



**OFFICE OF THE PUBLIC AUDITOR  
Kosrae State, FSM**

**MICRONESIA PETROLEUM CORPORATION**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REPORT  
September 30, 2003**

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Audit Report No. FA 05-002

**Madison O. Tosie**  
PUBLIC AUDITOR



# GOVERNMENT OF KOSRAE

## OFFICE OF THE PUBLIC AUDITOR

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### INDEPENDENT AUDITORS' REPORT

Board of Directors  
Micronesia Petroleum Corporation

We have audited the accompanying statement of net assets of Micronesia Petroleum Corporation ("MPC"), a component unit of the State of Kosrae, as of September 30, 2003, and the related statements of operations and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the MPC's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of MPC as of and for the fiscal year ended September 30, 2002. These financial statements were audited by other auditors whose report dated April 1, 2003, expressed an unqualified opinion on those statements and included an explanatory paragraph which describes that MPC has a receivable from a certain customer at September 30, 2002 discussed in note 11 to the financial statements.

Except as discussed in the following paragraph, we conducted our audits 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We were not able to obtain MPC Attorney's Legal Representation Letter nor were we able to apply sufficient alternative procedures to assure ourselves as to the propriety of liabilities and expenses arising from claims or pending litigations at September 30, 2003.

In our opinion, except for the effects of adjustments to the financial statements, if any, as might have determined to be necessary had we been able to assure ourselves as to the propriety of liabilities and expenses arising from claims or pending litigations, the accompanying financial statements present fairly, in all material respects, the financial position of Micronesia Petroleum Corporation as of September 30, 2003 and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 2 to the financial statements, MPC adopted provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB Statement No. 38, *Certain Financial Statements Note Disclosures* as of October 1, 2002. The accompanying fiscal year 2002 financial statements have been restated to reflect changes required by GASB 34.

As discussed also in note 11 to the financial statements, MPC has a receivable of \$385,040 from a customer at September 30, 2003, which is carried net of allowance of \$268,218. The collectibility of the receivable is under negotiation and is not currently possible to assess the ultimate outcome of this negotiation or its effect on the accompanying financial statements.

The Management Discussion and Analysis on pages 3 to 5 is not a required part of the basic financial statements but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 12, 2005 on our consideration of Micronesia Petroleum Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

  
MADISON O. TOSIE  
Public Auditor

October 12, 2005

## MICRONESIA PETROLEUM CORPORATION

### Management's Discussion and Analysis

Year Ended September 30, 2003

This section of the annual financial report of Micronesia Petroleum Corporation (the Company) presents the analysis of the Corporation's annual performance as of and for the fiscal year ended September 30, 2003. We encourage readers to read the information presented here in conjunction with additional information that we have furnished in the Company's financial statements, which follow this narrative.

The Company is presently selling petroleum products and lubricants for domestic use to various customers in Kosrae including the State Government and its agencies and Continental Micronesia airline. It also distributes petroleum products and lubricants to some vessels that bunker in Kosrae for their fuel requirements and in some instances delivers fuel to the Republic of Nauru. At present, the Company is serving about 37 customers.

The following summarizes the financial position and results of operations of Micronesia Petroleum Corporation for fiscal years 2003 and 2002.

	2003	2002
Assets		
Current Assets	\$ 1,088,665	\$ 1,129,079
Property and equipment, net	2,163,908	2,701,089
Other Assets	31,824	31,824
	<u>\$ 3,734,397</u>	<u>\$ 3,861,992</u>
Liabilities and Net Assets		
Current Liabilities	\$ 570,889	\$ 303,914
Long Term Debt	1,107,350	1,506,180
Net Assets	2,056,158	2,051,898
	<u>\$ 3,734,397</u>	<u>\$ 3,861,992</u>



	<u>2003</u>	<u>2002</u>
Revenues, expenses and changes in net assets		
Operating revenues	\$ 3,254,423	\$ 2,827,266
Operating expenses	<u>3,421,106</u>	<u>2,814,718</u>
Net operating income (loss)	(166,683)	12,548
Other income	260,330	146,015
Interest expense	<u>(89,388)</u>	<u>(112,316)</u>
Total non operating revenue	<u>170,942</u>	<u>33,699</u>
Increase in net assets	\$ <u>4,259</u>	\$ <u>46,247</u>

#### FINANCIAL HIGHLIGHTS:

Operating revenue from sales of petroleum products increased in 2003 as against 2002 by as much as 15% which is attributed mainly on increased fuel requirements shipped to Republic of Nauru.

