

**MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE STATE OF KOSRAE)**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

INDEPENDENT AUDITORS' REPORT

Board of Directors
Micronesia Petroleum Corporation:

We have audited the accompanying statements of net assets of Micronesia Petroleum Corporation (the Company), a component unit of the State of Kosrae, as of September 30, 2006 and 2005, and the related statements of revenue, expenses, and changes in net assets and cash flows for the years 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 audits.

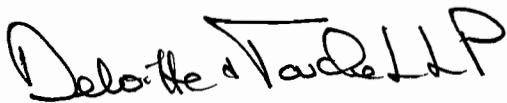
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 audits provide 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, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 10, a receivable is in arrears and the ultimate resolution of this matter is not predictable, but could have a material impact on the accompanying financial statements.

The Management's Discussion and Analysis on pages 3-4 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 Micronesia Petroleum Corporation's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement 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 June 29, 2007, 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", written in a cursive, stylized script.

June 29, 2007

MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

Management's Discussion and Analysis
Year Ended September 30, 2006

INTRODUCTION

The following summarizes the financial position and results of operations of Micronesia Petroleum Corporation for fiscal years 2006, 2005 and 2004:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets:			
Current assets	\$ 1,502,578	\$ 1,326,014	\$ 1,238,582
Property, plant & equipment, net	2,178,093	2,278,236	2,353,264
Other assets	<u>31,824</u>	<u>31,824</u>	<u>31,824</u>
	<u>\$ 3,712,495</u>	<u>\$ 3,636,074</u>	<u>\$ 3,623,670</u>
Liabilities and net assets:			
Current liabilities	1,016,903	754,031	666,865
Long-term debt	885,370	1,117,283	1,035,198
Net assets	<u>1,810,222</u>	<u>1,764,760</u>	<u>1,921,607</u>
	<u>\$ 3,712,495</u>	<u>\$ 3,636,074</u>	<u>\$ 3,623,670</u>
Revenues, Expenses, and Changes in Net Assets			
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating revenues	\$ 4,030,074	\$ 3,091,144	\$ 2,343,661
Cost and operating expenses	<u>3,920,997</u>	<u>3,182,806</u>	<u>2,412,653</u>
Net operating income (loss)	<u>109,077</u>	<u>(91,662)</u>	<u>(68,992)</u>
Other income	1,644	5,422	74,828
Interest expense	(65,259)	(70,607)	(80,575)
Other expense	<u>-</u>	<u>-</u>	<u>(59,811)</u>
Total non-operating expenses, net	<u>(63,615)</u>	<u>(65,185)</u>	<u>(65,558)</u>
Increase (Decrease) in Net Assets	<u>\$ 45,462</u>	<u>\$ (156,847)</u>	<u>\$ (134,550)</u>

Financial Highlights

The financial figures for fiscal year 2004 are included in this report. However, analysis and comparison is based only on fiscal year 2006 and 2005.

Total current assets increased by about 13% when compared to the 2005 figures. Of the total current asset components, inventory increased by 41% from \$668,872 to \$940,837 due to increases in the cost of fuel; accounts receivable increased by as much as 32% due to increase in the selling price of fuel to compensate for the increase in cost. Other receivables decreased by 100% since the total amount shown in the balance sheet as of fiscal year 2005 was collected in full this fiscal year. The above changes mainly contributed to the 13% increase in current assets.

MICRONESIA PETROLEUM CORPORATION
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Management's Discussion and Analysis
Year Ended September 30, 2006

Property and equipment of the Corporation consists of fixed assets owned by the Corporation. The components of this account are shown in note 4 to the financial statements. Property, plant and equipment decreased by about 5%, which is attributable to depreciation for the current year.

Current liabilities increased by \$262,872 or 34% compared with the previous year. This mainly results from a loan which will mature next fiscal year. Long term debt decreased by \$231,913 or 20% due to loan payments and increases in current loan maturities.

The 2006 increase in net assets of \$45,462 represents profit for the year.

Operating revenues increased by about 30% from \$3,091,144 in 2005 to \$4,030,074 this fiscal year. This is due to an increase in the Company's selling price to cope with the rising cost of fuel.

	<u>2006</u>	<u>2005</u>
Operating Revenues	\$ 4,030,074	\$ 3,091,144
Cost of Goods Sold	<u>3,522,294</u>	<u>2,786,069</u>
Gross Profit	\$ <u>507,780</u>	\$ <u>305,075</u>
Gross Profit Rate	13%	10%

Increase in net assets of \$45,462 as compared with a decrease in previous year of \$156,847 is due to an adjustment in selling price of fuel as shown in the increase in gross profit rate. Operating expenses remain almost the same as the previous year's figures.

