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November 9, 2022

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), a component unit of the FSM National Government, as of and for the year ended December 31, 2021 (on which we have issued our report dated November 9, 2022), 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. 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, 2021, that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated November 9, 2022, 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. Within that report, we noted certain matter that we considered to be a significant deficiency under standards established by the American Institute of Certified Public Accountants.

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.

Although we have included management's written response to our comments in the attached Appendix I, such responses have not been subjected to the auditing procedures applied in our audit of the financial statements and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses or the effectiveness of any corrective actions described therein.

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, 2021 that we wish to bring to your attention:

1. Credit Administration

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

   a) Loan # D3R-6767: Assignment of Income agreement was not on file.

   b) Loan # D3B5906L1, D3R-6767 and D4E6710L7: Credit life insurance policy was not on file.

   c) Loan# D3R-6767 and D4R-7656: Hazard insurance policy was not on file.

   d) Loan# D3R-6767: Updated financial information from the borrower was not on file.

   Recommendation: Completeness of credit files should be subject to verification. The Bank should review Loan File Checklists and timely follow up on open items.

   Management Response: The bank generally agrees with the exceptions and provides the following explanations and action plans below:

   Loan # D3R-6767
   - An assignment of income and updated financial information is not part of the loan approval conditions therefore not required.
   - Regarding, credit life insurance policy - borrowers opted to purchase insurance policy with Moylan's Insurance Co instead of CLI however through verbal follow ups and meetings with the primary borrower, she is still working with the co-borrower to have this insurance policy matter resolved. Moreover, the bank will inform the borrower of this non-compliance and demand that this be addressed immediately.
   - With respect to Hazard Insurance Policy, Bank continues to work with the borrowers to have this complied to as well to ensure compliance.

   Loan # D4E-6710L7
   - Given that the amount of the loan is over $100K which is the threshold for CLI, the borrower opted to purchase a life insurance policy with Oceania Insurance Co in Chuuk.
     Bank continues to follow up with the borrower through meetings with the borrower however the borrower has not complied with this particular loan condition.

   Loan D4R-7656
   - Borrower has not purchased Hazard Insurance therefore this exception remains pending. The bank will make it a priority to inform the borrower of this exception and have this non-compliance be adhered to at the earliest.

   Loan D3B-5906L1
   - CLI was not applicable as this loan exceeded the $100K limit therefore the borrower was instructed to purchase Keyman's Life Insurance but had not complied with purchasing that insurance. The bank will inform the borrower at the earliest of this non. compliance and make sure the insurance is purchased ASAP.

SECTION II – OTHER MATTERS

We identified, and have included below, matters involving the Bank's internal control over financial reporting as of December 31, 2021, that we wish to bring to your attention:

1. Loan Risk Grading Differences

   Condition: The following loan classification changes were identified:

Loan number	12/31/2021 Balance	Bank	Audit
D4C-5790	$ 779,928	5	6
D3R-3898	$ 70,668	4	1&2
D3D-5168	$ 152,564	4	1&2
D3F-4597	$ 1,090,419	4	5
D4F-6475	$ 3,260,607	3	4
D5F-6753	$ 1,183,290	1 & 2	4
D5F-6945	$ 78,943	1 & 2	4

   We noted a variance in the allowance for loan losses per the Bank's schedule and the General Ledger. The variance is due to an unreconciled variance per the Bank's schedule and an additional provision from classification changes documented above. The proposed audit adjustments were reviewed and accepted by the Bank during the course of the audit and were recorded as a corrected misstatement as of December 31, 2021.

   Recommendation: The Bank should review the loan classification report based on past due dates, with consideration of payment history, probability of collection from borrowers and length of time since the last loan restructure.

   Management Response: Management agrees with this recommendation for our consumer loans. However, for our commercial loans, there are unique, varying circumstances that management considers that goes beyond just the length of time or past due status. They include the securities on the loans, the economic situation in each of the states, shipping issues or delays, public health declarations and travel restrictions, among others.

2. Delinquent Loan

   Condition: The following loan classified as 6 (loss) due to continuing delinquency status has not been presented for charge-off.

Loan number	12/31/2021 Balance	Bank	Audit
D3D-6974	$ 825,979	6	6

   Recommendation: The Bank should consider charging off loans that are classified as 6 (loss).

   Auditee's Response: Management agrees with this recommendation.

SECTION II – OTHER MATTERS, CONTINUED

3. Interfund Off-Balance Items

   Condition: The interfund balances in the Bank's trial balance and trust funds' trial balance contain an unreconciled variance of $27,000.

   Recommendation: The Bank should review and reconcile interfund accounts and make necessary adjustment.

   Management Response: Management agrees with this recommendation.

4. Credit Life Insurance (CLI) Reconciliation

   Condition: The Bank's CLI payable balance as of December 31, 2021 was not reconciled and adjusted based on billing statements. The account was corrected through a proposed audit adjustment.

   Recommendation: The Bank should reconcile CLI accounts payable based on billing statements.

   Management Response: Management agrees with this recommendation and will make sure CLI reconciliation and the timing of such process improves.

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.