FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2016 and 2015

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

Years Ended December 31, 2016 and 2015
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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, 2016 and 2015, and the related statements of revenues, expenses, and changes in net position and, where applicable, cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Company's basic financial statements as set forth in Section III of the foregoing table of contents.

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. The financial statements of the discretely presented component unit were not audited in accordance with *Government Auditing Standards.* 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 opinions.

Deloitte.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Company and its discretely presented component unit as of December 31, 2016 and 2015, and the respective changes in financial position and, where applicable, cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

Implementation of New Accounting Standards

As discussed in Note 2 to the financial statements, the Company adopted Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application*, effective January 1, 2015. Our opinion is not modified with respect to this matter.

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 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 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* in considering the Company's internal control over financial reporting and compliance.

Deloitte & Touche LLP

April 28, 2017

STRATEGIC OBJECTIVES

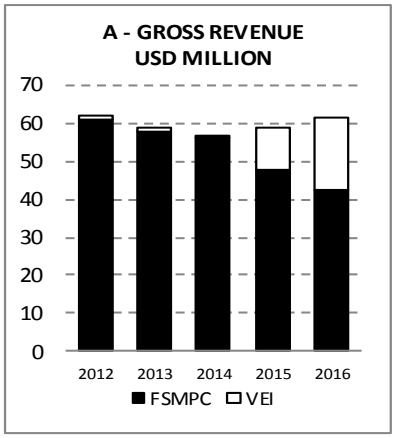
The primary long term role and function of the Federated States of Micronesia Petroleum Corporation (FSMPC or "the Corporation") is to secure a stable supply of petroleum products to meet the nation's core energy needs. In addition, and as a result of Public Law 18-68 entitled "The Coconut Tree Act", the Corporation transitioned the assets, staff and operations of the former FSM Coconut Development Authority (CDA) in September 2014.

The Corporation engages efficiently, responsibly and profitably in the country. 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, and to provide the necessary resources to develop the coconut industry.

The Corporation 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

The Corporation operates a total of eight fuel terminal facilities across the region. It services the international aviation, marine bunkering, and inland market segments. It also owns and operates a copra and coconut processing facility in Pohnpei producing soaps and edible oils.



Vital Energy Incorporated (VEI), Guam, is wholly owned by the FSMPC. It has a terminal operations and management contract with the Guam Power Authority (GPA), and a supply and terminal operating agreement with the Government of Nauru. The Corporation stores, handles and delivers over 2.3 million barrels of petroleum products per annum.

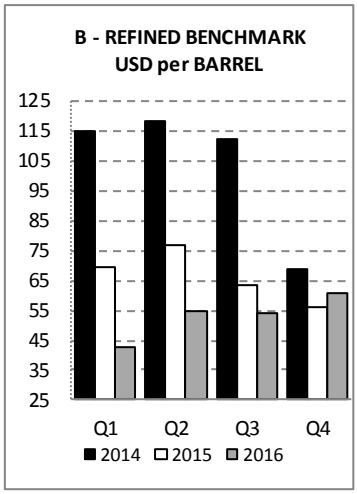
A Pricing Policy Framework (PPF) provides a mechanism to stabilize domestic prices, and cushion the effect of international volatility. There are no cross subsidies within the PPF, and the prices reflect the costs of procuring, financing, storing, handling and distribution of fuels in the markets that we operate.

The Corporation continues to benchmark domestic price competitiveness through comparison of pump prices of island neighbors. Throughout CY16, domestic prices remained stable and by the end of the year were very competitive compared to Guam pump prices. This is largely due to the design of the price stabilization mechanism within the PPF, the maintenance of a fuel reserves account in the event of rebounding prices, and the development of a new financing plan to fund a new strategic plan.

Pricing practices did not change throughout 2016. The PPF maintained a monthly price change for contract customers such as utilities, airlines, and a quarterly price change for retail service stations. This strategy continues to provide stable energy prices for homes, businesses, and government; however, is expected to undergo a review in 2017.

