

**FEDERATED STATES OF MICRONESIA  
TELECOMMUNICATIONS CORPORATION**

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

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**INDEPENDENT AUDITOR'S REPORT ON  
COMPLIANCE WITH ASPECTS OF CONTRACTUAL  
AGREEMENTS AND REGULATORY REQUIREMENTS  
FOR TELECOMMUNICATIONS BORROWERS**

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**YEAR ENDED SEPTEMBER 30, 2018**

## **INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS FOR TELECOMMUNICATIONS BORROWERS**

Board of Directors  
Federated States of Micronesia Telecommunications Corporation

We have audited, 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, the financial statements of the Federated States of Micronesia Telecommunications Corporation (the Corporation), which comprise the statement of net position as of September 30, 2018, the related statements of revenue, expenses and changes in net position, and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 20, 2018. In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2018, 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. No reports other than the reports referred to above and our schedule of findings and responses related to our audit have been furnished to management.

In connection with our audit, we noted that the Corporation failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the Rural Utilities Service (RUS) policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below:

### RUS Loan Agreement

Criteria: Section 5.12, *TIER Requirement*, of the RUS Loan Agreements state the required Times Interest Earned Ratio (TIER) rate that is to be maintained. Such provision has also been stated under the preliminary review of "B" Loan letter dated November 19, 2008 requiring at least 1.5 commencing December 31, 2012.

Condition: Per examination of RUS Form 479 for the year ended December 31, 2017, submitted by the Corporation on February 5, 2018, the TIER rate reported was 0.45, which is less than the criteria.

### Auditee Response:

Management is fully aware of the situation as to the non-compliance to the TIER required by RUS, due to the fact that the Corporation has been experiencing major losses for the last 10 years including FY2018. Although the loss recovery is noticeable over the last 5 years, the operations of the company has been improving. We have also employed an expert or a consultant to help us find new sources of revenue other the ones we had been offering. Management had been lobbying at FSM Congress for more capital funding for the expansion and upgrade of the aging telecommunications facilities. The Board of Directors have noticed the weight of the RUS loan financing to the financial condition of the Corporation and had given priority in resolving the issue. We continue to look at the possibilities of loan refinancing or a payment break from RUS. With new facilities, upgraded technologies, support from FSM National Government, aggressive marketing & operational efficiencies, management believes that RUS tier requirements will be met.

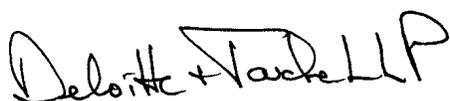
The Corporation's Response to Findings: The Corporation's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Corporation's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Corporation's accounting and records to indicate that the Corporation did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over materials and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the telecommunications system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments.

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This report is intended solely for the information and use of the Board of Directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



December 20, 2018