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June 22, 2015

Mr. Jared C. Morris  
Chief Executive Officer  
Federated States of Micronesia Petroleum Corporation  
P.O. Box 1762  
Kolonia, 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, 2014, (on which we have issued our report dated June 22, 2015), 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, 2014 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 22, 2015, 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.

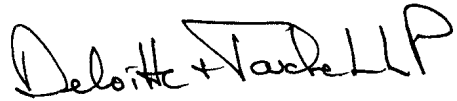
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Attachment II and should be read in conjunction with 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 + Nauck LLP". The signature is written in a cursive, stylized font. The word "Deloitte" is on the left, followed by a plus sign, and "Nauck LLP" is on the right. The letters are connected and fluid.

**SECTION I –DEFICIENCIES**

We identified the following deficiencies involving the Company's internal control over financial reporting as of December 31, 2014 that we wish to bring to your attention.

(1) Inventories

Comment: Tests of inventories noted the following:

- For all locations other than Yap (location #40), the Company did not add back inventory quantities sold after December 31, 2014 but prior to the closing date on January 1-5, 2015. This was corrected through a proposed audit adjustment.
- For one terminal (location #40), measurements input in Tanks 4 and 5 per PetroX were not consistent with measurements in gauge sheets obtained during our year end observation on January 6, 2015. The tank numbers in the gauge sheets were switched.
- For one terminal (location #40), fuel received on 12/26/14 through delivery receipt no. 12977 and invoice #14794866 for 5,499 gallons (\$2.97/gallon) at \$16,332 was not included in the year-end inventory.
- For three terminals (location #10, 20 and 40), the average unit cost at yearend differs from the unit cost per the latest voyage as of 12/31/2014 due to (a) average costs per system are based on unit costs over the last four years from 2011 thru 2014; or (b) yearend 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>
<u>Location #10</u>			
Automotive Diesel Oil	2.5631	2.8184	0.2553
XOM ULP	2.3920	2.6120	0.2200
<u>Location #20</u>			
XOM ULP	2.3371	2.4470	0.1099
Dual Purpose Kerosene	2.5611	2.9964	0.4353
<u>Location #40</u>			
Automotive Diesel Oil	2.6705	2.8141	0.1436
XOM ULP	2.4919	2.6561	0.1642

Recommendation: We recommend that the Company perform daily tank 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 December 31 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 our observations concerning operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention.

**(1) Tax Filing**

Comment: Tests of voyage taxes noted the following:

- a. The tax paid for two voyages (AV-059 and AV-061), was paid in the correct amount but not within the required 15-day period. Interest and penalties were incurred because of late filing. Details are as follows:

Voyage No.	Gallons Received	Date Received	Tax Due	Check No.	Check Date	Days Lapsed
AV-059	589,249	09/24/2014	\$ 29,462.45	11844	10/16/2014	22
AV-061	918,752	11/01/2014	\$ 45,937.60	12101	11/19/2014	18

- b. The tax for two voyages (AV-045 and AV-048), were not accrued and paid on time. Details are as follows:

Voyage No.	Gallons Received	Date Received	Tax Due	Check No.	Check Date	Days Lapsed
AV-045	505,835	02/25/2014	\$ 25,291.75	not paid yet	not paid yet	306
AV-048	133,554	04/14/2014	\$ 6,677.70	not paid yet	not paid yet	257

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

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

Comment: Tests of fuel purchases noted the following:

- a. The BSR was not signed by at least one of the required parties for the following:

<u>Voyage Number</u>	<u>Location</u>	<u>BSR Number</u>	<u>Deficiency Noted</u>
AKV#61	POHNPEI	BSR021400047 BSR021400048 BSR021400049 BSR021400050	"Witnessed by" section was not signed

- b. The date received in the voyage report schedule differs from the date received in the BSR. Details follow:

<u>Voyage Number</u>	<u>Location</u>	<u>BSR Number</u>	<u>Date per Voyage Report</u>	<u>Date per BSR</u>
AKV#52	CHUUK	BSR031400010 BSR031400008	06/09/2014 06/09/2014	06/17/2014 06/17/2014

**SECTION II –OTHER MATTERS, CONTINUED****(2) Bulk Shipment Report (BSR), Continued**

- c. The quantities received per voyage report were based on the BSR instead of final invoices. This is due to incorrectly picking up quantities in the schedule provided. Details follow:

<u>Voyage</u> <u>Number</u>	<u>Location</u>	<u>BSR Number</u>	<u>Quantities</u> <u>per Final</u> <u>Invoice</u>	<u>Quantities per</u> <u>Schedule/BSR</u>
AKV#60	CHUUK	BSR031400014	196,345	196,674
		BSR031400015	231,292	230,772
		BSR031400016	104,475	104,314
AKV#62	YAP	BSR041400040	93,700	93,820

Recommendation: We recommend that FSMPC verify that all required parties sign the BSR. Information in the voyage report schedule provided should be consistent with the BSR and final invoices.

**(3) Fixed Assets**

Comment: Of nineteen (19) fixed assets tested, the existence of seven (7) iPhones could not be verified. The Company represented that these phone units were assigned to managers; however, asset issuance forms or equivalent documentation supporting asset custody was not evident.

Recommendation: We recommend that moveable asset custody be documented and monitored.

**(4) Accounts Payable (AP)**

Comment: As of December 31, 2014, AP subsidiary ledger (SL) included a \$29,000 payable to customer #694 that was paid before year-end. The payment was posted in the general ledger (GL) but the subledger was not updated.

Recommendation: We recommend regular reconciliations of AP SL and AP GL occur and differences be timely investigated.

**(5) Sales**

Comment: For 1 of 75 sales transactions tested (S051401748), the "receiving authority signature" portion of the tanker delivery receipt is November 4, 2014 while the delivery confirmation is dated November 7, 2014.

Recommendation: We recommend that personnel handing delivery confirmations ascertain that details in delivery receipts are accurate.

### 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.