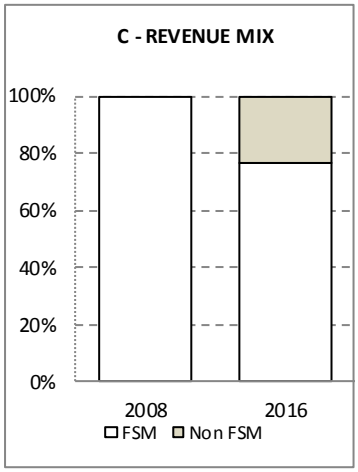
Revenues

Over 97% of company revenues are petroleum fuel-related. Revenues are directly linked to the international oil markets, as the continued use of a PPF matches international oil price increases or decreases with output sales prices. Therefore, since 2014, revenues have fallen with the falling global oil prices.



The refined product benchmark fell rapidly in 2014 from a high of US$115/bbl. 2016 started at an all time low of $US42/bbl. By December 2016, it had regained position to $60/BBL. The refined product benchmark average for CY2016 was $52/BBL, a decrease of approximately 20% over 2015 (graph B).

FSMPC revenues have fallen over 30% from a high of $60MM to $42MM in 2016 (refer Graph A) as lower international prices have been passed on to consumers. In addition, sales volumes continue to be depressed for the second consecutive year. Conversely, VEI has grown to a high of $17MM improving the revenue mix considerably (refer Graph C).



As a result, the company has managed to retain a consolidated gross revenue of the Group at $59.9 million. (refer graph A) with business unit contributions of Kosrae 7.12%, Yap 10.65%, Chuuk 18.8%, Pohnpei 34.5%, Guam and Nauru 28.8%. Automotive diesel oil remains the highest revenue component at 46.35%, followed by unleaded petrol (or gasoline) 34.14%, and home kerosene and Jet A1 of 14.79%. Non-fuel related revenues from power plant electricity sales, terminal management fees, as well as coconut related products are approximately 4% of total revenues mix, and lubricants under 1%.

Our petroleum operations throughout the FSM, Guam and Nauru are supported by fuel, lubricant and technical service agreements with Mobil Oil Micronesia Incorporated (MOGI), Total Oil Asia Pacific (TOAP), and ExxonMobil Aviation (EMA). In 2015, we added Winson Oil (HK) Limited and Pacific Bulk Fuels (NZ) Limited as primary product suppliers to the Company. There were no changes in primary product suppliers in 2016.

Investment and 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 Board confirms their commitment to the SGBP annually. There were no reported breaches of these principles in 2016.

A new Strategic Plan was launched in June 2016. The Strategic Plan is aligned with national and state development policies. An organizational restructure has also been implemented to support an improved strategy execution framework. The Corporation has maintained its annual business planning process; however, planning is now over a six-year horizon.

The business anticipates investments in excess of $35M into its FSM operations over the next five years for fuel terminal risk reduction, operational efficiency and coconut industry rehabilitation work. The Investment Appraisal Framework adopted by the Board in 2015 remains in place. The appraisal framework provides clear guidelines for management for all investments made by the Corporation.

Risk Management

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

Risks are managed proactively. The Board Committee on Risk and Audit (CoRA) has maintained a quarterly meeting schedule. The CoRA remain accountable for enterprise level risks, remedial action plans, and business internal controls.

Organizational resources continue to be allocated primarily towards risk mitigation. The three areas that remain a priority are i) competent people, ii) asset rehabilitation, and iii) credible scenario planning and preparedness.

The 2015 Strategic Plan has acknowledged that the end of the financial assistance under the Compact of Free Association (CoFA) is a threat event that needs to be planned for, and monitored closely. This has elevated the need for revenue diversification and structural cost reductions initiatives.

Financial Condition

The Corporation continues to invest all operating surplus into capital improvement projects that are for mandatory compliance, reduction of operating risk, structural cost reduction, improvement in operational efficiency or investment in to coconut industry development.

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. We are now able to attract competitive long term financing to fund our proposed investments and obligations in the agricultural sector, as well as Phase II of the Asset Rehabilitation Program.

