

MICRONESIA PETROLEUM CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2004 AND 2003

INDEPENDENT AUDITORS' REPORT

Board of Directors
Micronesia Petroleum Corporation:

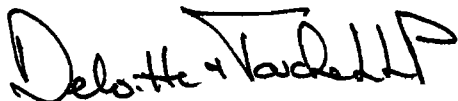
We have audited the accompanying statement of net assets of Micronesia Petroleum Corporation, a component unit of the State of Kosrae as of September 30, 2004, and the related statements of activities and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The 2003 financial statements were audited by other auditors who, in their report dated October 12, 2005, indicated that they were not able to obtain legal representations and could not assure themselves as to the adequacy of disclosures concerning those matters in the 2003 financial statements.

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. 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 includes consideration of 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Micronesia Petroleum Corporation as of September 30, 2004, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3-5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Micronesia Petroleum Corporation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the 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 February 28, 2006, on our consideration of Micronesia Petroleum Corporation's internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A handwritten signature in black ink, appearing to read "Deloitte & Touche LLP", with a stylized flourish at the end.

February 28, 2006

MICRONESIA PETROLEUM CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2004

Introduction

This section of the annual financial report of Micronesia Petroleum Corporation presents the analysis of the Company's annual performance for the fiscal year ended September 30, 2004.

The following summarizes the financial position and results of operations of Micronesia Petroleum Corporation for fiscal year 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Assets:		
Current assets:	\$ 1,238,582	\$ 1,088,665
Property, plant and equipment, net	2,353,264	2,613,908
Other assets	<u>31,824</u>	<u>31,824</u>
	\$ <u>3,623,670</u>	\$ <u>3,734,397</u>
Liabilities and net assets:		
Current liabilities:	\$ 666,865	\$ 570,890
Long-term debt	1,035,198	1,107,350
Net assets	<u>1,921,607</u>	<u>2,056,157</u>
	\$ <u>3,623,670</u>	\$ <u>3,734,397</u>
Statements of Revenue, Expenses, and Changes in Net Assets		
	<u>2004</u>	<u>2003</u>
Operating revenues	\$ 2,305,591	\$ 3,254,423
Cost of goods sold	<u>1,952,053</u>	<u>2,857,973</u>
Gross profit	353,538	396,450
Operating expenses	<u>460,600</u>	<u>563,133</u>
Loss from operations	(107,062)	(166,683)
Other income	112,898	260,330
Interest expense	(80,575)	(89,388)
Loss on sale of fixed assets	<u>(59,811)</u>	<u>-</u>
Total nonoperating expenses, net	<u>(27,488)</u>	<u>170,942</u>
(Decrease) increase in net assets	\$ <u>(134,550)</u>	\$ <u>4,259</u>

MICRONESIA PETROLEUM CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2004

Financial Highlights

Operating revenues decreased by 29% from \$3,254,423 in 2003 to \$2,305,591 in 2004. This decrease in revenues is mainly attributed to non-delivery of fuel outside of the Federated States of Micronesia.

The gross profit for 2004 is 15% as compared to 12% in 2003. There is a slight increase in gross profit for the year. The slight increase is due to an adjustment in selling price of fuel toward the last quarter of the fiscal year. Due to the high cost of fuel from the supplier, MPC commenced implementing a provision in a law that allows the Company to increase the price of fuel sold to its customers.

	<u>2004</u>		<u>2003</u>	
Operating revenues	\$ 2,305,591	100%	\$ 3,254,423	100%
Cost of goods sold	<u>1,952,053</u>	<u>85%</u>	<u>2,857,973</u>	<u>88%</u>
Gross profit	\$ <u>353,538</u>	<u>15%</u>	\$ <u>396,450</u>	<u>12%</u>

Operating expenses decreased by as much as 18% when compared to 2003. This is attributed greatly to the sale of the tanker, where the expenses directly related to maintaining the tanker decreased by as much as 52%.

