

December 6, 2010

Mr. John Sohl  
President/CEO  
Federated States of Micronesia  
Telecommunications Corporation

Dear Mr. Sohl:

In planning and performing our audit of the financial statements of the Federated States of Micronesia (FSM) Telecommunications Corporation (the Corporation) as of and for the year ended September 30, 2010 (on which we have issued our report dated December 6, 2010), in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service (RUS) Borrowers*, we considered the Corporation'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 Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation'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 Corporation's internal control over financial reporting and other matters as of September 30, 2010 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated December 6, 2010, 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.

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

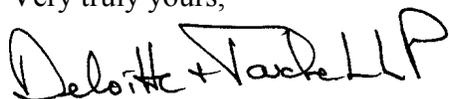
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

This report is intended solely for the information and use of the Board of Directors, management, others within the organization, and the Office of the FSM Public Auditor 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 Corporation for their cooperation and assistance during the course of this engagement.

Very truly yours,



**SECTION I – CONTROL DEFICIENCIES**

We identified, and have included below, control deficiencies involving the Corporation’s internal control over financial reporting as of September 30, 2010 that we wish to bring to your attention:

1) Official Business Calls

Comment: A control does not appear to be exercised over determining that off-island calls from corporate phones are for business purposes.

Recommendation: We recommend that management implement policies and procedures to address this matter.

2) Accounts Receivable

Comment: Collection rates vary among states. In some states, the Corporation is able to collect an average of 70% of billings.

Recommendation: We recommend that collection efforts be increased. Furthermore, management should consider reviewing existing collection policies and procedures to determine if further improvements can occur.

3) Other Receivables

Comment: Most of the account balance consists of transactions that occurred prior to fiscal year 2003.

Recommendation: We recommend that management consider writing-off long outstanding individual accounts.

4) Purchase Orders

Comment: Some purchase orders have been outstanding for over three years.

Recommendation: We recommend that management regularly follow up on the status of prepaid purchase orders to document that items or services have been received or refunds obtained.

5) Accounts Payable Clearing Account

Comment: For certain transactions, invoice information in the PO module is not timely posted to the accounts payable module.

Recommendation: We recommend that the accounts payable clearing account be regularly reviewed.

6) Time Allocation

Comment: The Corporation is currently utilizing electronic timekeepers. Time allocation is based on percentages established during the system set-up.

Recommendation: We recommend that management require employees to periodically indicate actual time spent for each job code or establish their best estimate of project related time.

## APPENDIX I, CONTINUED

### 7) Recording of Expenses

Comment: For two of seven contractual expenses tested, prior year expenses were recorded in the current year.

Recommendation: We recommend that management ensure that expenses are recorded in the appropriate period.

### 8) Capitalized Interest

Comment: During tests of capitalized interest, we noted that the Corporation has only informal documentation related to project close-outs.

Recommendation: We recommend that management ask engineers to submit a signed project close out document indicating actual dates. This will allow projects to be closed out on a timely basis and interest can be capitalized in the correct period.

## SECTION II — OTHER MATTERS

We noted no matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention.

## SECTION III – DEFINITIONS

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* 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 Corporation'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.