The following table summarizes the Corporation's financial position and results of operations as of the and for the years ended December 31, 2016, 2015, and 2014.

Assets:	2016	2015	2014
Capital assets, net	$ 16,350,090	$ 16,888,711	$ 16,692,475
Cash	8,998,024	7,582,852	13,878,521
Inventory, net	6,521,950	5,563,851	7,568,958
Investments	2,007,764	1,871,223	-
Due from related parties	12,412,524	12,094,999	-
Receivables and other assets	4,152,451	3,013,444	4,643,377
Total assets	$ 50,442,803	$ 47,015,080	$ 42,783,331

	2016	2015	2014
Liabilities and Net Position:			
Current liabilities	$ 5,659,971	$ 8,039,122	$ 8,208,953
Noncurrent liabilities	2,284,049	2,284,049	2,284,049
Net position:			
Net investment in capital assets	16,350,090	16,888,711	16,692,475
Unrestricted	26,148,693	19,803,198	15,597,854
Total net position	42,498,783	36,691,909	32,290,329
Total liabilities and net position	$ 50,442,803	$ 47,015,080	$ 42,783,331
Revenues, Expenses and Changes in Net Position:			
Operating revenues	$ 42,763,730	$ 47,637,303	$ 56,114,912
Cost of goods sold	(24,947,476)	(31,190,027)	(43,184,791)
Gross profit	17,816,254	16,447,276	12,930,121
Operating expenses	(12,124,975)	(11,587,295)	(9,112,193)
Nonoperating revenues (expenses), net	115,595	(458,401)	(13,625)
Change in net position	$ 5,806,874	$ 4,401,580	$ 3,804,303

Major changes in the profit and loss and statement of net position components for CY16 are a result of the following:

a) The Corporation maintained one-year term Line of Credit with Bank of Guam (BOG) for $10,000,000. The short term note with banks remained at a zero balance in CY2016 as a result of prudent cash management. The Corporation continues to invest its operating surplus into capital expenditures to reduce operating risks and strengthen oil distribution infrastructure, into strategic oil inventory to increase the energy security of the nation, and to execution of its strategy (VT2025) for the long term sustainability of the Corporation;

b) The higher operating expenses for 2016 are directly attributed to increased activities of a fast growing company, additional professional fees attributed to investment due diligence and financial modeling for compliance with the Investment Policy Framework, and additional staff recruited to implement a centralized procurement and stores team.

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 in 2016 was $3,569,904 as compared to $9,476,127 in 2015;

d) A total of $1,316,261 was used for capital and related investing activities mainly for the purchase of capital assets. The Corporation's total investments in capital assets, inclusive of construction in progress as of December 31, 2016 and 2015 were $16,350,090 and $16,888,711 respectively, which are net of accumulated depreciation of $8,637,374 and $6,865,675, respectively.

CAPITAL ASSETS AND DEBT MANAGEMENT

Capital Assets and Long-Term Debt: At the end of CY2016, the Corporation had $16.3 million invested in capital assets. This represents a decrease in net capital assets (including additions and deletions) of $0.5 million or 3% over the previous year. For additional information about the Corporation's capital assets, refer to Note 3 to the financial statements. The Corporation had no long-term debt outstanding at December 31, 2016 and 2015.

ECONOMIC OUTLOOK

Two main forms of energy are supplied in the market economy of FSM: fossil fuels by FSM Petroleum Corporation and electricity by four State owned power utilities, namely: Pohnpei Utility Corporation (PUC), Kosrae Utilities Authority (KUA), Yap State Public Services Corporation (YSPSC) and Chuuk Public Utility Corporation (CPUC). It was estimated in 2010 that around 55% of households are connected to the electricity network[1].

The Household Income Expenditure Survey (HIES) indicated that with reducing or stressed household budgets and few new economic activities, there will be a significant challenge in extending electricity access on commercially viable and/or affordable arrangements to the remaining 45% of households. It is expected that increased trade in coconut and coconut related products will provide remote and disadvantaged communities with an additional household income stream to assist with energy related expenditure.

