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April 17, 2017

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

Dear Ms. Mendiola:

In planning and performing our audits of the financial statements of Federated States of Micronesia Development Bank (the Bank) and the fiduciary financial statements of the Investment Development Fund and the Yap Development Loan Fund (the Funds) as of and for the year ended December 31, 2016 (on which we have issued our report dated April 17, 2017), 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, 2016 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated April 17, 2017, 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 management, the Board of Directors, 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

SECTION I –DEFICIENCIES

We identified the following deficiencies involving the Bank's internal control over financial reporting for the year ended December 31, 2016 that we wish to bring to your attention:

1. Credit Administration

Condition: The following exceptions were noted in the respective credit files:

a) Loan # D3F-4735, D4F-5114 and D4H-4736: Credit life insurance policy is required but has not been obtained from the borrower.
b) Loan # D4D-4902, D4E4596LC, D4F-5114, D4H-4736, D3D-4766 and D3E3649LS: Hazard/property insurance is required but has not been obtained from the borrower.
c) Loan # D4H-4736: Financial information has not been obtained from the borrower.

Recommendation: Completeness of credit files should be subject to verification. Loan file checklists should be monitored and open items timely followed up. Loan boarding information and credit analysis should be reviewed and verified.

SECTION II – OTHER MATTERS

We identified, and have included below, other matters involving the Bank's internal control over financial reporting as of December 31, 2016, that we wish to bring to your attention:

1. Loan Risk Grading Differences

Condition: We recommend the following loan classification changes:

Loan number	12/31/2016 Balance	Bank	Audit
D2G-5044	55,847.54	1&2	3
D3E-3648	492,568.33	4	5
D4D-2804	397,450.98	1&2	3
D4P-4281	19,034.44	1&2	3
D3B-4049	52,083.09	4	5
D3E-4165	420,787.12	4	5

Recommendation: The Bank should consider reviewing the above and if agrees, reflect the risk changes in the first quarter 2017 loan classification report (LCR).

2. Title Insurance for Collateralized Real Property in Saipan

Condition: Loan # D5G-4731 and E5G-4731: Title insurance has not been obtained from the borrower for collateralized real property located in Saipan. The Bank's lending manual does not contain provisions for collateralized properties outside of the Federated States of Micronesia, where commercial title insurance policies can be obtained.

Recommendation: The Bank should consider obtaining leasehold title insurance policies for collateralized real property located in Saipan.

SECTION III – DEFINITIONS

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.