FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2012 AND 2011

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Years Ended December 31, 2012 and 2011
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Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia Petroleum Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Federated States of Micronesia (FSM) Petroleum Corporation (the Company), and its discretely presented component unit, collectively a component unit of the FSM National Government, which comprise the respective statements of net position as of December 31, 2012 and 2011, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended and for the period from inception (February 10, 2012) to December 31, 2012, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Federated States of Micronesia (FSM) Petroleum Corporation and its discretely presented component unit as of December 31, 2012 and 2011, and the respective results of their operations and their cash flows, where applicable, for the years then ended and for the period from inception (February 10, 2012) to December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 1 to the financial statements, during the year ended December 31, 2012, the Company has implemented the Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, and Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

Other Matters

Required Supplementary Information:

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June June 26, 2013, on our consideration of the State'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 purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

June 26, 2013

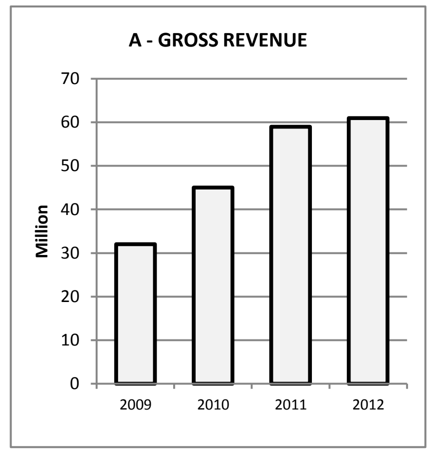
FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Management's Discussion and Analysis
Years Ended December 31, 2012 and 2011

STRATEGIC OBJECTIVES

The primary long term role and function of the Federated States of Micronesia Petroleum Corporation (FSMPC) is to secure a stable supply of petroleum products to meet the nations' core energy needs. The Company engages efficiently, responsibly and profitably in the sector. This ensures that there are sufficient resources to maintain assets, train people, hold strategic oil inventories, and provide petroleum products in full, on-time, and to international specifications.

The Company is the largest supplier of energy in the FSM and constantly evaluates opportunities to expand vertically into markets which use and supply modern energy services, as well as laterally into alternative energy technologies with an aim of improving the energy security of the nation.

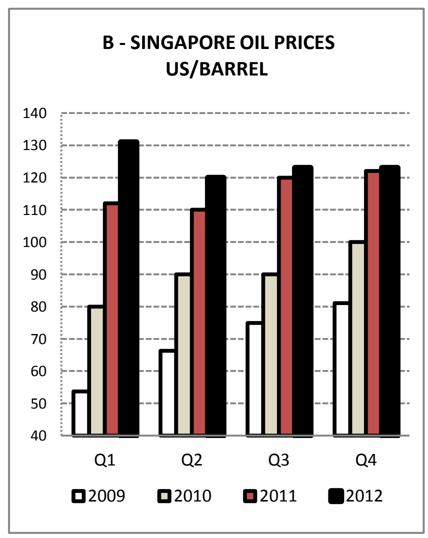


SUMMARY OF OPERATIONS

Locations

In the FSM, the Company operates a total of six fuel terminal facilities in the States of Yap, Chuuk, Kosrae, and Pohnpei, and services the international aviation, marine bunkering, and inland market segments.

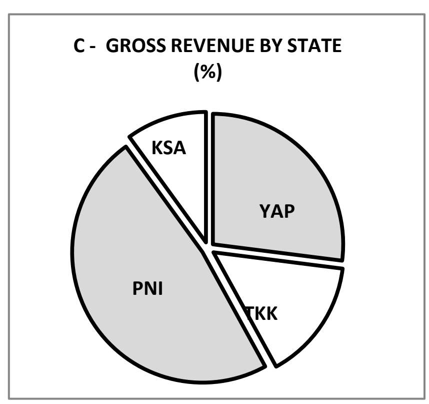
In February 2012, Vital Energy (Guam) Incorporated was established. In June it was successful in securing a terminal operations and management contract with the Guam Power Authority (GPA). Across the seven fuel facilities we now store, handle and deliver over 2.3 million barrels of petroleum products per annum.



Revenues

Gross revenues for CY12 were $61.6 million, reflecting a small increase over the prior year (refer A). Revenue growth is attributed to increased prices as a result of cost import costs. International oil prices started in 2012 at a quarterly peak of $131/bbl, however eased off towards the end of the year. On average, Singapore oil prices were on average $10/bbl higher than 2011 (refer B) placing an upwards pressure on overall working capital.