Key indicators such as total sales volumes continue to hint at a challenging future for the petroleum business, and this continues to underpin the importance of a diversification strategy of operations and revenue sources away from both fuel, and outside of COFA impacted countries. Currently non-FSM and non-fuel related activities of the Corporation have reached its initial target of 30%.

The investment into the restructuring of the coconut industry, the construction of a new integrated coconut processing facility in 2017, an additional independent power plant in the Chuuk State, and further geographical expansion outside of FSM boarders is expected to increase revenue diversification a further 10% within five (5) years. The new industry integrated coconut processing facility is expected to grow exports to $5MM per annum within the next six years.

Management's Discussion and Analysis for the year ended December 31, 2015 is set forth in the report on the audit of FSMPC's financial statements, which is dated June 28, 2016. That Discussion and Analysis explains the major factors impacting the 2015 financial statements and may be obtained from the contact show below.

CONTACT

Questions associated with the above Management's Discussion and Analysis may be sent by post, addressed to Mr. Johnny Adolph, Chief Financial Officer, P.O. Box 1762, Kolonia, Pohnpei, FSM 96941 or via email to petrocorp@fsmpc.com.

(1) Organization and Basis of Presentation

[1] Expression of Interest to Participate in SREP, Micronesia Climate Investment Funds: https://www-cif.climateinvestmentfunds.org/sites/default/files/meeting-documents/federated_states_of_micronesia_eoi_0.pdf

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

Statements of Net Position
December 31, 2016 and 2015

ASSETS	2016	2015
Current assets:		
Cash and cash equivalents	$ 8,998,024	$ 7,582,852
Trade receivables	2,239,873	1,917,485
Due from related parties	12,412,524	12,094,999
Inventory, net	6,521,950	5,563,851
Prepaid expenses	1,412,578	1,095,959
Total current assets	31,584,949	28,255,146
Investments	2,007,764	1,871,223
Other noncurrent asset	500,000	-
Capital assets:		
Nondepreciable capital assets	3,174,562	3,938,313
Other capital assets, net of accumulated depreciation	13,175,528	12,950,398
	$ 50,442,803	$ 47,015,080
LIABILITIES AND NET POSITION		
Current liabilities:		
Accounts payable - fuel	$ 2,241,889	$ 2,110,415
Accounts payable - other	622,922	760,278
Accrued liabilities and others	2,795,160	5,168,429
Total current liabilities	5,659,971	8,039,122
Due to States and the FSM National Government	2,284,049	2,284,049
Total liabilities	7,944,020	10,323,171
Commitments and contingencies		
Net position:		
Net investment in capital assets	16,350,090	16,888,711
Unrestricted	26,148,693	19,803,198
Total net position	42,498,783	36,691,909
	$ 50,442,803	$ 47,015,080

See accompanying notes to financial statements.

VITAL ENERGY, INC.

Statements of Net Position
December 31, 2016 and 2015
Discretely Presented Component Unit

ASSETS	2016	2015
Current assets:		
Cash	$ 12,529,991	$ 7,957,922
Time certficates of deposit	400,000	-
Trade receivables	498,783	662,118
Inventory	5,489,067	5,632,808
Prepaid expenses	60,587	132,022
Total current assets	18,978,428	14,384,870
Property and equipment, net	223,277	160,140
	$ 19,201,705	$ 14,545,010
LIABILITIES AND NET POSITION		
Current liabilities:		
Accounts payable	$ 2,078,382	$ 226,222
Accrued liabilities and others	871,198	916,531
Income tax payable	119,589	24,000
Due to FSM Petroleum Corporation	12,327,520	12,001,569
Other current liabilities	467,730	-
Total current liabilities	15,864,419	13,168,322
Deferred tax liability	30,000	11,000
Other noncurrent liability	2,080,388	653,858
Total liabilities	17,974,807	13,833,180
Commitments and contingencies		
Net position:		
Net investment in capital assets	223,277	160,140
Unrestricted	1,003,621	551,690
Total net position	1,226,898	711,830
	$ 19,201,705	$ 14,545,010