Management's Discussion and Analysis for the year ended September 30, 2005 is set forth in MPC's report on the audit of financial statements, which is dated June 2, 2006. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmpublicauditor.fm.

PLAN OF ACTION FOR FISCAL YEAR 2007

1. To improve and maintain in good condition the bulk plant facilities of the Corporation. To budget for a purchase of delivery trucks to improve the operation of the Corporation.
2. To secure a steady supply of fuel and with the lowest price available in the market.
3. To negotiate with the government on the flexibility of pricing fuel products for the benefit of the Corporation and the public as well.
4. To participate in the Fuel Task Force negotiation to secure extension of business to other FSM States.
5. To monitor all areas of expenses.

MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

Statements of Net Assets
September 30, 2006 and 2005

<u>ASSETS</u>	<u>2006</u>	<u>2005</u>
Current assets:		
Cash	\$ 88,787	\$ 30,508
Trade receivables, net	460,291	348,987
Other receivables	-	264,503
Due from employees	11,430	13,144
Inventory	940,837	668,872
Prepaid expenses	1,233	-
Total current assets	1,502,578	1,326,014
Property and equipment, net	2,178,093	2,278,236
Investment in joint venture	31,824	31,824
	<u>\$ 3,712,495</u>	<u>\$ 3,636,074</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current portion of notes payable	\$ 643,132	\$ 412,016
Accounts payable	300,460	269,245
Accrued liabilities and others	11,033	10,492
Payable to Kosrae State Government	62,278	62,278
Total current liabilities	1,016,903	754,031
Notes payable, net of current portion	885,370	1,117,283
Total liabilities	1,902,273	1,871,314
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	2,178,093	2,278,236
Unrestricted deficit	(367,871)	(513,476)
Total net assets	1,810,222	1,764,760
	<u>\$ 3,712,495</u>	<u>\$ 3,636,074</u>

See accompanying notes to financial statements.

MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

Statements of Revenue, Expenses, and Changes in Net Assets
Years Ended September 30, 2006 and 2005

	2006	2005
Sales and service income	\$ 4,030,074	\$ 3,091,144
Cost of goods sold	<u>3,522,294</u>	<u>2,786,069</u>
Gross profit	<u>507,780</u>	<u>305,075</u>
Operating expenses:		
Salaries	130,899	130,889
Taxes	128,209	124,578
Depreciation	44,012	34,037
Professional fees	26,000	24,049
Travel and entertainment	12,354	12,905
Bank service charges	8,470	1,735
Utilities	7,757	5,047
Repairs and maintenance	6,629	6,305
Office supplies	6,311	4,541
Rent	5,400	5,400
Insurance	4,557	6,268
Communication	4,276	6,435
Plant supplies	1,251	3,645
Freight, handling and storage	723	572
Fuel	6,771	7,299
Miscellaneous	<u>5,084</u>	<u>23,032</u>
Total operating expenses	<u>398,703</u>	<u>396,737</u>
Income (loss) from operations	<u>109,077</u>	<u>(91,662)</u>
Nonoperating revenues (expenses):		
Other income	1,644	5,422
Interest expense	<u>(65,259)</u>	<u>(70,607)</u>
Total nonoperating expenses, net	<u>(63,615)</u>	<u>(65,185)</u>
Increase (decrease) in net assets	45,462	(156,847)
Net assets at beginning of year	<u>1,764,760</u>	<u>1,921,607</u>
Net assets at end of year	<u>\$ 1,810,222</u>	<u>\$ 1,764,760</u>

See accompanying notes to financial statements.