The loss on sale of fixed assets in the amount of \$59,811 is attributed to the sale of the tanker. Other income decreased also by as much as 57% when compared with 2003 figures as a result of the sale of the tanker. The other income amount primarily consists of the delivery of water outside of the Federated States of Micronesia through the tanker.

Current assets increased by almost 14% or \$149,917 when compared with 2003 figures. Of the current asset components, inventory accounted for the major increase. This increase is due to purchase of fuel at fiscal year end, and this also accounted for the increase in accounts payable, one of the components of current liabilities.

Net assets represents the residual interest in the Company's assets after liabilities are deducted. The decrease in net assets represents loss for the period.

MICRONESIA PETROLEUM CORPORATION

Management's Discussion and Analysis
Year Ended September 30, 2004

Plan of Action for 2005

1. Improvement of bulk plant facilities and other assets
2. Secure steady supply of fuel
3. Exert more effort on collection of receivables in arrears
4. To effectively monitor operating expenses
5. To come up with a pricing policy.

MICRONESIA PETROLEUM CORPORATION

Statements of Net Assets September 30, 2004 and 2003

<u>ASSETS</u>	<u>2004</u>	<u>2003</u>
Current assets:		
Cash	\$ 138,837	\$ 305,491
Trade receivables, net	376,783	372,513
Due from employees	13,135	16,612
Inventory	699,919	376,887
Prepaid expenses	<u>9,908</u>	<u>17,162</u>
Total current assets	1,238,582	1,088,665
Property and equipment, net	2,353,264	2,613,908
Investment in joint venture	<u>31,824</u>	<u>31,824</u>
	<u>\$ 3,623,670</u>	<u>\$ 3,734,397</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current portion of notes payable	\$ 354,350	\$ 425,656
Accounts payable	238,546	71,819
Accrued liabilities and others	11,691	11,137
Payable to Kosrae State Government	<u>62,278</u>	<u>62,278</u>
Total current liabilities	666,865	570,890
Notes payable, net of current portion	<u>1,035,198</u>	<u>1,107,350</u>
Total liabilities	<u>1,702,063</u>	<u>1,678,240</u>
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	2,353,264	1,927,113
Deficit	<u>(431,657)</u>	<u>129,044</u>
Total net assets	<u>1,921,607</u>	<u>2,056,157</u>
	<u>\$ 3,623,670</u>	<u>\$ 3,734,397</u>

See accompanying notes to financial statements.

MICRONESIA PETROLEUM CORPORATION

Statements of Revenue, Expenses, and Changes in Net Assets Years Ended September 30, 2004 and 2003

	2004	2003
Sales	\$ 2,305,591	\$ 3,254,423
Cost of goods sold	<u>1,952,053</u>	<u>2,857,973</u>
Gross profit	<u>353,538</u>	<u>396,450</u>
Operating expenses:		
Salaries	150,916	155,244
Taxes	78,889	82,649
Depreciation	60,732	89,229
Vessel expenses	57,307	118,194
Professional fees	39,367	42,190
Travel and entertainment	23,857	23,704
Communication	7,373	8,867
Insurance	6,329	4,006
Rent	5,400	5,950
Fuel	4,811	5,740
Office supplies	4,633	3,007
Repairs and maintenance	4,294	3,280
Utilities	4,172	5,361
Bank service charges	3,969	2,883
Plant supplies	2,190	2,342
Freight, handling and storage	980	5,177
Miscellaneous	<u>5,381</u>	<u>5,310</u>
Total operating expenses	<u>460,600</u>	<u>563,133</u>
Loss from operations	<u>(107,062)</u>	<u>(166,683)</u>
Nonoperating revenues (expenses):		
Other income	112,898	260,330
Interest expense	(80,575)	(89,388)
Loss on sale of fixed assets	<u>(59,811)</u>	<u>-</u>
Total nonoperating expenses, net	<u>(27,488)</u>	<u>170,942</u>
(Decrease) increase in net assets	(134,550)	4,259
Net assets at beginning of year	<u>2,056,157</u>	<u>2,051,898</u>
Net assets at end of year	<u>\$ 1,921,607</u>	<u>\$ 2,056,157</u>

See accompanying notes to financial statements.