Prices of fuel sold to the general public did not change since the company started its operation in November 1996 despite of the increase in fuel prices in the world market. Of the total revenue of \$3,254,423, 48% represents revenue generated from sale of diesel, 40% from gasoline, 10% on aviation fuel and 2% from lubricants. Sales generated to 2 customers alone comprise 52% of the total revenue - 29% on sales to the Republic of Nauru and 23% to Kosrae Utilities Authority; the balance of 48% was generated from all other customers.

Operating expenses increased by as much as 22% in 2003 as compared to 2002. This figure represents increase in cost of fuel where the cost per gallon at refinery is less than a dollar in 2002 as compared to more than a dollar per gallon of fuel in 2003. The increase in prices of fuel at refinery covers about 10 to 20% per gallon as compared to 2002 prices. General and administrative expenses as part of the operating expenses decreased by 15% in 2003.

The non operating revenue increased by 44% in 2003 as compared to 2002. This non-operating revenue covers water deliveries to the Republic of Nauru.

Of the total current assets, receivables increased by \$55,323 which accounts for about 15% of the total outstanding net receivables. Out of the gross receivables of \$787,797 46% represents receivable from the Republic of Nauru and 34% from the previous partnership of MPC Kosrae and Yap. However, these receivables are fully covered by an allowance for doubtful accounts. Further, MPC and Yap Fresh Tuna, Inc. (YFTI) has already entered into



a dissolution agreement where YFTI will make a settlement of \$200,000 to MPC Kosrae for all interests and claims on the partnership.

Inventories increased by as much as \$120,000 at year end and this accounts for the increase in prices of fuel at refinery.

Property, plant and equipment include cost of the bulk plant and related assets, land, improvements, machineries, equipment and furniture for office use. The gross value of these property totals \$3,971,000 with an accumulated depreciation of \$1,357,092 as of September 30, 2003. Out of the gross value \$3,971,000, 63% comprises cost of the bulk plant and related assets which includes fuel storage tanks and bulk plant office, 15% for the cost of vehicles, fuel delivery trucks and the vessel MT Micronesian Sunrise and the remaining 22% is for the cost of furniture, machineries and equipment and cost of land.

Current liabilities increased by 47%. The loan maturity with Bank of Federated States of Micronesia as of September 2003 accounts for the major increase. Because of the loan maturity and payments on amortization of these loans, long term debt decreased by as much as 26% compared with the previous year.

Increase in net assets of \$2,459 represents income for fiscal year 2003.

#### PLAN OF ACTION FOR 2004:

1. Request approval from the government on flexibility in pricing structure;
2. Exert more efforts on collection of receivables especially those in arrears;
3. Sale of MT Micronesian Sunrise; and
4. Improvement of storage tanks and assets.

# MICRONESIA PETROLEUM CORPORATION

## Statements of Net Assets September 30, 2003 and 2002

	2003	2002
ASSETS		
Current assets		
Cash, available for operations	\$ 305,491	\$ 276,342
Trade receivables, net	372,513	317,190
Due from employees	16,612	12,849
Inventory	376,887	496,901
Prepaid expenses	17,162	25,797
Total Current Assets	1,088,665	1,129,079
Property and equipment, net	2,613,908	2,701,089
Investment in joint venture	31,824	31,824
	\$ 3,734,397	\$ 3,861,992
LIABILITIES AND NET ASSETS		
Current liabilities		
Current portion of notes payables	\$ 425,656	\$ 165,794
Accounts payable	71,819	62,841
Accrued liabilities	11,137	13,001
Payable to Kosrae State Government	62,278	62,278
Total Current Liabilities	570,890	303,914
Notes Payable, net of current portion	1,107,350	1,506,180
Total Liabilities	1,678,240	1,810,094
Commitments and contingencies		
Net Assets		
Investment in capital assets, net of related debt	1,927,113	1,946,913
Unrestricted	129,044	104,985
Total Net Assets	2,056,157	2,051,898
	\$ 3,734,397	\$ 3,861,992

*See accompanying notes to financial statements*

**MICRONESIA PETROLEUM CORPORATION**  
**Statements of Revenues, Expenses and Changes in Net Assets**  
**Years ended September 30, 2003 and 2002**

