

**FEDERATED STATES OF MICRONESIA
TELECOMMUNICATIONS CORPORATION**

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

**INDEPENDENT AUDITORS'
MANAGEMENT LETTER REPORT**

YEAR ENDED SEPTEMBER 30, 2013

INDEPENDENT AUDITORS' MANAGEMENT LETTER REPORT

Chairman
Board of Directors
Federated States of Micronesia Telecommunications Corporation

We have audited the financial statements of the Federated States of Micronesia Telecommunications Corporation (the Corporation) for the year ended September 30, 2013, and have issued our report thereon dated December 27, 2013. We conducted our audit 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*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of the Corporation for the year ended September 30, 2013, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide an opinion on the internal control over financial reporting.

Management is responsible for establishing and maintaining internal control over financial reporting. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A *material weakness* is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses, which are described in our Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit of Financial Statements Performed In Accordance With *Government Auditing Standards* dated December 27, 2013.

7 CFR Part 1773.33 requires comments on specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters. We have grouped our comments accordingly. In addition to obtaining reasonable assurance about whether the financial statements are free from material misstatements, at your request, we performed tests of specific aspects of the internal control over financial reporting, of compliance with specific RUS loan and security instrument provisions, and of additional matters. The specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters tested include, among other things, the accounting procedures and records, materials control, compliance with specific RUS loan and security instrument provisions set forth in 7 CFR Part 1773.33(e)(2) and related party transactions. In addition, our audit of the financial statements also included the procedures specified in 7 CFR Part 1773.38-.45. Our objective was not to provide an opinion on these specific aspects of the internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, or additional matters, and accordingly, we express no opinion thereon.

No reports (other than our Independent Auditors' Report on the Financial Statements, our Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit of Financial Statements Performed In Accordance With *Government Auditing Standards*, and our separate letter regarding recommendations concerning control deficiencies and other matters, all dated December 27, 2013) related to our audit have been furnished to management.

Our comments on specific aspects of internal control over financial reporting, compliance with specific RUS loan and security instrument provisions, and other additional matters as required by 7 CFR Part 1773.33 are presented below.

COMMENTS ON CERTAIN SPECIFIC ASPECTS OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING

We noted matters, as described in our Independent Auditors' Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit of Financial Statements Performed In Accordance With *Government Auditing Standards* dated December 27, 2013, regarding the Corporation's internal control over financial reporting that we consider to be material weaknesses as previously defined with respect to:

- The accounting procedures and records;
- The process for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts, and;
- The materials control.

COMMENTS ON COMPLIANCE WITH SPECIFIC RUS LOAN AND SECURITY INSTRUMENT PROVISIONS

Compliance with laws, regulations, contracts, and grant agreements is the responsibility of the Corporation's management. At your request, we have performed the procedures enumerated below with respect to compliance with certain provisions of laws, regulations, contracts and grant agreements. The procedures we performed are summarized as follows:

- Procedures performed with respect to the requirement for a borrower to obtain written approval of the mortgagee to enter into any contract for the operation or maintenance of its property, or for the use of its mortgaged property by others for the year ended September 30, 2013:

1. Inquired with management of the existence of new written contracts, agreements or leases entered into during the year between the Corporation and an affiliate as defined in 7 CFR Part 1773.33(e)(2)(i).
 2. Read Board of Directors' minutes to ascertain whether there are board-approved written contracts, agreements of leases entered into during the year between the Corporation and an affiliate as defined in 7 CFR Part 1773.33(e)(2)(i).
 3. Noted no contracts that require written RUS approval.
- Procedures performed with respect to the requirement to submit RUS Form 479 to the RUS:
 1. Agreed amounts reported in Form 479 to the Corporation's accounting records.

The results of our tests indicate that, with respect to the items tested, the Corporation complied, except as noted below, in all material respects, with the specific RUS loan and security instrument provisions referred to below. The specific provisions tested, as well as any exceptions noted, include the requirements that:

- The borrower has obtained written approval of the RUS to enter into any contract, agreement or lease with an affiliate as defined in 7 CFR Part 1773.33(e)(2)(i); and
- The borrower has submitted its Form 479 to the RUS and the Form 479, Financial and Statistical Report, as of December 31, 2012, represented by the borrower as having been submitted to RUS, appears reasonable based upon the audit procedures performed.

(1) Coverage Ratios

Section 5.12, *TIER Requirement*, of the RUS Loan Agreements states the required 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 1.50 commencing December 31, 2012. Per examination of RUS Form 479 ending December 31, 2012, submitted by the Corporation on February 7, 2013, the TIER rate reported was (0.42), which is less than the required ratio. We recommend compliance with the minimum TIER ratio requirement.

Auditee Response: Management is fully aware of the situation as to noncompliance to the TIER required by RUS, due to the fact that the Corporation has been experiencing major losses since 2007. We have requested RUS a Loan Payment break and utilize the fund for other projects that could contribute to increase in revenue like the 3G/4G system. As a requirement, a 5 year plan has to be submitted to RUS projection the plan of action to bring the TIER to the required number, which is 1.5. The current financial condition of the Corporation is the main reason why the TIER number is impossible to achieve unless more capital is infused into the Corporation. As of December 10, 2013, the Corporation had signed a contract with ACCLINKS to provide 3G System in the FSM with arranged financing requirement affordable by the Corporation. Management is optimistic that this new service will contribute to the recovery of losses that is being experienced over the past 6 years. Hoping that the TIER will at least increase if not the required number is actually achieved.

COMMENTS ON OTHER ADDITIONAL MATTERS

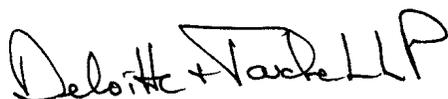
In connection with our audit of the financial statements of the Corporation, nothing came to our attention that caused us to believe that the Corporation failed to comply with respect to:

- The reconciliation of subsidiary plant records to the controlling general ledger plant accounts addressed at 7 CFR Part 1773.33(c)(1);

- The clearing of construction accounts and the accrual of depreciation on completed construction addressed at 7 CFR Part 1773.33(c)(2);
- The retirement of plant addressed at 7 CFR Part 1773.33(c)(3) and (4);
- Approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap addressed at 7 CFR Part 1773.33(c)(5); and
- The disclosure of material related party transactions, in accordance with the Financial Accounting Standards Board Accounting Standards Codification 850, *Related Party Disclosures*, for the year ended September 30, 2013, in the financial statements referred to in the first paragraph of this report addressed at 7 CFR Part 1773.33(f);

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This report is intended solely for the information and use of the Board of Directors, management, the RUS and supplemental lenders, and the cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

December 27, 2013