MICRONESIA PETROLEUM CORPORATION

Statements of Cash Flows Years Ended September 30, 2004 and 2003

	2004	2003
Cash flows from operating activities:		
Cash received from customers	\$ 2,304,798	\$ 3,199,100
Cash paid to suppliers for goods and services	(2,275,798)	(2,970,929)
Cash paid to employees for services	(151,094)	(155,244)
Net cash (used in) provided by operating activities	<u>(122,094)</u>	<u>72,927</u>
Cash flows from noncapital financing activities:		
Other income	112,898	260,330
Payment of interest expense	(80,397)	(89,388)
Repayment of notes payable	(143,458)	(138,968)
Net cash (used in) provided by noncapital financing activities	<u>(110,957)</u>	<u>31,974</u>
Cash flows from capital and related financing activities:		
Purchase of property, plant and equipment	(6,324)	(75,752)
Proceeds from the sale of fixed assets and others	72,721	-
Net cash provided by (used in) capital and related financing activities	<u>66,397</u>	<u>(75,752)</u>
Net (decrease) increase in cash	(166,654)	29,149
Cash at beginning of year	305,491	276,342
Cash at end of year	<u>\$ 138,837</u>	<u>\$ 305,491</u>
Reconciliation of loss from operations to net cash (used in) provided by operating activities:		
Operating loss	\$ (107,062)	\$ (166,683)
Adjustments to reconcile operating loss to net cash (used in) provided by operating activities:		
Depreciation	134,436	162,933
(Increase) decrease in assets:		
Receivables	(793)	(59,086)
Inventory	(323,032)	120,014
Prepayments	7,254	8,635
Increase (decrease) in liabilities:		
Accounts payable	166,727	8,978
Accrued liabilities	376	(1,864)
Net cash (used in) provided by operating activities	<u>\$ (122,094)</u>	<u>\$ 72,927</u>

See accompanying notes to financial statements.

MICRONESIA PETROLEUM CORPORATION

Notes to Financial Statements
September 30, 2004 and 2003

(1) Organization

Micronesia Petroleum Corporation (the Company) was established on November 14, 1996 by Kosrae State Law 6-98 and 7-28. The primary purpose of the Company is to operate and manage the State's fuel storage facilities and to engage in the business of buying and selling petroleum products.

The affairs of the Company are managed by a five-member board consisting of representatives of Kosrae State Government and the private sector. Daily operations of the Company are delegated to the Chief Executive Officer, who is hired by and serves at the pleasure of the Board.

(2) Summary of Significant Accounting Policies

Basis of Accounting

The accounting policies of Micronesia Petroleum Corporation 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. The Company has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The Company has adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement No. 37, "Basic Financial Statements – Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Disclosures" and applied those standards on a retroactive basis. GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following four net asset categories:

- Invested in capital assets, net of related debt:

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

- Restricted:
 - Nonexpendable – Net assets subject to externally imposed stipulations that require the Company to maintain them permanently. For the years ended September 30, 2004 and 2003, the Company does not have nonexpendable net assets.
 - Expendable – Net assets whose use by the Company is subject to externally imposed stipulations that can be fulfilled by actions of the Company pursuant to those stipulations or that expire by the passage of time.

MICRONESIA PETROLEUM CORPORATION

Notes to Financial Statements
September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies, Continued

Basis of Accounting, Continued

- **Unrestricted:**

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

Net Assets

Net assets represent the residual interest in the Company's assets after liabilities are deducted and consist of three sections: invested in capital assets, net of related debt; restricted and unrestricted. Net assets classified as invested in capital assets net of debt, include capital assets, restricted and unrestricted, net of accumulated depreciation and 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. The Company's restricted assets are expendable. All other net assets are unrestricted.