	2003	2002
Operating revenues:		
Sales	\$ 3,254,423	\$ 2,827,266
Cost of sales	<u>2,857,973</u>	<u>2,135,336</u>
Gross profit	396,450	691,930
General and administrative expenses:		
Salaries and wages	155,244	200,846
Depreciation	89,229	99,171
Taxes	82,649	81,080
Professional fees	42,190	36,762
Travel and entertainment	23,704	31,822
Communication	8,867	7,387
Rent	5,950	12,537
Utilities	5,361	5,557
Freight, handling and storage	5,177	1,785
Insurance	4,006	3,427
Repairs and maintenance	3,280	3,405
Office Supplies	3,007	3,483
Bank service charges	2,883	2,250
Plant supplies	2,342	8,816
Miscellaneous	<u>129,244</u>	<u>181,054</u>
	<u>563,133</u>	<u>679,382</u>
Operating (loss) revenues	(166,683)	12,548
Other income (expense):		
Other income	260,330	146,015
Other expenses	<u>(89,388)</u>	<u>(112,316)</u>
Total other income (expense), net	<u>170,942</u>	<u>33,699</u>
Increase in net assets	4,259	46,247
Net assets at beginning of year	2,051,898	2,005,651
Net assets at end of year	<u>\$ 2,056,157</u>	<u>\$ 2,051,898</u>

*See accompanying notes to financial statements*

**MICRONESIA PETROLEUM CORPORATION**

Statements of Cash Flows

Years ended September 30, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Cash received from customers	\$ 3,199,100	\$ 3,034,114
Cash paid to suppliers and employees	(3,126,173)	(2,918,445)
Net cash provided by operating activities	<u>72,927</u>	<u>115,669</u>
Cash flows from noncapital financing activities		
Other income (expenses), net	170,942	33,699
Net cash provided by noncapital financing activities	<u>170,942</u>	<u>33,699</u>
Cash flows from capital and related financing activities		
Purchase of property, plant and equipment	(75,752)	(12,624)
Repayment of notes payable	(138,968)	(129,737)
Net cash used in capital and related financing activities	<u>(214,720)</u>	<u>(142,361)</u>
Net increase in cash	29,149	7,007
Cash at beginning of year	<u>276,342</u>	<u>269,335</u>
Cash at end of year	\$ <u><u>305,491</u></u>	\$ <u><u>276,342</u></u>
Reconciliation of operating (loss) income from operations		
to net cash provided by operating activities:		
Operating (loss) income	(166,683)	12,548
Adjustment to reconcile operating (loss) income		
to net cash provided by operating activities:		
Depreciation	162,933	172,875
(Increase) decrease in assets:		
Receivables	(59,086)	203,887
Inventories	120,014	(18,501)
Prepayments	8,635	(5,287)
Increase (decrease) in liabilities:		
Accounts payable	8,978	(237,076)
Accrued liabilities	(1,864)	(12,777)
Net cash provided by operating activities	\$ <u><u>72,927</u></u>	\$ <u><u>115,669</u></u>
Supplemental disclosure of cash flow information:		
Interest expense paid for the year	\$ <u><u>94,870</u></u>	\$ <u><u>112,316</u></u>

*See accompanying notes to financial statements*

# MICRONESIA PETROLEUM CORPORATION

## NOTES TO FINANCIAL STATEMENTS

September 30, 2003 and 2002

### (1) Organization

Micronesia Petroleum Corporation (the Corporation), a component unit of Kosrae State was established on November 13, 1996 by Kosrae State Law 6-98 and 7-28. The primary purpose of the Corporation is to operate and manage the State's fuel storage facilities and to engage in buying and selling petroleum products.

The affairs of the Corporation are managed by a five member board consisting of representatives of Kosrae State Government. Daily operations of the Corporation are delegated to the Chief Executive Officer/General Manager who is hired by and serves at the pleasure of the Board.

### (2) Summary of Significant Accounting Policies

The accounting policies of Micronesia Petroleum Corporation (MPC) conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. MPC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

For the year ended September 30, 2003, MPC adopted GASB Statement No. 34, "Basic Financial Statement and Management's Discussion and Analysis for State and Local Governments" as amended by GASB Statement No. 37 and GASB Statement No. 38 and applied those standards on a retroactive basis. GASB Statement No. 34 establishes standards for external financial reporting purposes into the following net assets categories:

- Invested in capital assets, net of related debt:

Capital assets, net of related accumulated depreciation and outstanding principal balances of debt attributable to acquisition, construction or improvements of those assets.