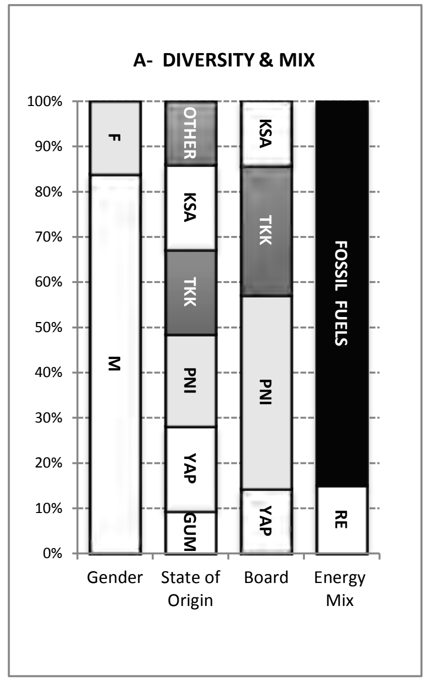
Gross revenue contributions by State (refer C) were Kosrae 10%, Yap 15%, Chuuk 26% and Pohnpei 49%, with a product mix of automotive diesel oil 53%, unleaded petrol (or gasoline) 35%, home kerosene and Jet A1 of 10%, and other revenues of 2%.



Our petroleum businesses throughout the FSM and Guam and are supported by fuel, lubricant and technical service agreements with Mobil Oil Micronesia

Incorporated (MOGI), Total Oil Asia Pacific (TOAP), and ExxonMobil Aviation (EMA).

Our expansion initiatives are expected to deliver results in 2013/14 once the initial establishment costs are recovered, and the business starts growing its customer base.

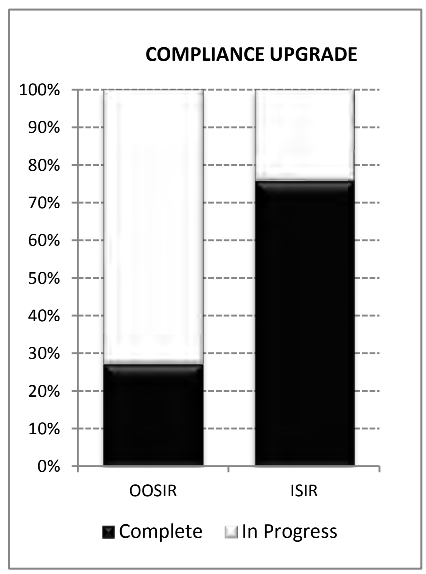


Business Planning

The business continues to conduct itself in accordance with the standards set out in the Statement of General Business Principles (SGBP). Management seeks formal reassurance from each Staff member that they operate within these principles annually.

The Company maintains an annual business plan that sits firmly within a five year development window defined by our Strategic Plan that is aligned with national and state energy policies that are in effect.

In 2012, we entered into a strategic alliance with Ernst & Young for business advisory services. This was to assist with our corporate planning, potential commercialization and financing options. This alliance plays an integral part of the business continuity plan that ensures that management capacity is maintained when there is an unplanned loss of key personnel, and for succession plans for senior executives.



Risk Management

Risks are proactively managed across the business. Remedial action plans have been developed, resources allocated to risk mitigation, and every risk is assigned to an individual within the Company.

The risk management system is compliant with the ISO31000:2009 international standard for Risk Management. The company has also adopted the most recent American Petroleum Institute Standard 653 (API653) for maintenance of oil storage tanks, and the Joint Implementation Group (JIG) standard for international airports.

We have commenced our compliance program in 2010 to upgrade facilities to comply with these most recent versions of the standard. The program has completed 30% of the mandatory out-of-service inspection and repairs (OOSIR), 75% of the in-service inspection (ISI).

Domestic Pricing

We continue to maintain the Pricing Policy Framework (PPF) that was adopted in 2009. It provides a mechanism to stabilize domestic prices and to cushion the effect of international volatility. There are no cross subsidies within the PPF, and the prices in each State reflect the costs of procuring, financing, storing, handling and distribution of fuels in that State.

Petroleum prices are amongst the most easily comparable data around the world. The company continues to benchmark domestic price competitiveness through comparison of pump prices of island neighbors. Throughout CY12, domestic prices compared favorably with Guam, with the observable pump price difference generally less than $0.25 per gallon down from a high of $1.40/gallon in 2008. The PPF has maintained a monthly price change contract customers such as utilities and airlines, and quarterly price changes to service stations. This strategy has provided stable energy prices for homes, business, and government. There are no significant changes expected in the PPF in 2013.

Financial Condition

The Company continues to invest all operating surplus into the retirement of long term notes and capital improvement projects that are for mandatory compliance, reduction of operating risk, improvement of profitability, driving operational efficiency or strategic in nature. There is work underway to further align our investment decisions with the intent and direction of the 2012 FSM Energy Policy.