New Accounting Standards

In fiscal year 2005, MPC will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3) and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. As of the date of the opinion, the Company has not evaluated the financial statement impact of GASB Statement No.'s 40 and 42.

Cash

For purposes of the statement of net assets and of cash flows, cash represents cash on hand and in bank accounts. As of September 30, 2004, \$100,000 of the cash balances were subject to FDIC insurance.

Depreciation

Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Lives of equipment, vehicles, furniture and fixtures and bulk plant assets range from 3 to 40 years.

Inventory

Inventory is substantially carried at lower of cost (first-in, first-out) or market.

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.

MICRONESIA PETROLEUM CORPORATION

Notes to Financial Statements
September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies, Continued

Investment

Investment in a joint venture is carried at management's estimate of net realizable value.

Accounts Receivable

Accounts receivable are due from businesses and individuals located in the Federated States of Micronesia and in the Republic of Nauru. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb potential losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience.

	<u>2004</u>	<u>2003</u>
Trade receivables	\$ 791,726	\$ 787,797
Allowance for doubtful accounts	(414,943)	(415,284)
	\$ <u>376,783</u>	\$ <u>372,513</u>

(3) Investment

At September 30, 2004 and 2003, MPC held a 55% interest in a joint venture, Micronesia Petroleum Corporation-Yap (MPC-Yap). MPC-Yap's main business objective is to provide competitive priced petroleum products to support the economic activities in the State of Yap. MPC's participation in MPC-Yap primarily involves management of the joint venture. In 2001, management determined that it has no substantial control over this investment and its assets and has elected to record the investment at its best estimate of net realizable value. Management is reviewing its options with respect to this investment which may include discontinuation or sale of MPC's interest to its joint venture partner.

(4) Property, Plant and Equipment

A summary of property and equipment at September 30, 2004 and 2003, is as follows:

	<u>Balance at October 1, 2003</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2004</u>
Bulk plant	\$ 2,506,000	\$ -	\$ -	\$ 2,506,000
Vehicles and tank trucks	585,074	-	(289,410)	295,664
Office equipment	45,597	137	-	45,734
Furniture and fixtures	61,221	300	-	61,521
Machines and equipment	366,307	5,343	-	371,650
Buildings and improvements	206,802	544	-	207,346
Land	200,000	-	-	200,000
	3,971,001	6,324	(289,410)	3,687,915
Less accumulated depreciation	(1,357,093)	(134,436)	156,878	(1,334,651)
Net investment in plant	\$ <u>2,613,908</u>	\$ <u>(128,112)</u>	\$ <u>(132,532)</u>	\$ <u>2,353,264</u>

MICRONESIA PETROLEUM CORPORATION

Notes to Financial Statements September 30, 2004 and 2003

(4) Property, Plant and Equipment, Continued

	Balance at October 1, 2002	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2003
Bulk plant	\$ 2,506,000	\$ -	\$ -	\$ 2,506,000
Vehicles and tank trucks	577,103	43,574	(35,603)	585,074
Office equipment	118,414	8,849	(81,666)	45,597
Furniture and fixtures	61,096	125	-	61,221
Machines and equipment	343,696	22,611	-	366,307
Buildings and improvements	206,209	593	-	206,802
Land	<u>200,000</u>	<u>-</u>	<u>-</u>	<u>200,000</u>
	4,012,518	75,752	(117,269)	3,971,001
Less accumulated depreciation	<u>(1,311,429)</u>	<u>(162,933)</u>	<u>117,269</u>	<u>(1,357,093)</u>
Net investment in plant	\$ <u>2,701,089</u>	\$ <u>(87,181)</u>	\$ <u>-</u>	\$ <u>2,613,908</u>

