Deloitte.

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

Tel: +1 (671) 646-3884
Fax: +1 (671) 649-4265

www.deloitte.com

March 21, 2019

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, 2018 (on which we have issued our report dated March 21, 2019), 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, 2018 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated March 21, 2019, 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

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, 2018 that we wish to bring to your attention:

1. Loans Restructure

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

   a.) Loan # D2E-3371: Loan consolidation amortization calculation did not include capitalized interest.
   b.) Loan # D3E-3648: Quarterly amortization of $11,400 set on restructured loan does not cover interest due for the period, which will cause the restructure loan to continue in a negative amortization position for the 2-year period. In addition, amortization schedule using the new terms was not on file and no evidence was noted that borrower is aware of that the payment is not sufficient.

   Recommendation: The Bank should update loan amortization to include capitalized interest on loan consolidation. Loan restructures that result in a negative amortization during the restructure/forebearance period should be disclosed to the borrower with an updated amortization schedule.

2. Credit Administration

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

   a.) Loan # D3F-5788: Assignment of the lease payment for six properties is required but such has not been obtained from the borrower.
   b.) Loan # D4C-5790, D3D-5758, D3F-5788, D3B-5971, D3H-5970, D4B6005L1, D4E5605L4 and D5H5660L1: Credit life insurance policy is required but such has not been obtained from the borrower.
   c.) Loan # D4E-6175, D3H-5970 and D3E5955LL: Financial information has not been obtained from the borrower.
   d.) Loan # 5438: Approval to extend grace period from December 25, 2018 to March 25, 2019 was not on file.
   e.) Loan # D4C-5790: Chattel mortgage for new equipment purchased 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. The Bank's updated loan amortization should include capitalized interest on loan consolidation.

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, 2018, that we wish to bring to your attention:

1. Loan Risk Grading Differences

   Condition: We recommend the following loan classification changes:

Loan number	12/31/2018 Balance	Bank	Audit
D3F-4597	$ 1,047,835	4	5
D4C-5790	742,304	1&2	3
D3E-3648	734,140	1&2	5
D3D-5758	703,278	1&2	3
D2H-5438	465,222	4	5
D4D-4483	159,878	4	6
D5E-5877	51,811	1&2	3
D4E5588LC	44,238	1&2	3
D4B6005L1	30,000	1&2	3

   Recommendation: The Bank should consider reviewing the above and if in agreement, reflect the risk changes in the first quarter 2019 loan classification report (LCR).

2. Collection

   Condition: Loan # D4C-5790: Collection on November 21, 2018 was posted entirely to accrued interest due, with no amount available to reduce principal balance; however, the next due date was changed from February 25, 2019 to March 25, 2019.

   Recommendation: The Bank should work with the system programmer to correct the system glitch on setting the next due date.

3. Timeliness of Collection Report

   Condition: The daily cash count report of Chuuk branch for collections on December 31, 2018 was prepared on January 2, 2019.

   Recommendation: The Bank should prepare the daily cash count report on the date collections were received.

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.