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, 2016 and 2015

	2016	2015
Operating revenue:		
Sales and service income	$ 42,630,453	$ 47,541,504
Other	133,277	95,799
	42,763,730	47,637,303
Cost of goods sold	24,947,476	31,190,027
Gross profit	17,816,254	16,447,276
Operating expenses:		
Salaries and benefits	2,373,429	2,026,852
Depreciation and amortization	1,854,881	1,650,938
Professional fees	1,845,194	910,375
Taxes	1,237,844	1,336,372
Staff travel, training and development	981,324	705,452
Rent	865,489	797,804
Repairs and maintenance	762,729	774,663
Corporate governance	440,591	835,467
Insurance	337,039	335,967
Contracted services	332,473	372,910
Office supplies	247,021	260,322
Communications	215,428	255,410
Utilities	149,716	240,617
Fuel	60,260	74,776
Start up costs	-	682,451
Miscellaneous	421,557	326,919
Total operating expenses	12,124,975	11,587,295
Operating income	5,691,279	4,859,981
Nonoperating revenues (expenses):		
Contributions from FSM National Government	-	35,711
Contributions to component unit	-	(383,221)
Investment income (loss), net	136,541	(128,777)
Interest (expense) income, net	(20,946)	17,886
Total nonoperating revenues (expenses), net	115,595	(458,401)
Change in net position	5,806,874	4,401,580
Net position at beginning of year	36,691,909	32,290,329
Net position at end of year	$ 42,498,783	$ 36,691,909

See accompanying notes to financial statements.

VITAL ENERGY, INC.

Statements of Revenue, Expenses, and Changes in Net Position
Years Ended December 31, 2016 and 2015
Discretely Presented Component Unit

	2016	2015
Operating revenue:		
Sales and service income	$ 17,296,781	$ 11,277,666
Cost of sales and services	(13,726,840)	(9,120,361)
Gross profit	3,569,941	2,157,305
Operating expenses:		
Rent	499,152	286,329
Salaries and benefits	435,613	305,886
Insurance	349,423	157,983
Foreign exchange	336,270	55,210
Contracted services	185,884	141,588
Repairs and maintenance	178,902	70,627
Professional fees	148,817	272,361
Staff training and development	134,826	2,354
Income taxes	114,589	35,000
Corporate office shared services	107,682	-
Utilities	106,545	79,531
Travel and entertainment	91,438	66,957
Communications	78,003	45,633
Gross revenue/receipt tax	76,197	28,503
Depreciation	60,692	31,834
Office supplies	51,631	30,872
Bank charges	35,185	72,801
Fuel	26,730	13,240
Start up costs	-	204,529
Miscellaneous	67,691	26,154
Total operating expenses	3,085,270	1,927,392
Operating income	484,671	229,913
Nonoperating revenues:		
Interest income	30,397	-
Contributions from FSM Petroleum Corporation	-	372,487
Total nonoperating revenues	30,397	372,487
Change in net position	515,068	602,400
Net position at beginning of year	711,830	109,430
Net position at end of year	$ 1,226,898	$ 711,830

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, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Cash received from customers	$ 42,441,341	$ 48,036,204
Cash paid to suppliers for goods and services	(36,498,008)	(36,533,225)
Cash paid to employees for services	(2,373,429)	(2,026,852)
Net cash provided by operating activities	3,569,904	9,476,127
Cash flows from noncapital financing activities:		
Contributions from FSM National Government	-	35,711
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(1,316,261)	(1,847,174)
Cash flows from investing activities:		
Advances to related parties	(317,525)	(12,094,999)
Purchases of investments	-	(2,000,000)
Increase in other non-current asset	(500,000)	-
Contributions to component unit	-	(383,221)
Investment (loss) income	(20,946)	17,887
Net cash used for investing activities	(838,471)	(14,460,333)
Net change in cash	1,415,172	(6,795,669)
Cash and cash equivalents at beginning of year	7,582,852	14,378,521
Cash and cash equivalents at end of year	$ 8,998,024	$ 7,582,852
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 5,691,279	$ 4,859,981
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,854,881	1,650,938
(Increase) decrease in assets:		
Trade receivables	(322,388)	398,901
Inventory and related deposit with supplier	(958,099)	2,482,696
Prepaid expenses	(316,619)	253,443
Increase (decrease) in liabilities:		
Accounts payable	(5,883)	(1,537,634)
Accrued liabilities and others	(2,373,267)	1,367,802
Net cash provided by operating activities	$ 3,569,904	$ 9,476,127