- **Restricted:**

Nonexpendable – Net assets subject to externally imposed stipulations that require MPC to maintain them permanently.

Expendable – Net assets whose use by MPC is subject to externally imposed stipulations that can be fulfilled by actions of MPC pursuant to those stipulations or that expire by the passage of time.

- **Unrestricted:**

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purpose by action of the management or the Board of Directors or may otherwise limited by contractual agreements with outside parties.

Net Assets: Net assets represent the residual interest in MPC's assets after liabilities are deducted and consists of three sections: invested capital assets, net of related debt; restricted and unrestricted. Net assets invested in capital assets, net of debt include capital assets, restricted or unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. All other assets are unrestricted.

Cash

For purposes of the balance sheets and the statements of cash flows, cash represents cash on hand and in bank accounts.

Provision of Allowance for Doubtful Accounts

The Corporation uses the specific identification method to provide an allowance which management believes adequate to absorb potential losses on accounts receivable that may become uncollectible based on evaluations and prior collection experience.

Inventories

Inventories are substantially carried at the lower of cost (using first in first out method) or net realizable value.

Property and Equipment

Property and equipment are carried at historical cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Lives of equipment, vehicles, furnitures and fixtures and bulk plant assets range from 3 to 40 years.

Assests acquired for use in operations, not for resale and long term in nature are capitalized. Significant renewals, repairs and improvements which contributes to an extension of life of an asset or an increased output of operations are also capitalized.



When assets are retired or otherwise disposed of, the cost and the related accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is credited or charged to current operations.

#### Investments

Investment in joint venture is carried at management estimates of net realizable value.

#### Revenue Recognition

Sales are recognized when title to inventory passes to the buyer.

#### Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### (3) Accounts Receivable

These receivables are due from businesses and individuals located in the Federated States of Micronesia and in the Republic of Nauru.

	2003	2002
Trade receivables	\$ 787,797	\$ 735,715
Allowance for doubtful accounts	(415,284)	(418,525)
	<u>\$ 372,513</u>	<u>\$ 317,190</u>

### (4) Investments

As of September 30, 2003 and 2002, MPC holds a 55% interest in a joint venture, Micronesia Petroleum Corporation - Yap (MPC-Yap). MPC Yap's main business objective is to provide competitive petroleum products to support the economic activities in the State of Yap.

#### Subsequent events:

On September 9, 2005 a dissolution agreement and note to pay was signed wherein MPC to receive \$200,000 from its joint venture partner as payment for its interests and all claims in MPC-Yap. Related gains or losses arising from this transaction, if any will be recognized in fiscal year 2005.



**(5) Property, plant and equipment**

Property, plant and equipment consists of the following:

	Estimated Useful Lives	Balance at October 1, 2002	Additions	Deletions/ Disposals	Balance at September 30, 2003
<b><u>Depreciable assets:</u></b>					
Bulk plant	40 years	\$ 2,506,000		-	\$ 2,506,000
Vehicles and tank trucks	5 years	577,103	43,574	(35,603)	585,074
Office equipment	3 to 5 years	118,414	8,849	(81,666)	45,597
Furniture and fixtures	3 years	61,096	125	-	61,221
Machines and equipment	3 to 5 years	343,696	22,611	-	366,307
Buildings and improvements	3 to 5 years	206,209	593	-	206,802
Total depreciable assets in service		3,812,518	75,752	(117,269)	3,771,001
Accumulated depreciation		(1,311,429)	(162,933)	117,269	(1,357,913)
		2,501,089	(87,181)	-	2,413,908
<b><u>Non-depreciable asset:</u></b>					
Land		200,000	-	-	200,000
Property, plant and equipment - net		<u>\$ 2,701,089</u>	<u>\$ (87,181)</u>	<u>\$ -</u>	<u>\$2,613,908</u>
	Estimated Useful Lives	Balance at October 1, 2001	Additions	Deletions/ Disposals	Balance at September 30, 2002
<b><u>Depreciable assets:</u></b>					
Bulk plant	40 years	\$ 2,506,000		-	\$ 2,506,000
Vehicles and tank trucks	5 years	572,192	4,911	-	577,103
Office equipment	3 to 5 years	118,062	352	-	118,414
Furniture and fixtures	3 years	61,096		-	61,096
Machines and equipment	3 to 5 years	336,682	7,361	(347)	343,696
Buildings and improvements	3 to 5 years	206,209	-	-	206,209
Total depreciable assets in service		3,800,241	12,624	(347)	3,812,518
Accumulated depreciation		(1,138,901)	(172,875)	347	(1,311,429)
		2,661,340	(160,251)	-	2,501,089
<b><u>Non-depreciable asset:</u></b>					
Land		200,000		-	200,000
Property, plant and equipment - net		<u>\$ 2,861,340</u>	<u>\$ (160,251)</u>	<u>\$ -</u>	<u>\$ 2,701,089</u>