MICRONESIA PETROLEUM CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Cash received from customers	\$ 4,183,273	\$ 3,118,940
Cash paid to suppliers for goods and services	(3,911,834)	(3,138,234)
Cash paid to employees for services	<u>(130,899)</u>	<u>(130,889)</u>
Net cash provided by (used in) operating activities	<u>140,540</u>	<u>(150,183)</u>
Cash flows from noncapital financing activities:		
Other income	1,644	5,422
Payment of interest expense	(65,259)	(70,607)
Repayment of notes payable	(200,797)	(160,249)
Proceeds from notes payable	<u>200,000</u>	<u>300,000</u>
Net cash (used in) provided by noncapital financing activities	<u>(64,412)</u>	<u>74,566</u>
Cash flows from capital and related financing activities:		
Purchase of property and equipment	<u>(17,849)</u>	<u>(32,712)</u>
Net cash used in capital and related financing activities	<u>(17,849)</u>	<u>(32,712)</u>
Net change in cash	58,279	(108,329)
Cash at beginning of year	<u>30,508</u>	<u>138,837</u>
Cash at end of year	<u>\$ 88,787</u>	<u>\$ 30,508</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:		
Operating income (loss)	\$ 109,077	\$ (91,662)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Depreciation	117,815	107,740
Loss on retirement of asset	177	-
(Increase) decrease in assets:		
Trade receivables	(111,304)	27,796
Other receivables	264,503	(264,503)
Due from employees	1,714	(9)
Inventory	(271,965)	31,047
Prepaid expenses	(1,233)	9,908
Increase (decrease) in liabilities:		
Accounts payable	31,215	30,699
Accrued liabilities	<u>541</u>	<u>(1,199)</u>
Net cash provided by (used in) operating activities	<u>\$ 140,540</u>	<u>\$ (150,183)</u>

See accompanying notes to financial statements.

MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

Notes to Financial Statements
September 30, 2006 and 2005

(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.

A five-member board, which consists of representatives of Kosrae State Government and the private sector, oversee the affairs of the Company. 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 three 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, 2006 and 2005, the Company does not have nonexpendable restricted 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
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Notes to Financial Statements
September 30, 2006 and 2005

(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.

All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statement of net assets.

The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred. Revenues are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued based on the most recent billing cycle.

New Accounting Standards

The Company implemented the following accounting pronouncements for the year ended September 30, 2006:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*, which improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination of Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

The implementation of these pronouncements did not have a material impact on the accompanying financial statements.

MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In October 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. GASB Statement No. 48 establishes uniform financial reporting for these types of revenues. The provisions of this Statement are effective for periods beginning after December 15, 2006. In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Additionally, in June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition and display of other postemployment benefit expenses and related liabilities, note disclosures, and, if applicable, required supplementary information in the reports of the state and local employers. The provisions of this Statement are effective for periods beginning after December 15, 2006.

Management does not believe that the implementation of these Statements will have a material effect on the financial statements of MPC.

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.

Cash

For purposes of the statements of net assets and of cash flows, cash represents cash on hand and in bank accounts. As of September 30, 2006 and 2005, up to \$100,000 of cash balances were subject to FDIC insurance. Balances in excess of FDIC insurance are not collateralized. Accordingly, these deposits are exposed to custodial credit risk. There are no significant differences between cash per book and per bank balances.

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>2006</u>	<u>2005</u>
Trade receivables	\$ 875,234	\$ 763,930
Allowance for doubtful accounts	(414,943)	(414,943)
	\$ <u>460,291</u>	\$ <u>348,987</u>

Other receivables in 2005 consist primarily of a refund due from a fuel supplier, which was fully collected during 2006.

MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

Inventory

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

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.

Reclassifications

Certain reclassifications have been made to the 2005 financial statements to correspond with the 2006 presentation.

(3) Investment

At September 30, 2006 and 2005, 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 has entered into an agreement to sell its investment in MPC Yap to the Yap State Government for \$200,000, which includes recovery of the investment and other net receivables.

(4) Property, Plant and Equipment

A summary of property, plant, equipment at September 30, 2006 and 2005, is as follows:

	Balance at October 1, 2005	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2006
Bulk plant	\$ 2,506,000	\$ -	\$ -	\$ 2,506,000
Vehicles and tank trucks	295,664	15,000	-	310,664
Office equipment	47,604	2,090	(276)	49,418
Furniture and fixtures	61,521	-	(2,915)	58,606
Machines and equipment	397,587	759	-	398,346
Buildings and improvements	207,346	-	-	207,346
	3,515,722	17,849	(3,191)	3,530,380
Less accumulated depreciation	(1,437,486)	(117,815)	3,014	(1,552,287)
Depreciable assets, net	2,078,236	(99,966)	(177)	1,978,093
Land	200,000	-	-	200,000
Property, plant and equipment, net	\$ 2,278,236	\$ (99,966)	\$ (177)	\$ 2,178,093

MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(4) Property, Plant and Equipment, Continued