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.

Coconut Development Unit (CDU) was established through Public Law No. 18-68 enacted on June 16, 2014, which dissolved the FSM Coconut Development Authority (CDA) and transferred the responsibility of coconut development to FSMPC. Effective January 1, 2015, CDU started operations and was created as a division of FSMPC; therefore, its financial position and activities are included in FSMPC's financial statements.

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 assets and deferred outflows of resources, and 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 three net position 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.

(1) Organization and Basis of Presentation, Continued

Basis of Accounting, Continued

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

- 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)

Vital Energy, Inc. is a legally separate entity which meets the criteria set forth for component units. Vital was incorporated on February 10, 2012 in Guam 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. On May 22, 2015, Vital established Vital Energy, Inc. (Nauru) (the "Nauru Branch"), a foreign branch operations in the Government of Nauru (GON) for the purpose of providing fuel supply and distribution in Nauru. Vital's main operations are in Guam and Nauru effective June 2015. Copies of Vital's report can be obtained by contacting Vital management. Vital's significant notes are summarized in Note 2J.

(2) Summary of Significant Accounting Policies

A. Cash and Cash Equivalents

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.

(2) Summary of Significant Accounting Policies, Continued

A. Cash and Cash Equivalents, Continued

For purposes of the statements of net position and of cash flows, cash and cash equivalents represent cash on hand, cash in bank accounts and time certificates of deposits with maturity of up to ninety days. As of December 31, 2016 and 2015, total carrying amounts of cash and cash equivalents were $8,998,024 and $7,582,852, respectively, and the corresponding bank balances were $9,151,765 and $7,709,488, respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2016 and 2015, bank deposits in the amount of $250,000 were subject to FDIC insurance. Bank balances in excess of FDIC insurance are not collateralized.

B. Investments

Investments held by the Company consist of money market funds, fixed income securities, exchange-traded funds, and common stock. Investments and related investment earnings or loss are recorded at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the date of which the fair value of an asset or liability is determined.

As of December 31, 2016 and 2015, investments at fair value are as follows:

	2016	2015
Fixed income securities:		
Domestic fixed income	$ 476,703	$ 469,912
International fixed income	200,567	188,139
	677,270	658,051
Other investments:		
Common equities	828,406	773,072
Exchange traded funds	443,864	396,627
Money market funds	58,224	43,473
	1,330,494	1,213,172
	$ 2,007,764	$ 1,871,223

(2) Summary of Significant Accounting Policies, Continued

B. Investments, Continued

As of December 31, 2016, the Company's fixed income securities had the following maturities:

Investment Type	Fair value	Less than 1 year	1 to 5 years	5 to 10 years	More than 10 years
Mortgage and asset-backed securities	$ 81,868	$ -	$ 81,868	$ -	$ -
International bonds	200,567	200,567	-	-	-
Corporate bonds	208,238	-	14,248	164,819	29,171
U.S. Government Agency Bonds	186,597	-	92,863	48,936	44,798
	$ 677,270	$ 200,567	$ 188,979	$ 213,755	$ 73,969

As of December 31, 2015, the Company's fixed income securities had the following maturities:

Investment Type	Fair value	Less than 1 year	1 to 5 years	5 to 10 years	More than 10 years
International bonds	$ 188,139	$ -	$ -	$ -	$ 188,139
Corporate bonds	268,244	-	98,366	141,196	28,682
U.S. Government Agency Bonds	201,668	-	78,659	80,467	42,542
	$ 658,051	$ -	$ 177,025	$ 221,663	$ 259,363

