

June 28, 2012

The Board of Directors  
Federated States of Micronesia Petroleum Corporation

Dear Members of the Board of Directors:

We have performed an audit of the financial statements of the Federated States of Micronesia Petroleum Corporation (the Company), a component unit of the FSM National Government, as of December 31, 2011, in accordance with auditing standards generally accepted in the United States of America (“generally accepted auditing standards”) and have issued our report thereon dated and have issued our report thereon dated June 28, 2012.

We have prepared the following comments to assist you in fulfilling your obligation to oversee the financial reporting and disclosure process for which management of the Company is responsible.

## **OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS AND GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS**

Our responsibility under generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, have been described in our engagement letter dated September 13, 2011. As described in that letter, the objective of a financial statement audit conducted in accordance with the aforementioned standards is:

- To express an opinion on the fairness of the presentation in the Company’s basic financial statements and to disclaim an opinion on the required supplementary information for the year ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America (“generally accepted accounting principles”), in all material respects; and
- To report on the Company’s internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended December 31, 2011 based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*.

Our responsibilities under generally accepted auditing standards include forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of the Board of Directors are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The audit of the financial statements does not relieve management or the Board of Directors of their responsibilities.

We considered the Company’s internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

## **ACCOUNTING ESTIMATES**

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are ordinarily based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the Company's 2011 financial statements include management's estimate of the allowance for doubtful accounts, which is determined based upon past collection experience and aging of the accounts, management's estimate of inventory obsolescence, which is based on management's evaluation of the inventory's realizable value, and management's estimate of depreciation expense, which is based on estimated useful lives of the respective capital assets. During the year ended December 31, 2011, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

## **CORRECTED MISSTATEMENTS**

Our audit of the financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Material misstatements were brought to the attention of management as a result of our audit procedures and were corrected by management during the current period. We have attached to this letter, as Appendix B to Attachment I, a summary of misstatements corrected by management.

## **UNCORRECTED MISSTATEMENTS**

Our audit of the financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. We have attached to this letter, as Appendix A to Attachment I, a summary of uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

## **SIGNIFICANT ACCOUNTING POLICIES**

The Company's significant accounting policies are set forth in Note 2 to the Company's 2011 financial statements. During the year ended December 31, 2011, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by the Company:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

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

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements— and Management’s Discussion and Analysis— for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*, which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty’s credit support provider, is replaced. The provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

## **DISAGREEMENTS WITH MANAGEMENT**

We have not had any disagreements with management related to matters that are material to the Company’s 2011 financial statements.

## **CONSULTATION WITH OTHER ACCOUNTANTS**

We are not aware of any consultations that management may have had with other accountants about auditing and accounting matters during 2011.

## **SIGNIFICANT ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT PRIOR TO OUR INITIAL ENGAGEMENT OR RETENTION**

Throughout the year, routine discussions were held, or were the subject of correspondence, with management regarding the application of accounting principles or auditing standards in connection with transactions that have occurred, transactions that are contemplated, or reassessment of current circumstances. In our judgment, such discussions or correspondence were not held in connection with our retention as auditors.

## **OTHER SIGNIFICANT ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT**

Throughout the year, routine discussions were held, or were the subject of correspondence, with management. In our judgment, such discussions or correspondence did not involve significant issues requiring communication to the Board of Directors.

## **SIGNIFICANT DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

In our judgment, we received the full cooperation of the Company's management and staff and had unrestricted access to the Company's senior management in the performance of our audit.

## **MANAGEMENT'S REPRESENTATIONS**

We have made specific inquiries of the Company's management about the representations embodied in the financial statements. Additionally, we have requested that management provide to us the written representations the Company is required to provide to its independent auditors under generally accepted auditing standards. We have attached to this letter, as Attachment I, a copy of the representation letter we obtained from management.

## **CONTROL-RELATED MATTERS**

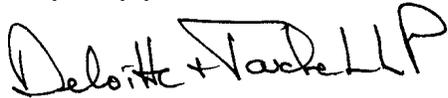
We have issued a separate report to you, also dated June 28, 2012, on our consideration of the Company's internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

We have also communicated to management, in a separate letter also dated June 28, 2012, certain control deficiencies and other matters that we identified during our audit.

\* \* \* \* \*

This report is intended solely for the information and use of management, the Board of Directors, others within the Company and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

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



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**File Ref. PC/F/11**

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Senator Gibson Siba  
**Vice Chairman**  
 Kosrae State Representative

Alexander Narruhn  
**Secretary**  
 Chuuk State Representative

Redley Killion  
**Member**  
 Private Sector Representative

Faustino Yangmog  
**Member**  
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Yalmer Helgenberger  
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June 28, 2012

Deloitte & Touche LLP  
 361 S Marine Corps Dr  
 Tamuning GU 96913-3911

Dear Sir:

We are providing this letter in connection with your audits of the statements of net assets of the Federated States of Micronesia Petroleum Corporation (the Company), a component unit of Federated States of Micronesia (FSM) National Government, as of December 31, 2011 and 2010 and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended, for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the Company in conformity with accounting principles generally accepted in the United States of America (GAAP). We confirm that we are responsible for the following:

- a. The fair presentation in the basic financial statements of financial position, results of operations, and cash flows in conformity with GAAP;
- b. The fair presentation of the required supplementary information, including Management's Discussion and Analysis, accompanying the basic financial statements;
- c. The design, implementation, and maintenance of programs and controls to prevent and detect fraud;
- d. Establishing and maintaining effective internal control over financial reporting; and
- e. The review and approval of the financial statements and related notes and acknowledge your role in the preparation of this information. Specifically, we acknowledge that your role in the preparation of financial statements was a matter of convenience rather than necessity. We have reviewed the financial statement preparation assistance provided by you and acknowledge that the financial statements are prepared in accordance with GAAP. Our review was based on the use of the financial statement disclosure checklist for stand-alone business-type activities obtained from the Government Finance Officers Association. In addition, we concur with the adjusting entries included in Appendix B.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audits.

1. The basic financial statements referred to above are fairly presented in conformity with GAAP. In addition:
  - a. Net assets components (invested in capital assets, net of related debt; restricted and unrestricted) are properly classified and, if applicable, approved;
  - b. Expenses have been appropriately classified in or allocated to functions and programs in the statements of activities, and allocations have been made on a reasonable basis;
  - c. Revenues are appropriately classified in the statement of activities;
  - d. Deposits are properly classified in category of custodial credit risk;
  - e. Capital assets, including infrastructure assets, are properly capitalized and reported, and, if applicable, depreciated;
  - f. Required supplementary information is measured and presented in prescribed guidelines; and
  - g. Applicable laws and regulation are followed in adopting, approving and amending budgets.
2. The Company has provided to you all relevant information and access as agreed in the terms of the audit engagement letter, including:
  - a. Contracts and grant agreements (including amendments, if any);
  - b. Financial records and related data for all financial transaction of the Company. The records, books and accounts, as provided to you, record the financial and fiscal operations of the Company and provide the audit trail to be used in a review of accountability. Information presented in financial reports is supported by the books and records from which the financial statements have been prepared; and
  - c. Resolutions and minutes of the meetings of the Board of Directors or summaries of actions of recent meetings for which minutes have not yet been prepared. Board meetings were held on the following dates:
    - January 17 to 21, 2011
    - March 15 to 20, 2011
    - July 18 to 23, 2011
    - November 19 to 26, 2011
    - December 19 to 21, 2011
    - February 7 to 10, 2012
3. There have been no:
  - a. Actions taken by the Company's management that contravenes the provisions of federal laws and FSM laws and regulations; and
  - b. Communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices or other matters that could have a material effect on the financial statements.
4. We believe the effects of any uncorrected financial statement misstatements aggregated by you during the current audit engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such uncorrected misstatements has been attached as Appendix A.
5. The Company has provided to you the results of management's risk assessment, including the assessment of the risk that the financial statements may be materially misstated as a result of fraud.
6. We have no knowledge of any fraud or suspected fraud affecting the Company involving:
  - a. Management

- b. Employees who have significant roles in the Company's internal control over financial reporting
  - c. Others, if the fraud could have a material effect on the financial statements.
7. We have no knowledge of any allegations of fraud or suspected fraud affecting the Company received in communications from employees, former employees, regulators, or others.
  8. There are no unasserted claims or assessments that legal counsel has advised us are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 450, *Contingencies* (formerly FASB Statement No. 5, *Accounting for Contingencies*).
  9. Significant assumptions used by us in making accounting estimates are reasonable.
  10. During the year 2011, the Company implemented the following pronouncements:
    - GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.
    - GASB Statement No. 59, Financial Instruments Omnibus, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.
  11. In December 2009, GASB issued Statement No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans, which amends Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, and Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.
  12. In December 2010, GASB issued Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.
  13. In December 2010, GASB issued Statement No. 61, The Financial Reporting Entity: Omnibus, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, The Financial Reporting Entity, and No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.
  14. In December 2010, GASB issued Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

15. In July 2011, GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.
16. In July 2011, GASB issued Statement No. 64, Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.
17. There are no reportable conditions including significant deficiencies and material weaknesses, in the design or operation of internal control that could adversely affect the Company's ability to initiate, record, process, and report financial information.
18. There are no control deficiencies in the design or operation of internal control over financial reporting that could adversely affect the Company's ability to initiate, record, process, and report financial information.
19. We are aware of our requirements to disclose to you any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting and we advise you that no such changes have occurred.
20. Management has identified and disclosed to you all laws and regulations that have direct and material effect on the determination of financial statement amounts.
21. The Company is a major corporation for FSM tax purposes. A legal opinion is being sought to state that the Company is not subject to 21 percent income tax.

Except where otherwise stated below, immaterial matters less than \$152,600 collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to, or disclosure in, the financial statements.