There is a noticeable improvement in the condition and asset value of our oil distribution infrastructure as well as the levels of strategic oil inventory that maintains the current energy security of the nation and the current policies have also positively impacted our debt-to-equity ratio, decreasing from it from a high of 75% in 2009 to the targeted 21% in 2012. We are now able to attract competitive long term financing, mange oil price volatility, and continue to invest in strategic onshore inventory.

The following table summarizes the Company financial position for calendar year 2012, 2011 and 2010 respectively.

Assets:	**2012**	**2011**	**2010**
Property, Plant and Equipment	$ 12,117,382	$ 8,707,118	$ 7,042,956
Cash and Cash Equivalents	7,720,743	6,201,192	7,626,408
Inventory on Hand	4,731,901	7,956,135	5,730,415
Receivables and Other Current Assets	5,980,985	3,586,182	2,548,482
Total Assets	30,551,011	26,450,627	22,948,261
Current Liabilities	2,923,823	2,636,275	1,866,394
Noncurrent Liabilities	3,646,672	4,071,272	5,561,268
Net Asset	23,980,516	19,743,080	15,520,599
Total Liabilities and Net Position	$ 30,551,011	$ 26,450,627	$ 22,948,261

Revenues, Expenses and Changes in Net Assets:	**2012**	**2011**	**2010**
Operating Revenues	$ 61,575,499	$ 59,207,576	$ 51,366,135
COGS	(49,649,654)	(47,881,765)	(39,776,511)
Gross Profit	11,925,845	11,325,811	11,763,526
Operating Expenses	(7,380,238)	(7,004,264)	(5,802,508)
Non-Operating Expenses	(308,171)	(99,066)	(265,955)
Net Income	4,237,436	4,222,481	5,695,063
Net Position at Beginning of Year	19,743,080	15,520,599	9,825,536
Net Position at End of Year	$ 23,980,516	$ 19,743,080	$ 15,520,599

Major changes in the balance sheet components for CY12 are a result of:

a) the Company maintained one-year term Line of Credits with Bank of Guam (BOG) for $4,300,000. The Short Term Note with banks remained at a zero balance in CY2012 as a result of prudent cash management, and continue to invest its operating surplus into retirement of long term notes, in capital expenditure to reduce operating risks and strengthen oil distribution infrastructure, and into strategic oil inventory to increase the energy security of the nation.

b) at the end of December 31, 2012, the Company's Long Term Notes with Bank of Guam for the initial acquisition of fixed assets from Mobil Oil Micronesia Inc. amounted to $1,806,783 of which $587,629 was classified as current portion of the Note. The principal amount paid during CY2012 was $844,412. For additional information concerning debt, please refer to Note 5 to the financial statements.

c) the total amount received from sales of petroleum products exceeded the amount paid to vendors and employees for goods and services. The net cash provided by operating activities amounted to $6,949,989 as compared to $2,075,104 for the 12 months of operations in CY2011.

d) $5,121,680 was used for capital and related financing activities for the purchase of Property, Plant and Equipment. The Corporation's total investments in Property, Plant and Equipment, inclusive of construction in-progress for 2012 and 2011 were $12,117,382 and $8,707,118, respectively, net of accumulated depreciation of $2,833,782 and $1,966,778, respectively. For additional information concerning capital assets, please refer to Note 3 to the financial statements.

ECONOMIC OUTLOOK

The most significant pending impact on the economy in coming years are the pending national and state tax reforms across the FSM. This includes implementation of a Value Added Tax (VAT), Excise Tax (ET) and Net Profit Tax (NPT) regime.

The Company is currently a significant tax contributor in the FSM and through gross revenue taxes, import duties, sales and municipal taxes contributes in excess of $3.4MM per annum. The implementation of the new tax regime is expected to increase the tax burden on petroleum/energy products to approximately $7.6MM per annum. This will introduce a step inflationary impact that may not be adequately matched by the safety nets being proposed. The regime is also being uniformly applied, and lacks any concessions or incentives for renewable energy or energy efficient technology that could offset this increased tax burden.

The tax reforms however are an essential for FSM's preparations for financial independence in light of the given the end of the financial assistance package under the Compact of Free Association. This inflationary impact on an already stressed household budget is expected curb the domestic energy demand.

In anticipation of this, in 2012, the Company completed a comprehensive analysis of the energy sector and the potential of early investment into energy efficiency and local energy resources to mitigate the impact of the pending tax reforms. Work has commenced on coconut biomass electricity production, solar grid connected system, and proposals for investment into new efficient thermal power plants under independent power production (IPP) arrangements with local utilities.

The Company has embarked on a number of initiatives provide some vertical integration within the domestic energy market, expansion into alternate and renewable energy resources, as well as aggressive geographical expansion into regional markets. This enhanced economy of scope and scale will offset the potential impacts of a dampened domestic energy market in the FSM.