(5) Notes Payable

Notes payable consist of the following at September 30, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
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	\$ 272,500
Loan payable to FSM Development Bank in the original amount of \$500,000 due in monthly installments of \$5,100, with a balloon payment of approximately \$264,000 due at maturity. Interest is at 9%, maturity in September 2008, collateralized by the property and inventory of the Company.	360,725	387,921
Term loan payable to Bank of the FSM, interest at 2.75% greater than TCD rate pledged 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.	251,099	298,874
Loan payable to FSM Development Bank, ten year term, interest at 5%, monthly repayment of \$7,958.	<u>505,224</u>	<u>573,711</u>
Total debt	1,389,548	1,533,006
Less current portion	<u>(354,350)</u>	<u>(425,656)</u>
Long-term debt, net of current portion	\$ <u>1,035,198</u>	\$ <u>1,107,350</u>

MICRONESIA PETROLEUM CORPORATION

Notes to Financial Statements
September 30, 2004 and 2003

(5) Notes Payable, Continued

Future maturities of the above debt are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 354,350	\$ 69,066
2006	105,516	51,339
2007	112,038	44,818
2008	347,017	35,870
2009	358,594	9,906
2010-2014	<u>112,033</u>	<u>3,668</u>
	<u>\$ 1,389,548</u>	<u>\$ 214,677</u>

Changes in long-term liabilities during the year ended September 30, 2004 occurred as follows:

<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance end of year</u>	<u>Balance due currently</u>
\$ <u>1,533,006</u>	\$ <u>-</u>	\$ <u>143,458</u>	\$ <u>1,389,548</u>	\$ <u>354,350</u>

The change in long-term liabilities for the year ended September 30, 2003 was not available.

(6) 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, 2004 and 2003, reflects expenditures incurred in excess of such appropriations. Kosrae State Government and Micronesia Petroleum Corporation are currently negotiating a payment schedule for the amount.

(7) Commitments and Contingencies

Management is of the opinion that the Company is a tax-exempt organization and is therefore not liable for gross receipts taxes. The FSM National Government Customs Division has maintained that Micronesia Petroleum Corporation is not tax exempt. The Company and the FSM National Government have attempted to resolve this issue through their respective attorney general's offices. A compromise and settlement has been reached wherein MPC will pay \$200,000 in 20 quarterly installments of \$10,000 to commence during the second quarter of calendar year 2006. No liability has been recorded for any portion of this balance as management will record the liability in fiscal year 2006.

(8) 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 for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

MICRONESIA PETROLEUM CORPORATION

Notes to Financial Statements
September 30, 2004 and 2003

(9) Significant Revenue Sources

Sales to (generated from) one Kosrae State component unit accounted for \$756,908 or 33% of total sales for the year ended September 30, 2004 and \$752,336 or 21% in 2003.

(10) Contingencies

As of September 30, 2004, approximately \$380,000 of receivables is due from one customer. The customer's ability to pay appears contingent on certain future events, of which management cannot currently predict the outcome. Management is of the opinion that the balance will ultimately be collectible. Accordingly, no reserve for this balance has been made in the accompanying financial statements. However, if the balance is not collectible, the accompanying financial statements could be materially impacted.

(11) Subsequent Events

On May 5, 2005, Kosrae State Government loaned \$300,000 to Micronesia Petroleum Corporation.

In fiscal year 2005, certain inventory was found not to meet specifications. Ultimate disposition of the inventory resulted in a loss of \$66,374.

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

Board of Directors
Micronesia Petroleum Corporation:

We have audited the financial statements of the Micronesia Petroleum Corporation (MPC), as of and for the year ended September 30, 2004, and have issued our report thereon dated February 28, 2006. 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

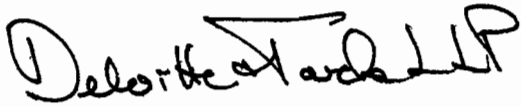
In planning and performing our audit, we considered Micronesia Petroleum Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

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. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether Micronesia Petroleum Corporation'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 MPC 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, appearing to read "Delbert A. Adams, LLP". The signature is stylized with a large, looped initial "D" and a prominent horizontal stroke across the middle.

February 28, 2006