**(6) Notes Payable**

Notes payable of MPC at September 30, 2003 and 2002 consist of the following:

	<u>2003</u>	<u>2002</u>
a) Loan payable to Kosrae State Government, primary government, in the original amount of \$300,000 due in monthly installments of \$2,628, interest at 1% maturing in February 1, 2009.	\$ 272,500	\$ 277,981
b) Loan payable to FSM Development Bank in the original amount of \$500,000, due on monthly installments of \$5,100, with a balance of approximately \$222,390 due at maturity. Interest is at 9%, maturity in September 2008, collateralized by the property and inventory of the Company.	387,921	412,133
c) Term loan payable to Bank of FSM, interest at 2.75% greater than TCD rate pledge as collateral by Kosrae State Government, collateralized by a first security interest in essentially all MPC assets and a time certificate of deposit held by Kosrae State Government. Balloon payment at the 48 <sup>th</sup> month approximately \$264,056 due on July 2004.	298,874	342,043
d) Loan payable to FSM Development Bank, ten year term, interest at 5% monthly repayment of \$7,958 collateralized by inventories and receivables of the Company.	573,711	639,817
Total Debt	1,533,006	1,671,974
Less current portion	<u>(425,656)</u>	<u>(165,794)</u>
Long-term debt, net of current portion	<u>\$ 1,107,350</u>	<u>\$ 1,506,180</u>

Future maturities of above debt are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 425,656	\$ 76,292
2005	132,821	55,571
2006	139,272	49,120
2007	146,164	42,228
2008	375,922	34,860
Thereafter	313,171	16,678
	<u>\$ 1,533,006</u>	<u>\$ 274,749</u>



(7) Payable to Kosrae State Government

During fiscal year 1997, Kosrae State Government incurred expenditures under various appropriations for Micronesia Petroleum Corporation. The amount payable to Kosrae State Government at September 30, 2003 and 2002 reflects expenditures incurred in excess of such appropriations. Kosrae State Government and Micronesia Petroleum Corporation are currently negotiating a payment schedule for the amount.

(8) Commitments and Contingencies

Micronesia Petroleum Corporation was not able to obtain its Attorney's Legal Representation Letter as of the date of the report. Outcome of any commitments and contingencies arising from any threats and pending litigations that MPC might have is not currently possible to assess. The financial statements as of and for the fiscal year ended September 30, 2003 were not adjusted for any effects or adjustments that may arise.

During the fiscal years ended September 30, 2003 and 2002, Micronesia Petroleum Corporation expended approximately \$75,448 and \$72,565, respectively for gross receipts tax. Management is of the opinion that the Corporation is a tax-exempt organization and therefore not liable for gross receipts taxes. The FSM National Government are currently attempting to resolve this issue through their respective attorney general's offices.

(9) Risk Management

Micronesia Petroleum Corporation purchases commercial insurance to cover its potential risks from refueling operations, maintains workmen's compensation coverage and purchases commercial coverage relative to its risks covering inventory and facilities. Micronesia Petroleum Corporation is substantially self-insured from all other risks. Management is of opinion that no material losses have been sustained as a result of this practice.

(10) Significant Revenue Sources

Sales to (generated from) a related party, also a component unit of Kosrae State Government amounted to \$752,336 or 21% and \$715,385 or 25% of the total sales for fiscal years ended September 30, 2003 and 2002 respectively.

(11) Receivable from Nauru Phosphate Corporation

As of September 30, 2003, receivables in the amount of \$385,040 are due from Nauru Phosphate Corporation, a major customer. The Company's ability to collect appears contingent on its current negotiations with the customer. Management is of the opinion that the balance will ultimately be collectible. In addition, the customer has confirmed that it will pay \$35,000 on a monthly basis.