Management's Discussion and Analysis for the period December 31, 2011 is set forth in the report on the audit of FSMPC's financial statements, which is dated June 28, 2012. That Discussion and Analysis explains the major factors impacting the 2011 financial statements and may be obtained from the contact shown below.

CONTACT

Questions associated with the above MD&A may be sent by post, addressed to Mr. Mathias Lawrence Chief Financial Officer, P. O. Box 1762, Kolonia, Pohnpei, FSM 96941 or via email to petrocorp@fsmpc.com.

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Statements of Net Position
December 31, 2012 and 2011

ASSETS	2012	2011
Current assets:		
Cash	$ 7,720,743	$ 6,201,192
Trade receivables	2,010,177	1,505,502
Due from employees	-	7,716
Inventory, net	4,731,901	7,956,135
Deposit with supplier	2,860,067	1,216,265
Prepaid expenses	594,724	341,270
Total current assets	17,917,612	17,228,080
Restricted cash	516,017	515,429
Property and equipment, net	6,796,880	6,251,014
Construction in-progress	5,320,502	2,456,104
	$ 30,551,011	$ 26,450,627
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 587,629	$ 526,586
Current portion of due to states and primary government	-	668,313
Accounts payable	1,023,335	306,072
Accrued liabilities and others	1,312,859	1,135,304
Total current liabilities	2,923,823	2,636,275
Long-term debt, net of current portion	1,219,154	2,124,609
Due to states and primary government, net of current portion	2,427,518	1,946,663
Total liabilities	6,570,495	6,707,547
Commitments and contingencies		
Net position:		
Invested in capital assets, net of related debt	10,310,599	6,055,923
Unrestricted	13,669,917	13,687,157
Total net position	23,980,516	19,743,080
	$ 30,551,011	$ 26,450,627

See accompanying notes to financial statements.

VITAL ENERGY, INC.

Statement of Net Position
December 31, 2012
Discretely Presented Component Unit

ASSETS		
Current assets:		
Cash	$	1,000
Receivables		139,856
Prepaid expenses		25,577
Total current assets		166,433
Property and equipment, net		61,691
	$	228,124
LIABILITIES		
Current liabilities:		
Accounts payable	$	19,158
Accrued liabilities and others		22,525
Total current liabilities		41,683
Contingencies		
Net position:		
Invested in capital assets		61,691
Unrestricted		124,750
Total net position		186,441
	$	228,124

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Statements of Revenue, Expenses, and Changes in Net Position
Years Ended December 31, 2012 and 2011

	2012	2011
Operating revenue:		
Sales and service income	$ 61,564,075	$ 59,060,690
Other	11,424	146,886
	61,575,499	59,207,576
Cost of goods sold	49,649,654	47,881,765
Gross profit	11,925,845	11,325,811
Operating expenses:		
Taxes	1,792,477	1,721,621
Salaries and benefits	1,273,967	1,098,283
Depreciation	867,004	764,661
Staff travel, training and development	638,565	241,889
Professional fees	577,732	677,437
Rent	490,180	424,464
Insurance	394,487	293,241
Repairs and maintenance	243,586	366,281
Corporate governance	228,725	285,094
Contracted services	186,082	205,091
Utilities	158,441	132,982
Office supplies	146,418	165,874
Communications	140,138	153,218
Fuel	89,481	97,690
Miscellaneous	152,955	376,438
Total operating expenses	7,380,238	7,004,264
Operating income	4,545,607	4,321,547
Nonoperating expenses:		
Contributions to component unit	(305,785)	-
Interest expense, net	(2,386)	(99,066)
Total nonoperating expenses	(308,171)	(99,066)
Change in net position	4,237,436	4,222,481
Net position at beginning of year	19,743,080	15,520,599
Net position at end of year	$ 23,980,516	$ 19,743,080

See accompanying notes to financial statements.

VITAL ENERGY, INC.

Statement of Revenue, Expenses, and Changes in Net Position
Period from Inception (February 10, 2012) to December 31, 2012
Discretely Presented Component Unit

Operating revenue:		
Service income	$	393,910
Operating expenses:		
Salaries and benefits		115,476
Professional fees		110,854
Contracted services		107,243
Utilities		62,403
Insurance		28,856
Office supplies		21,990
Rent		18,325
Taxes		9,499
Travel and entertainment		7,488
Depreciation		7,202
Communications		6,207
Repairs and maintenance		5,407
Fuel		4,870
Staff training and development		1,039
Miscellaneous		4,515
Total operating expenses		511,374
Operating loss		(117,464)
Nonoperating income (expense), net:		
Bank charges		(1,880)
Contributions from FSM Petroleum Corporation		305,785
Total nonoperating income		303,905
Change in net position		186,441
Net position at beginning of the period		-
Net position at end of the period	$	186,441

See accompanying notes to financial statements.

FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from customers	$ 61,326,119	$ 58,295,907
Cash paid to suppliers for goods and services	(53,109,879)	(55,215,179)
Cash paid to employees for services	(1,266,251)	(1,005,624)
Net cash provided by operating activities	6,949,989	2,075,104
Cash flows from investing activities:		
Contribution to component unit	(305,785)	-
Interest received	588	-
Net cash used for capital investing activities	(305,197)	-
Cash flows from capital and related financing activities:		
Acquisition of capital assets, including capitalized internet	(4,277,268)	(2,428,823)
Principal repayment of long-term debt	(844,412)	(971,625)
Interest paid	(3,561)	(99,872)
Net cash used for capital and related financing activities	(5,125,241)	(3,500,320)
Net change in cash	1,519,551	(1,425,216)
Cash at beginning of year	6,201,192	7,626,408
Cash at end of year	$ 7,720,743	$ 6,201,192
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 4,545,607	$ 4,321,547
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	867,004	764,661
Purchase of fuel	-	220,181
(Increase) decrease in assets:		
Trade receivables	(504,675)	(911,669)
Due from employees	7,716	21,661
Inventory and related deposit with supplier	1,580,432	(2,419,307)
Prepaid expenses	(253,454)	46,701
Increase in liabilities:		
Accounts payable	717,263	(175,254)
Accrued liabilities and others	177,554	206,583
Due to states and primary government	(187,458)	-
Net cash provided by operating activities	$ 6,949,989	$ 2,075,104

Non-cash operating activity:

In 2011, the Company purchased the equivalent of gallons of fuel of $220,181 from its supplier, which was funded by a grant from the Government of Japan. The grant money was paid directly to the supplier.

See accompanying notes to financial statements.

(1) Organization and Basis of Presentation

Federated States of Micronesia Petroleum Corporation (FSMPC or the Company) is a component unit of the Federated States of Micronesia (FSM) National Government (FSMNG). FSMPC was created under Public Law 15-08, as passed by the FSM Congress and which was signed into law on September 11, 2007, for the purpose of providing oil and gas distribution for the entire FSM.

FSMPC is governed by a seven-member Board of Directors appointed as follows:

- 1 member appointed by the President with the advice and consent of the FSM Congress to represent the FSMNG.
- 4 members appointed by each State governor to represent each of the States.
- 2 members from the private sector, appointed by the President with the advice and consent of the FSM Congress.

FSMPC's financial statements are incorporated into the financial statements of the FSM National Government as a component unit.

Basis of Accounting

The accounts of FSMPC are organized as a discretely presented component unit - proprietary fund of the FSM National Government. Proprietary funds are used by governmental units to account for operations that are financed and operated in a manner similar to a private business. This accounting is appropriate when costs of providing goods or services to the general public are to be financed primarily through user charges or where the periodic determination of net income is appropriate for accountability purposes. The accrual basis of accounting is utilized by proprietary funds. Under the accrual basis, revenues are recorded when earned, and expenses are recorded at the time the liabilities are incurred.

FSMPC utilizes the flow of economic resources measurement focus. Its financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units using the accrual basis of accounting. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The Statement of Net Position presents all of the FSMPC's non-fiduciary assets, deferred outflows of resources, liabilities and deferred inflows of resources, with the difference reported as net position. Net position is classified for accounting and reporting purposes into the following four net asset categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets as well as deferred outflows of resources and deferred inflows of resources that are attributable to those assets or related debt.

- Restricted - restricted assets reduced by liabilities and deferred inflows of resources related to those assets that are subject to externally imposed stipulations.

(1) Organization and Basis of Presentation, Continued

Basis of Accounting, Continued

- Unrestricted - the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Operating revenues and expenses generally result directly from the operation and maintenance of the Company. Non-operating revenues and expenses result from capital and related financing activities as well as certain other non-recurring income and expense items.

Reporting Entity

Vital Energy, Inc. (Vital) is a legally separate entity which meets the criteria set forth for component units. Vital was incorporated on February 10, 2012 for the purpose of carrying on the operation of importation and sale of petroleum products, and operation, management and maintenance of petroleum storage terminals, international marine bunkering services, operation of road and aviation bridging tankers, and aviation refueling operations. Vital's fiscal year-end is as of December 31. Copies of Vital's report can be obtained by contacting Vital management. Vital's significant notes are summarized in Note 2i.

(2) Summary of Significant Accounting Policies

(a) Cash

Custodial credit risk is the risk that in the event of a bank failure, the Company's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. FSMPC does not have a deposit policy for custodial credit risk.