	Balance at October 1, 2004	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2005
Bulk plant	\$ 2,506,000	\$ -	\$ -	\$ 2,506,000
Vehicles and tank trucks	295,664	-	-	295,664
Office equipment	45,734	1,870	-	47,604
Furniture and fixtures	61,521	-	-	61,521
Machines and equipment	371,650	30,842	(4,905)	397,587
Buildings and improvements	207,346	-	-	207,346
	3,487,915	32,712	(4,905)	3,515,722
Less accumulated depreciation	(1,334,651)	(107,740)	4,905	(1,437,486)
Depreciable assets, net	2,153,264	(75,028)	-	2,078,236
Land	200,000	-	-	200,000
Property, plant and equipment, net	\$ 2,353,264	\$ (75,028)	\$ -	\$ 2,278,236

(5) Notes Payable

Notes payable consist of the following at September 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Loan payable to Kosrae State Government, in the original amount of \$300,000, due in monthly installments of \$2,628, interest at 1%, maturing on February 1, 2009.	\$ 272,500	\$ 272,500
Loan payable to Kosrae State Government, primary government in the original amount of \$300,000, due in monthly installments of \$2,000. Commencing June 1, 2008 installments shall be increased to \$4,000 per month, interest at 1%.	272,106	292,000
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.	298,777	331,231
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. Interest rate effective as of September 30, 2006 and 2005 is 5.25% and 6.92%, respectively.	144,641	200,640
Loan payable to FSM Development Bank, ten year term, maturing on July 18, 2010, interest at 5%, monthly repayment of \$7,958, collateralized by MPC's accounts receivable and inventory.	356,538	432,928

MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(5) Notes Payable, Continued

Loan payable to FSM Development Bank, two year term, maturing on July 31, 2008, interest at 9%, monthly repayment of \$9,136, collateralized by interest in essentially all MPC assets.

183,940 -

Total debt

1,528,502 1,529,299

Less current portion

(643,132) (412,016)

Long-term debt, net of current portion

\$ 885,370 \$ 1,117,283

Future maturities of the above debt are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 643,132	\$ 71,586
2008	482,718	48,462
2009	131,577	11,919
2010	136,318	7,178
2011	68,645	2,219
2012-2013	<u>66,112</u>	<u>849</u>
	\$ <u>1,528,502</u>	\$ <u>142,213</u>

Changes in long-term liabilities during the year ended September 30, 2006 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>1,529,299</u>	\$ <u>200,000</u>	\$ <u>200,797</u>	\$ <u>1,528,502</u>	\$ <u>643,132</u>

Changes in long-term liabilities during the year ended September 30, 2005 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>1,389,548</u>	\$ <u>300,000</u>	\$ <u>160,249</u>	\$ <u>1,529,299</u>	\$ <u>412,016</u>

(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, 2006 and 2005, reflects expenditures incurred in excess of such appropriations. Kosrae State Government and Micronesia Petroleum Corporation are currently negotiating a payment schedule for the amount.

MICRONESIA PETROLEUM CORPORATION
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Notes to Financial Statements
September 30, 2006 and 2005

(7) Subsequent Event

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 tentatively reached wherein MPC will pay \$200,000 in 20 quarterly installments of \$10,000. No liability has been recorded for any portion of this balance as it is management's opinion that the amount will be reduced and the liability will be recorded upon finalization of the settlement. Therefore, the ultimate resolution of this matter may materially impact the accompanying financial statements.

(8) Risk Management

Micronesia Petroleum Corporation purchases commercial insurance to cover its potential risks from refueling operations, inventory and facilities. It also maintains workmen's compensation coverage. It 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 during the past three years.

(9) Significant Revenue Sources

Sales to a Kosrae State component unit accounted for \$1,316,131 or 33% of total sales for the year ended September 30, 2006 and \$1,100,998 or 36% in 2005.

(10) Contingency

As of September 30, 2006 and 2005, approximately \$385,040 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. However, an allowance amounting to \$267,777 has been made in the accompanying financial statements as of September 30, 2006 and 2005. If the balance is not collectible, the accompanying financial statements will be materially impacted.

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, 2006, and have issued our report thereon dated June 29, 2007. 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

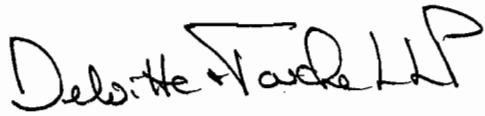
In planning and performing our audit, we considered Micronesia Petroleum Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over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

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. 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 "Deloitte & Touche LLP". The signature is stylized and cursive, with the letters "D", "T", and "L" being particularly prominent.

June 29, 2007