# GOVERNMENT OF KOSRAE

## OFFICE OF THE PUBLIC AUDITOR

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### **INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Board of Directors  
Micronesia Petroleum Corporation

We have audited the financial statements of the Micronesia Petroleum Corporation ("MPC"), as of and for the fiscal year ended September 30, 2003, and have issued our report thereon dated October 12, 2005. We conducted our audit 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.

#### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the MPC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect MPC's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 03-01 through 03-04.

A material weakness is a reportable 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 caused by error or fraud 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not consider the reportable conditions described above to be material weaknesses.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the MPC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the Board of Directors and management of Micronesia Petroleum Corporation, federal awarding agencies, pass-through entities, 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.



MADISON O. TOSIE  
Public Auditor

October 12, 2005

MICRONESIA PETROLEUM CORPORATION  
Schedule of Findings and Questioned Costs  
Year ended September 30, 2003

**Finding No. 03-1: Trade Receivables**

Condition: Aging schedule of accounts shows that 89% of trade receivables outstanding as of September 30, 2003 are over 90 days old. We noted also 4 trade accounts, which are non-moving for more than 1 year which approximates a total amount of \$47,000.

Criteria: Trade receivables should be collected in a timely manner.

Cause: The cause of this condition is failure of management to exercise prudent credit approval at the time the credit was extended.

Effect: The effect of this condition is a negative impact on cash flows from operations.

Recommendation: We recommend that MPC exert more effort to expedite its trade accounts collection and initiate legal action to demand payment for long overdue accounts.

Auditee response: We agree that for some reason it is the failure of management to exercise prudent credit approval at the time the credit was extended. These receivables are outstanding for several years back.

All efforts have been exhausted to collect these accounts but to no avail. However, these accounts are fully covered by an allowance for doubtful accounts. Management believes that about 40% of these accounts are totally uncollectible and the balance of 60% is being worked on for MPC Legal Counsel to proceed with the legal process.



### **Finding No. 03-2: Employee Receivable**

Condition: Cash advances to former employees still amount to \$7,651 which has been outstanding for a number of years.

Criteria: Employee receivables should be collected in a timely manner.

Cause: The cause of this condition is absence of a policy to limit outstanding balances due from employees.

Effect: The effect of this condition is a negative impact on cash flows from operations.

Recommendation: We recommend that MPC continue legal action to collect these funds and formulate policies to limit outstanding balances per employee an amount equivalent to two pay periods net pay checks.

Auditee response: There is a policy on cash advances extended to employees which was adopted only in December, 2000. The policy is to grant pay advances to employees to be deducted in full on the next pay period.

The advances mentioned in this audit report were granted before the policy was adopted which was several years back. These advances are with the legal counsel already and since then partial payments have been received.



**Finding No. 03-3: Issuance of "For Company Usage" Forms**

Condition. These forms were not pre-numbered and left unapproved on the space provided before issuance of materials and inventories for Company use.

Criteria: Withdrawal of materials and inventories for Company usage must be first approved before issuance.

Cause: The cause of this condition is unknown.

Effect: This condition hinders timely monitoring presence of unauthorized use of Company resources thereby increasing potential risk of asset misuse.

Recommendation: We recommend that at a minimum, MPC complete the approval process for this procedure before physical issuance of materials and inventories.

Auditee response: MPC recently implemented the approval of all withdrawal of materials and inventories for company use before issuance.



**Finding No. 03-4: Fixed assets capitalization policy**

Condition: The Company currently does not have any specific policy regarding the capitalization level of fixed asset costs. During our examination, we noted various items, which cost less than \$200 which were recorded as fixed assets.

Criteria: Sound internal control and accounting practices suggest that a fixed asset capitalization threshold must be established to improve consistency and simplification of accounting records.

Cause: Absence of a formal policy to address accounting for fixed assets contributed to the matter set forth in the criteria.

Effect: This condition causes an additional burden on accounting personnel to evaluate whether purchased items and significant renewals will extend the useful life of an asset and/or improve output of operations.  
Matching of fixed asset costs and revenues created might not be attained.

Recommendation. We recommend that the Company develop a policy whereby costs less than a certain amount are expensed rather than capitalized. This will ease the accounting for fixed assets in the future.

Auditee response: We agree that the company does not have any specific policy regarding the capitalization level of fixed assets costs.

Although cost of some fixed assets are not material but if the company believes that it will be useful for a longer period and there is physical possession, like some office equipment which cost less than \$200 the cost is being capitalized and consequently, it is being fully depreciated also during the fiscal year when it was purchased

MPC will develop a policy on this regard.