For purposes of the statements of net position and of cash flows, cash represents cash on hand and cash in bank accounts. Cash in bank accounts externally restricted for use are separately classified. As of December 31, 2012 and 2011, total carrying amounts of cash were $8,236,760 and $6,716,621, respectively, and the corresponding bank balances were $8,136,928 and $6,785,882 respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2012 and 2011, bank deposits in the amount of $333,712 and $250,000, respectively, were subject to FDIC insurance. Balances in excess of FDIC insurance are not collateralized.

(2) Summary of Significant Accounting Policies, Continued

(b) Accounts Receivable

Accounts receivable are due from businesses and individuals located in the Federated States of Micronesia and are interest free and uncollateralized, except those from utility companies. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb potential losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. Bad debts are written-off against the allowance based on the specific identification method. At December 31, 2012 and 2011, the Company deems it not necessary to establish an allowance for doubtful accounts.

(c) Inventory

Inventory is substantially carried at the lower of cost (moving average cost) or market value. At December 31, 2012, inventory is net of a $50,587 allowance for obsolescence.

(d) Property, Plant and Equipment

The Company capitalizes individual items with estimated useful lives of more than one year without regard to a capitalization threshold. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Estimated useful lives of property and equipment are as follows:

Building	15 years
Motor vehicle	5 years
Plant and equipment	3 to 15 years
Furniture and fixtures	4 years
Office equipment	4 years
Machinery and equipment	4 years

(e) Capitalized Interest

Interest cost for assets that require time to bring them to the condition and location necessary for their intended use is capitalized as part of the asset cost until such time as the assets are placed in service. The Company capitalized interest of $137,385 and $99,000 for the years ended December 31, 2012 and 2011, respectively.

(f) Taxes

The Company is responsible for gross receipt taxes, sales taxes and import taxes on its operations in the FSM.

(g) New Accounting Standards

During the year ended December 31, 2012, the Company implemented the following pronouncements:

(2) Summary of Significant Accounting Policies, Continued

(g) New Accounting Standards, Continued

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements,* which addressed 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities,* which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

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 April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Company.

(2) Summary of Significant Accounting Policies, Continued

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of the Company.

(h) Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(i) Vital's Accounting Policies

Receivable. Receivables are uncollected amounts from Guam Power Authority (GPA) (see note 9) and other debtors. Allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb potential losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. Accounts deemed uncollectible are written-off. At December 31, 2012, Vital deems it not necessary to establish an allowance for doubtful accounts.

Property and Equipment. The Company capitalizes individual items with estimated useful lives of more than one year without regard to a capitalization threshold. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Estimated useful lives of property and equipment are as follows:

Motor vehicle	5 years
Computer equipment	5 years
Furniture and fixtures	7 years
Machinery and equipment	7 years

Taxes. The Company is taxed by and files its income tax return in Guam. The Guam income tax code is similar to that of the United States of America.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income or expense in the period that includes the enactment date.

For Guam income tax purposes, a tax year generally remains open to assessment and collection for three years after the later of the due date for filing a tax return or the date on which the tax payer files its return.

(2) Summary of Significant Accounting Policies, Continued

(i) Reclassification

Certain account balances in the 2011 financial statements have been reclassified to correspond with the 2012 presentation.

(3) Capital Assets

FSM Petroleum Corporation

Capital asset activities for the years ended December 31, 2012 and 2011 are as follows:

	Balance at January 1, 2012	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2012
Buildings	$ 558,294	$ 14,746	$ -	$ 573,040
Motor vehicles	605,548	201,628	-	807,176
Plant and equipment	4,839,250	670,343	-	5,509,593
Furniture and fixtures	83,486	5,395	-	88,881
Office equipment	1,797,012	359,700	-	2,156,712
Machinery and equipment	334,202	161,058	-	495,260
	8,217,792	1,412,870	-	9,630,662
Less accumulated depreciation	(1,966,778)	(867,004)	-	(2,833,782)
	6,251,014	545,866	-	6,796,880
Construction in progress	2,456,104	3,611,905	(747,507)	5,320,502
	$ 8,707,118	$ 4,157,771	$ (747,507)	$ 12,117,382

	Balance at January 1, 2012	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2012
Buildings	$ 394,940	$ 163,354	$ -	$ 558,294
Motor vehicles	547,286	58,262	-	605,548
Plant and equipment	4,837,992	1,258	-	4,839,250
Furniture and fixtures	48,218	35,268	-	83,486
Office equipment	1,354,094	442,918	-	1,797,012
Machinery and equipment	148,350	185,852	-	334,202
	7,330,880	886,912	-	8,217,792
Less accumulated depreciation	(1,202,117)	(764,661)	-	(1,966,778)
	6,128,763	122,251	-	6,251,014
Construction in progress	914,193	1,928,738	(386,827)	2,456,104
	$ 7,042,956	$ 2,050,989	$ (386,827)	$ 8,707,118

(3) Capital Assets, Continued

Vital Energy, Inc.

