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April 28, 2017

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, 2016, (on which we have issued our report dated April 28, 2017), 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, 2016 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated April 28, 2017, 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.

Deloitte.

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,

Deloitte & Touche LLP

SECTION I –DEFICIENCIES

We identified the following deficiencies involving the Company's internal control over financial reporting as of December 31, 2016 that we wish to bring to your attention.

(1) Bank Reconciliations

Comment: Examination of the December 31, 2016 bank reconciliation noted the following:

- Bank reconciliation was only completed in March 2017, three months after year end.
- Bank reconciliation included a $5,000 check (check#1443) that has been outstanding for more than a year. This was corrected through proposed adjusting entry.
- Bank reconciliation included a $62,632 outstanding check (check#16066) that was not released as of December 31, 2016. This was corrected through proposed adjusting entry.

Recommendation: Bank reconciliations should be prepared and reviewed timely, preferably no later than the end of the following month. Check disbursements made close to period-end should be monitored and those unreleased items be classified back as liability. Lastly, management should develop a policy over stale-dated checks.

(2) Inventory

Comment: Tests of inventory noted the following:

- As of December 31, 2016, the MAS 500 and Petrox systems reflected different quantity in gallons for the Pohnpei and Yap locations, due to Isotanks not properly pushed into the Petrox system.
- Inventory as of December 31, 2016 was adjusted based on the January 3, 2017 dipping results. As such, inventory was understated by approximately $93,000. This was corrected through a proposed audit adjustment.

Recommendation: The Company should improve control procedures over year-end inventory closing.

(3) Inventory General Ledger (GL) vs. Subsidiary Ledger (SL) Balance

Comment: The inventory SL was not reconciled with the GL balances. The GL balances included prior year cut-off entries that should have been reversed. This was identified and corrected through adjusting entries during the audit.

Recommendation: A monthly reconciliation of SL and GL should be performed.

(4) Prepayments

Comment: Two of six prepayments tested, totaling $60,302, represent items that had been received prior to December 31, 2016. This was corrected through adjusting entries during the audit process. Additionally, prepayments of $74,000 have been outstanding for more than a year.

Recommendation: Management should perform timely review of prepayments, including the matching with receiving reports. Long-standing items should be investigated.

SECTION I –DEFICIENCIES, CONTINUED

(5) Fixed Assets (FA)

Comment: The Company does not utilize inventory tags. Consequently, of thirty one assets selected, seven items cannot be located or represent invalid items. Specifically, two of the seven items represented travel and shipping costs that were erroneously entered as unique assets, one item contained an "unknown asset" description, and two items were noted as likely disposed items.

Recommendation: The Company should consider implementing a FA tagging system to facilitate accurate record keeping and accountability. Additionally, management should review the existing FA register to identify items that do not represent unique assets and perform physical verification procedures to identify those that are no longer in existence. Lastly, management should improve procedures over FA recording and recording-keeping.

(6) Unrecorded Liability

Comment: A January 2017 payment of $9,409 (reference #APSC-0005426) for consulting services received in November 2016 was not accrued as of December 31, 2016. This was corrected through an adjusting entry during the audit process.

Recommendation: The Company should strengthen control procedures to verify the completeness of liabilities at each reporting date.

(7) Accounts Payable (AP)

Comment: The December 31, 2016 AP SL and GL balances for account #s 4000-00-00 and 4006-00-00 indicated an unknown variance of $26,501. As the Company additional post-closing adjustments during the audit process, the variance increased to $61,911. Additionally, the AP SL included debit balances totaling $29,346.

Recommendation: Reconciliation of AP SL and GL balance should be timely performed. Accounts with debit balances should be investigated and adjusted.

(8) Accrued Liabilities

Comment: Tests of accruals noted certain unapplied vendor debits/payments of $110,555 that should have been charged to the respective PO clearing account, accruals or other liabilities account. Of the total amount, $79,253 was subsequently corrected and the remaining AP debit balance of $31,302 was pending analysis and reconciliation.

Recommendation: Debit accounts in accruals should be timely verified for application to the proper liabilities accounts.

(9) Deferred Charges

Comment: As of December 31, 2016, fully expensed deferred charges of $90,600 was adjusted and updated during the audit process in February 2017.

Recommendation: Validity of deferred charges and prepayments should be timely viewed and adjusted.

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) Regular Inventory Valuation Assessment

Comment: The Company's inventory was recorded at weighted average cost (WAC). However, the Company does not perform a regular evaluation for potential inventory write-down by comparing the WAC with market value.

Recommendation: The Company should implement a process to review inventory balances for lower of cost or market on a regular basis.

(2) Lease Agreements

Comment: For two of eighteen lease transactions tested, updated signed lease agreements were not made available.

Recommendation: Regular monitoring of lease agreements should be performed.

(3) Missing Temperatures on Gauge Sheet

Comment: The gauge sheets for Tank 1 and Refueler 2 in the Pohnpei location did not include the required *Temperature* information. The gauge-taker unintentionally left out the information, which was overlooked by the reviewer.

Recommendation: Proper reviews of completed gauge sheets should be performed to avoid missing information.

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.