Deloitte.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

April 14, 2014

Ms. Anna Mendiola
CEO/President
Federated States of Micronesia Development Bank

Dear Ms. Mendiola:

In planning and performing our audit of the financial statements of Federated States of Micronesia Development Bank (the Bank) as of and for the year ended December 31, 2013 (on which we have issued our report dated April 14, 2014), 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, we considered the Bank's 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 Bank's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses or significant deficiencies. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to the Bank's internal control over financial reporting and other matters as of December 31, 2013 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated April 14, 2014, on our consideration of the Bank's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of the Board of Directors, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of the Bank for their cooperation and assistance during the course of this engagement.

Very truly yours,

Deloitte & Touche LLP

APPENDIX I

SECTION I –DEFICIENCIES

We identified the following deficiencies involving the Bank's internal control over financial reporting for the year ended December 31, 2013 that we wish to bring to your attention at this time:

1. Credit Administration

   Condition: Of twenty-five (25) new or refinanced 2013 loans tested, the following exceptions were noted in the respective credit files:

   a) Four (4) loans do not have evidence of an effective hazard insurance policy or an analysis to support a waiver of such requirement in file.

Loan Number	12/31/2013 Outstanding Loan Balance
D3E3545	$150,000 line of credit
D4E-3485 & D4E3651	$329,809 and a $600,000 line of credit
D4E3475	$175,000 line of credit

   b) Three (3) loans do not have evidence of a keyman insurance policy / credit life insurance policy or an analysis to support a waiver of such requirement in file.

Loan Number	12/31/2013 Outstanding Loan Balance
D4D-3650	$690,000
D4B-3666	$41,068
D4E3475	$175,000 line of credit

   c) Seven (7) loans do have not fully executed salary allotment forms or such were executed significantly after the loan dates:

Loan Number	12/31/2013 Outstanding Loan Balance	Condition
D3D-3556	225,951	The assignment of salary agreement in file does not contain the Employer information or acknowledgement.
D3P-3554	28,430	Salary allotment form was prepared on April 8, 2014, while the loan was originated in February 2013. Additionally, the form has not yet been accepted by the borrower's employer.
D3P-3717	5,655	Salary allotment form was prepared in March 2014 while the loan was originated in September 2013.
D3P-3856	20,508	Assignment of salary agreement of the borrower has not been completed.
D4P-3595	7,420	Assignment of salary agreement of the borrower has not been completed.
D4P-3696	8,204	Assignment of salary agreement of the borrower has not been completed.
D4P-3750	5,890	Salary allotment form was prepared in March 2014 while the loan was originated in September 2013.

   d) The interest rate for loan #D3D-3556 (original $225,951 in March 2013) was approved at 10% but was erroneously recorded in the system as 9%.

SECTION I – DEFICIENCIES, CONTINUED

1. Credit Administration, Continued

   e) The credit analysis worksheet for loan #D3P-3856 (original $20,508 in December 2013) erroneously excluded a loan to the USDA, which was included in the credit analysis of the previous loan granted in January 2013.

   Recommendation: Completeness of credit files should be subject to verification. A checklist should be developed and maintained so that pending documents are timely followed up. Loan boarding information and credit analysis should be reviewed and verified.

2. Loan Reconciliation

   Condition: The December 2013 account reconciliation for the Pohnpei Branch and Consumer loans have not been completed as of April 14, 2014.

   Recommendation: The Bank should follow its existing procedures and reconcile the loan accounts on a monthly basis.

3. Nonaccrual loans

   Condition: At December 31, 2013, two loans were erroneously included as nonaccrual loans. For loan #D3B-3037, a required payment was made in December 2013 but a portion of the payment was recorded in "unapplied" credit. For loan #D3D-3556, a construction loan, the first monthly payment is not due until May 2014.

   Recommendation: A monthly review of the nonaccrual loan report should be performed to identify erroneously included loans.

SECTION II – OTHER MATTER

We identified, and have included below, another matter involving the Bank's internal control over financial reporting as of December 31, 2013, that we wish to bring to your attention:

1. Loan Risk Grading Differences

   Condition: Of seventy-five loans (75) loans tested for appropriateness of loan classification, we recommended the following loan classification changes:

Loan number	12/31/2013 Balance	Bank	Audit
D3P-3554	28,430	3	4
D4E3475L6	17,685	1&2	3
D3B-2042A	249,289	NIL	3
D3F-2330	294,663	3	1&2
D3R-3105	67,742	5	6
D4D-2804	325,501	4	5
D4E-1846	98,001	1&2	3
D5E-2488	16,970	4	5
D4E-3352	132,126	1&2	3
D2E-2709	1,019,075	5	6
D5F-3012	639,365	4	5

SECTION II – OTHER MATTER, CONTINUED

1. Loan Risk Grading Differences, Continued

   Recommendation: The agreed-upon grading changes should be reflected in the Bank's 1st quarter 2014 calculation.

SECTION III – DEFINITIONS

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The definition of a deficiency is as follows:

A *deficiency* in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

The Bank's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.