

March 15, 2011

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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, 2010 and 2009, (on which we have issued our report dated March 15, 2011), 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. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to the Company's internal control over financial reporting and other matters as of December 31, 2010 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated March 15, 2011, 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 Appendix I.

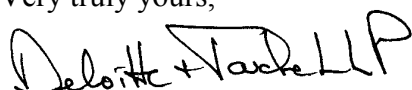
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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



## SECTION I – CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving the Company's internal control over financial reporting as of December 31, 2010 that we wish to bring to your attention:

### 1. Capitalization of Costs as Fixed Assets

Comment: Training costs for implementation and maintenance costs of MAS 500 in the amount of \$60,349 were capitalized as computer equipment. Capitalizable costs are those necessarily incurred to bring the asset to the condition and location necessary for intended use. Training and maintenance costs are ancillary and are not considered capitalizable. As the amount was not considered material to the financial statements, no audit adjustment was proposed.

Recommendation: The Company should review the nature of capitalized expenditures allowable costs should be recognized as assets.

### 2. Require Periodic Reset of User Passwords

Comment: Passwords are required per user but resets of passwords are not required.

Recommendation: To strengthen logical security, the Company should require periodic reset of user passwords.

## SECTION II – OTHER MATTERS

We noted no other matters related to operations and best practices involving internal control over financial reporting that we wish to bring to your attention.

## SECTION III – DEFINITION

The definition of a control deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *control deficiency* 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 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 is not always met. A deficiency in *operation* exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications 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.