22. Except as listed in Appendix A, there are no transactions that have not been properly recorded in the accounting records underlying the financial statements.
23. The Company has no plans or intentions that may affect the carrying value or classification of assets and liabilities.
24. The following, to the extent applicable, have been appropriately identified, properly recorded, and disclosed in the financial statements:
  - a. Related-party transactions and associated amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral); and
  - b. Guarantees, whether written or oral, under which the Company is contingently liable.
  - c. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.
  - d. Financial instruments with significant or group concentration of credit risk.
25. In preparing the financial statements in conformity with GAAP, management uses estimates. All estimates have been disclosed in the financial statements for which known information available prior to the issuance of the financial statements indicates that both of the following criteria are met:

- a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
  - b. The effect of the change would be material to the financial statements.
26. Risks associated with concentrations, based on information known to management, that meet all of the following criteria have been disclosed in the financial statements:
- a. The concentration exists at the date of the financial statements.
  - b. The concentration makes the enterprise vulnerable to the risk of a near-term severe impact.
  - c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.
27. There are no:
- a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency; and
  - b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450, *Contingencies* (formerly FASB Statement No. 5, *Accounting for Contingencies*).
28. The Company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral except as disclosed in the notes to the financial statements.
29. Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.
30. Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value. All inventories are the property of the Company and do not include any items consigned to it or any items billed to customers.
31. We believe that all expenditures that have been deferred to future periods are recoverable.
32. The Company has completely capitalized as property and equipment and, if applicable, depreciated all construction projects completed as of December 31, 2011.
33. With regard to the fair value measurements and disclosures of certain assets, liabilities, and specific components of equity, such as:
- a. The measurement methods, including the related assumptions, used in determining fair value were appropriate, consistent with market participant assumptions where available without undue cost and effort, and were consistently applied in accordance with GAAP.
  - b. The completeness and adequacy of the disclosures related to fair values are in conformity with accounting principles generally accepted in the United States of America.
  - c. No events have occurred after December 31, 2011, but before June 28, 2012, the date the financial statements were available to be issued that require adjustment to the fair value measurements and disclosures included in the financial statements.
34. The Company 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.

35. The Company has complied with all aspects of contractual agreements that may have an effect on the financial statements in the event of noncompliance.
36. No department or agency of the Company has reported a material instance of noncompliance to us.
37. No events have occurred after December 31, 2011, but before June 28, 2012, the date the financial statements were available to be issued that require consideration as adjustments to, or disclosures in, the financial statements.

Sincerely,



Mathias Lawrence  
Chief Financial Officer

**ATTACHMENT I, CONTINUED**

FSM Petroleum Corporation  
December 31, 2011 Audit

Appendix A

Description of Misstatement	Indicate if		Account Balance	Assets	Liabilities	Equity	Income	TOTAL
	Known	or Likely Misstatement						
<b>Current-Period Uncorrected Misstatements</b>								
PAJE <1> To correct error in cut-off of recording sales	Known		(DR) Sales				80,318	80,318.35
	Known		(DR) Inventory	65,372				65,372.48
	Known		(CR) Customer credit balance		22,370			(22,369.80)
	Known		(CR) Accounts receivable		57,949			(57,948.55)
	Known		(CR) Cost of goods sold				65,372	(65,372.48)
PAJE <1> To correct error in cut-off of recording sales	Known		(DR) Cost of goods sold				83,920	83,920
	Known		(CR) Prepayment to MOGI	83,920				(83,920)
<b>Total Misstatements</b>				65,372	141,869	22,370	164,238	65,372
								0

  
 Mathias Lawrence  
 Chief Accounting Officer

**ATTACHMENT I, CONTINUED**

**FSM Petroleum Corporation**  
**December 31, 2011 Audit**

Appendix B

Description of Misstatement	Account Balance	Assets		Liabilities		Equity		Income		TOTAL
		Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	
<b>Current-Period Corrected Misstatements</b>										
RJE <1> To reclassify portion of note payable to current account (DR) Note payable - noncurrent (CR) Note payable - current				526,586	526,586					526,586 (526,586)
AJE <2> To reclassify completed assets out of CIP (DR) Building Improvement (CR) CIP - Corp Engineering Building Upgrade (PN11-03)		86,479	86,479							86,479 (86,479)
AJE <3> To record capitalizable interest (DR) CIP (CR) Interest expense		99,000							99,000	99,000 (99,000)
AJE <4> To transfer out to FA related capitalized interest of completed assets (DR) Machinery - Yap (DR) Building improvement - PNI (CR) CIP		5,165 3,139	8,304							5,165 3,139 (8,304)
AJE <5> To offset miscellaneous income to expense - as CAJE (DR) Misc income (CR) Misc expense								128,168	128,168	128,168 (128,168)
<b>Total Misstatements Adjusted</b>		<b>193,783</b>	<b>94,783</b>	<b>526,586</b>	<b>526,586</b>	<b>-</b>	<b>-</b>	<b>128,168</b>	<b>227,168</b>	<b>-</b>

  
 Mathias Lawrence  
 Chief Accounting Officer