental lenders, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.


December 19, 2008