Capital asset activities for the period ended December 31, 2012 are as follows:

	Balance at February 1, 2012	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2012
Motor vehicles	$ -	$ 25,258	$ -	$ 25,258
Computer equipment	-	21,940	-	21,940
Furniture and fixtures	-	9,741	-	9,741
Machinery and equipment	-	11,954	-	11,954
	-	68,893	-	68,893
Less accumulated depreciation	-	(7,202)	-	(7,202)
	$ -	$ 61,691	$ -	$ 61,691

(4) Due to States and Primary Government

In 2008, the FSMNG was extended a ¥200,000,000 grant by the Government of Japan ("the Grant"). The Grant and accrued interest shall be used by FSMNG properly and exclusively for the purchase of products enumerated in a list to be mutually agreed upon between the two governments. The Grant will be received by FSMNG in Yen currency, will be used as described above within a period of twelve months and any excess amounts will be refunded to the Government of Japan thereafter. FSMNG is required to deposit in Micronesian currency (US dollars) all the proceeds from the sale and lease of the products purchased referred to above. The amount of the proceeds to be deposited shall not be less than half of the total yen disbursement paid with respect to the purchase of the products. The deposit shall be made within the period of three years from the date of entry into force of the understanding between the two governments. The deposited fund shall be utilized for economic and social development purposes in FSM.

In 2009, FSMPC signed a memorandum of agreement with FSMNG that the Grant be utilized for the supply of petroleum fuels to FSMPC to assist in the implementation of a number of initiatives aimed at mitigating the social and economic difficulties caused by volatile and sustained high oil prices. The Grant was paid directly by the Government of Japan through an independent procurement agent, Crown Agents, to FSMPC's supplier of fuel instead of to FSMNG. FSMPC has received the equivalent gallons of fuel from the supplier and this is now maintained as strategic inventory in each State. As of December 31, 2012 and 2011, FSMPC recognized a liability to the States and FSMNG of $1,927,518 and $2,114,976, respectively. On January 20, 2012, the Company paid $668,313 of the recorded liability and such is presented as current on the face of the 2011 statement of net position.

At December 31, 2012 and 2011, the remaining $500,000 in due to primary government represents non-interest bearing advance from the FSMNG. There is no specific repayment terms and management has classified the advance as long-term since it has no expectation that such will have to be repaid before December 31, 2013. The advance has been deposited in a bank account, which is presented as restricted cash in the accompanying statements of net position.

(5) Long-term Debt

Long-term debt represents balance outstanding on a bank note payable for purposes of acquiring capital assets, due in monthly installments of $57,949, with interest at 7% per annum, final payment due on March 2019, and unconditionally guaranteed by the FSM National Government. The loan is essentially collateralized by all FSMPC assets. During the years ended December 31, 2012 and 2011, the Company have been making monthly installments of approximately $100,000.

Future minimum contractual repayments are as follows:

Year Ending December 31,	Principal	Interest	Total
2013	$ 587,629	$ 107,753	$ 695,382
2014	630,108	65,274	695,382
2015	589,046	19,893	608,939
	$ 1,806,783	$ 192,920	$ 1,999,703

(6) Short-Term Borrowings

As of December 31, 2012 and 2011, the Company has a bank line of credit facility (LOC) of $4,300,000. On January 31, 2013, the LOC was increased to $5.7 million and now expires on February 28, 2014. This LOC is utilized by the Company to fund fuel inventory purchases. The LOC and the related long-term obligation are secured and collateralized by an executed Pledge and Security Agreement for the assignment of the Reserve Bank Account and Revenue, an executed Notice of Security Interest and Chattel Mortgage and are guaranteed by the FSM National Government.

Borrowings against the LOC bear an interest at 0.75% plus the effective Bank reference rate, with minimum rate of 7% (subsequently decreased to 5.75% on January 31, 2013), with interest payable monthly and principal due within 180 days. No borrowings are outstanding against the LOC at December 31, 2012 and 2011.

(7) Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended December 31, 2012 are as follows:

	Balance at January 1, 2012	Additions	Repayments	Balance at December 31, 2012	Due Within One Year
Note payable	$ 2,651,195	$ -	$ (844,412)	$ 1,806,783	$ 587,629
Due to states and primary government	2,614,976	529,890	(717,348)	2,427,518	-
	$ 5,266,171	$ 529,890	$ (1,561,760)	$ 4,234,301	$ 587,629

(7) Changes in Long-Term Liabilities, Continued

Changes in long-term liabilities for the year ended December 31, 2011 are as follows:

	Balance at January 1, 2011	Additions	Repayments	Balance at December 31, 2011	Due Within One Year
Note payable	$ 3,622,820	$ -	$ (971,625)	$ 2,651,195	$ 526,586
Due to states and primary government	2,394,795	220,181	-	2,614,976	668,313
	$ 6,017,615	$ 220,181	$ (971,625)	$ 5,266,171	$ 1,194,899

(8) Risk Management

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 during the past three years.

