

June 30, 2014

Mr. Jared C. Morris  
Chief Executive Officer  
Federated States of Micronesia Petroleum Corporation  
P.O. Box 1762  
Kolonias, Pohnpei FM 96941

Dear Mr. Morris:

In planning and performing our 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, 2013, (on which we have issued our report dated June 30, 2014), 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, 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 was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, in connection with our audit, we identified, and included in the attached Attachment I, deficiencies related to the Company's internal control over financial reporting and other matters as of December 31, 2013 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 30, 2014, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Attachment I.

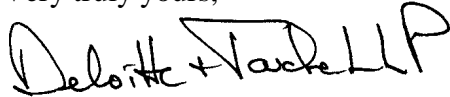
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Attachment II and should be read in conjunction with this report.

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

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of the Company for their cooperation and assistance during the course of this engagement.

Very truly yours,

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, flowing style with a large, stylized "D" at the beginning and a large "P" at the end.

**SECTION I –DEFICIENCIES**

We identified, and have included below, deficiencies involving the Company's internal control over financial reporting as of December 31, 2013 that we wish to bring to your attention.

**(1) Fixed Assets**

Comment: Tests of three fixed asset additions noted the following:

- For one completed project (reference no. YAP10-0203), a completion report was not available. Further, the supporting invoice and receiving report or equivalent documentation of completion was not provided.
- For two completed projects, the project completion date or the date the asset was put into service was several months prior to the stated project closing date. Details follow:

Project No.	Project Completion	Project Closing Date	Estimated Delay (in Months)
PNI11-0701	2/1/2013	05/27/13	4
PNI12-0202	7/1/2012	05/31/13	11

Recommendation: We recommend that FSMPC strengthen procedures over preparation of project completion reports and submission to Accounting.

**(2) Inventories**

Comment: Tests of inventories noted the following:

- For one terminal (location #40), the total quantities recorded in the inventory system were overstated due to a broken tank gauge. This was corrected through a proposed audit adjustment.
- For one terminal (location #10), the Company did not add back inventory quantities sold or used after December 31, 2013 but prior to the closing date on January 6, 2014. This was corrected through a proposed audit adjustment.
- For one terminal (location #10), the average unit cost at year end differed from the unit cost per the latest voyage as of 12/31/2013 due to (a) average costs per system based on the unit costs over the last three years from 2011 thru 2013; or (b) year end adjustments on total costs without corresponding quantities resulting from provisional to final invoice adjustment or month-end gain or loss on fuel expansion. Details follow:

<u>Fuel Type</u>	<u>Price per Latest AKV</u>	<u>Unit Cost per MAS500</u>	<u>Variance</u>
Automotive Diesel Oil	3.3723	3.7463	0.3740
XOM ULP	3.0748	3.1700	0.0952
Dual Purpose Kero	3.3635	3.6221	0.2586

Recommendation: We recommend that the Company perform daily actual dipping or provide safeguards to maintain meter reading devices in good condition. We further recommend that the Company strengthen control procedures to determine that quantities per the inventory system are based on the 12/31/2013 final dipping. Finally, we recommend that the Company revisit its average cost calculation to reflect recent fuel costs.

**SECTION II –OTHER MATTERS**

We noted below other matters related to operations and best practices involving internal control over financial reporting that we wish to bring to your attention.

**(1) Tax Filing**

Comment: For one voyage (AV-033 Pohnpei), taxes were paid on December 2, 2013 for a purchase received on September 2, 2013 at the correct amount but not within the required 15-day period. No penalty was assessed.

Recommendation: Management should facilitate timely filing of tax returns to minimize exposure to penalties.

**(2) Bulk Shipment Report (BSR)**

Comment: For 14 of 75 items tested, the BSR was not signed by all required parties. The signed BSR's were subsequently provided upon request from the respective terminals. Details follow:

<u>Voyage</u> <u>Number</u>	<u>Location</u>	<u>BSR Number</u>	<u>Deficiency Noted</u>
AKV#18	YAP	BSR041300004 BSR021300012	not signed by approver
AKV#21	POHNPEI	BSR021300009	not signed by preparer, receiver and approver
AKV#21	POHNPEI	BSR021300010	not signed by preparer, receiver and approver
AKV#22	YAP	BSR041300012	not signed by approver
AKV#26	YAP	BSR041300020 BSR021300021	not signed by receiver
AKV#27	POHNPEI	BSR021300023	not signed by preparer
AKV#27	POHNPEI	BSR021300022	not signed by preparer
AKV#28	YAP	BSR041300024	not signed by receiver
AKV#30	YAP	BSR041300027	not signed by approver
AKV#32	YAP	BSR041300033	not signed by approver
AKV#36	YAP	BSR041300040	not signed by receiver
AKV#40	YAP	BSR041300048	not signed by approver
AKV#41	KOSRAE	BSR051300011	not signed by preparer
AKV#41	KOSRAE	BSR051300009	not signed by preparer

Recommendation: We recommend that the Company maintain signed BSR's in the Accounting Division prior to disbursement.

**(3) Journal Entries**

Comment: Tests of sixteen journal vouchers (JVs) noted the following:

- Eight JVs did not have evidence of review and approval.
- Four original journal vouchers could not be located.

Recommendation: We recommend that the Company establish policies over journal vouchers review and approval.

**SECTION III – DEFINITION**

The definition of a deficiency is as follows:

A *deficiency* in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

## **MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING**

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

### **Management's Responsibility**

The Company's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

### **Objectives of Internal Control over Financial Reporting**

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

### **Inherent Limitations of Internal Control over Financial Reporting**

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.