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April 18, 2013

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) as of and for the year ended December 31, 2012 (on which we have issued our report dated April 18, 2013), 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, other matters related to the Bank's internal control over financial reporting as of December 31, 2012 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated April 18, 2013, 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 the Board of Directors, management, 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 – OTHER MATTERS

We identified, and have included below, other matters involving the Bank's internal control over financial reporting as of December 31, 2012, that we wish to bring to your attention:

1. Credit Admiration

   Condition: Of twenty-five (25) new or refinanced loans during 2012 tested, the following exceptions were noted in the respective credit files:

   - Evidence of property/casualty insurance has not been received for five loans
   - Loss payee information is missing from property/casualty insurance for one loan
   - Evidence of credit life insurance coverage assignment is pending for loan

   Recommendation: Management should continue to follow up with the borrowers to obtain necessary documents.

2. Loan Risk Ratings

   Condition: In 2012, as a response to the recommendation made during the 2011 audit, the Bank revised its policy to immediately downgrade loans restructured due to borrower financial difficulties (also referred to as "troubled-debt restructuring"), which would be maintained at the lower classification until the borrowers successfully demonstrate ability to adhere to restructured terms. However, this policy does not appear to have been consistently applied as a number of loans restructured during 2012 were not subjected to downgrade. For example, loan #D4F-1804 was restructured in July 2012 but was not downgraded to a lesser rating. Additionally, the borrower has not been in compliance with the restructured terms.

   Recommendation: The Bank should consistently apply this policy and consider assigning an independent person to verify this on a quarterly basis.

3. Loan Risk Grading Differences

   Condition: Of sixty-one loans (61) loans tested for appropriateness of loan classification (56 FSMDB loans and 5 IDF loans, representing 76% and 99% of the total gross outstanding loans, respectively), we recommended the following loan classification changes:

Loan number	Borrower	Bank	Audit
5 loans	T-Company Inc.	3	6
D4E3269L2	Kansou,Memorina	1	4
D4F-1804	Aisek,Gradvin	4	5
D4E3063L3	Robert,Chee Young Cho	4	5
L2D-2938	Skilling,Fred	4	3
D3F-2839	Yvonne's Hotel, Inc.	4	5
D4D-2804	Killion,Redley	4	5
D4E2994L4	Killion,Redley	4	5
D3E-2815	Worswick,Beauleen Carl	4	3
E4B-2064	Western Pacific Tuna Group	5	6
E5F-2686	Esa Family Corporation	4	5
E4C1521	Transco	4	3

SECTION I – OTHER MATTERS, CONTINUED

3. Loan Risk Grading Differences, Continued

   Recommendation: The agreed-upon grading changes should be reflected in the Bank's 1st quarter 2013 calculation.

4. Loan Risk Grading Worksheet

   Condition: The quarterly loan loss reserve adequacy and loan grading worksheets for the quarter ended December 31, 2012 contained arithmetic errors, loan classifications not properly completed, and incorrect loan balances, among others. These errors resulted in inaccuracy of the loan loss reserve calculation worksheets, which are used in Bank management quarterly reporting to the Board of Directors.

   Recommendation: Excel spreadsheets should be carefully checked by the preparer; additionally, a careful review of the worksheets should be performed by a second person.

SECTION II – 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 effected 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 and corrected 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.