(9) Significant Customers

FSM Petroleum Corporation

Revenue from one major customer for the years ended December 31, 2012 and 2011 approximated 19 percent and 20 percent, respectively, of the Company's total revenue.

The Company purchased substantially all fuel from one supplier in 2012 and 2011.

Vital Energy, Inc.

Vital has a contract with the Guam Power Authority (GPA) to manage, operate and maintain GPA's fuel bulk storage facility from June 1, 2012 to May 31, 2015. GPA may elect to extend the contract for up to two additional one-year terms. The contract is for an annual fixed fee of $675,273 payable by GPA monthly. The Company is required to seek approval from GPA for all major operation and maintenance activities exceeding $5,000 which are to be billed separately from monthly payments. Service fee revenue of $393,910 presented in the accompanying statement of revenue, expenses and changes in net position was earned from the GPA contract.

(10) Commitments and Contingencies

Leases

The Company leases land, warehouse, airport facilities and other such space through various leases expiring through 2027. Certain lease agreements contain options to renew with rent escalations. Three lease agreements require additional lease payments contingent on the level of gallons sold by the Company from that leased facility.

(10) Commitments and Contingencies, Continued

Future minimum lease payments are as follows:

Year Ending December 31,	
2013	$ 490,844
2014	430,688
2015	430,074
2016	424,254
2017	406,254
2018-2022	1,673,958
2023-2027	513,575
	$ 4,369,647

Sales

The Company has entered into agreements to sell fuel at an agreed pricing method. The agreements are for one year and automatically renew at the end of their respective terms every 30 days, unless terminated by either party.

Letter of Credit

A stand-by letter of credit of $675,274 is issued in favor of GPA to satisfy Vital's required performance bond related to the contract described in note 9. The letter of credit expired on April 17, 2013 and the Company is in the process of renewing the agreement.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Board of Directors
Federated States of Micronesia Petroleum Corporation:

We have audited, in accordance with the 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, the financial statements of the Federated States of Micronesia Petroleum Corporation (the Company) and its discretely presented component unit, Vital Energy, Inc., which comprise the respective statements of net position as of December 31, 2012, and the related statements of changes in net position for the year then ended and for the period from inception (February 10, 2012) to December 31, 2012, and the related notes to the financial statements, and have issued our report thereon dated June 26, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* 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 *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the respective financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Company in a separate letter dated June 26, 2013.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte + Touche LLP

June 26, 2013

Schedule of Finding and Response
Year Ended December 31, 2012

Finding No.: 2012-01

Procurement Documents

Criteria: In accordance with applicable procurement regulations, procurement transactions shall provide for full and open competition that is best suited to the circumstances.

Conditions:

1. Procurement documents evidencing full and open competition were not provided for five of nine expenditures aggregating $685,656 from a total population of $6,385,879.

2. Three of nine construction work-in-progress (CWIP) projected tested for stage of completion were in use and should have been capitalized as fixed assets as of December 31, 2012. Management submitted an adjustment to capitalize the assets at the time of audit.

PNI10-0101	Tank 1 API 653 Upgrade	$ 474,898
KSA11-0105	Truck, Bulk Fuel	201,628
PNI11-0702	Liquip Aviation Skid & Freight	152,940

Completion reports were not timely received from the engineering department. We further noted that most of the CWIP projects were capitalized at December 31, 2012, but were utilized prior to year end.

Cause: The cause of the above condition is a potential lack of compliance with procurement regulations and the lack of timely reconciliation and monitoring of CWIP project status.

Effect: The effect of the above condition is potential noncompliance with procurement regulations and inaccurate interim financial statements.

Recommendation: We recommend that the Company comply with procurement regulations. We recommend that management conduct a comprehensive and periodic review of the stage of completion of the CWIP projects. Quarterly reports as to percentage of completion should be obtained from project engineers.

Auditee Response and Corrective Action Plan: Management is currently restructuring the Finance office by adding two senior accountants that will head the divisions. Asset management division will manage responsibilities of CPR, PetroX, and Procurement. We will elevate the procurement position to an officer responsible to senior accountant and to manage purchases including maintaining a "central filing system" for bid documents.”

Unresolved Prior Year Findings
Year Ended December 31, 2012

There were no unresolved audit findings from the prior year audits of the Company.