The Company's exposure to credit risk at December 31, 2016 and 2015, was as follows:

Moody's Rating	2016	2015
AAA	$ 268,464	$ 257,888
A1	13,844	13,459
A2	29,518	44,371
A3	90,642	87,142
BA1	-	12,742
BAA1	28,956	14,295
BAA2	30,088	-
BAA3	15,191	40,014
Not rated	200,567	188,140
	$ 677,270	$ 658,051

The Company categorizes its fair value measurements within the fair value hierarchy established by GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The Company has the following recurring fair value measurements as of December 31, 2016 and 2015:

(2) Summary of Significant Accounting Policies, Continued

B. Investments, Continued

		Fair Value Measurements Using		
	December 31, 2016	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level:				
Fixed income securities	$ 677,270	$ -	$ 677,270	$ -
Equity securities	828,406	828,406	-	-
Exchange-traded funds	443,864	443,864	-	-
Total investments by fair value level	1,949,540	$ 1,272,270	$ 677,270	$ -
Investments measured at amortized cost:				
Money market funds	58,224			
	$ 2,007,764			

		Fair Value Measurements Using		
	December 31, 2015	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level:				
Fixed income securities	$ 658,051	$ -	$ 658,051	$ -
Equity securities	773,072	773,072	-	-
Exchange-traded funds	396,627	396,627	-	-
Total investments by fair value level	1,827,750	$ 1,169,699	$ 658,051	$ -
Investments measured at amortized cost:				
Money market funds	43,473			
	$ 1,871,223			

C. 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, 2016 and 2015, the Company is of the opinion that an allowance for doubtful accounts is not necessary.

(2) Summary of Significant Accounting Policies, Continued

D. Inventory

Inventory is substantially carried at the lower of cost (moving average cost) or market value. At December 31, 2016 and 2015, inventory consists of the following:

	2016	2015
Inventory on hand:		
Fuel	$ 5,400,487	$ 3,829,665
Lubricants	485,355	454,971
Chemicals	89,627	94,866
Others	407,326	369,744
	6,382,795	4,749,246
Inventory in transit:		
Fuel	189,742	865,192
	6,572,537	5,614,438
Less allowance for obsolescence	(50,587)	(50,587)
	$ 6,521,950	$ 5,563,851

E. 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:

Buildings	15 years
Motor vehicles	5 years
Plant and equipment	3 to 15 years
Furniture and fixtures	4 years
Office equipment	4 to 8 years
Machinery and equipment	4 years

F. 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 did not have capitalized interest for the years ended December 31, 2016 and 2015.

G. Taxes

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

(2) Summary of Significant Accounting Policies, Continued

H. New Accounting Standards

During the year ended December 31, 2016, the Company implemented the following pronouncements:

- GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The implementation of this statement required additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques.

- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014. The implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(2) Summary of Significant Accounting Policies, Continued

H. New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for Asset Retirement Obligations (ARO). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(2) Summary of Significant Accounting Policies, Continued

I. Management Estimates

The preparation of financial statements in conformity with GAAP 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.

J. Vital's Accounting Policies

Cash and Cash Equivalents and Time Certificates of Deposit. Custodial credit risk is the risk that in the event of a bank failure, Vital'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. Vital does not have a deposit policy for custodial credit risk.

For purposes of the statements of net position, cash and cash equivalents represent cash on hand, cash in bank accounts and time certificates of deposits with maturity of up to ninety days. Time certificates of deposit with original maturities greater than ninety days are separately classified. As of December 31, 2016 and 2015, total carrying amounts of cash and cash equivalents and time certificates of deposits were $3,802,564 and $147,647, respectively, and the corresponding bank balances were $3,813,739 and $171,873, respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2016 and 2015, bank deposits in the amount of $250,000 and $171,873, respectively, were subject to FDIC insurance. Bank balances in excess of FDIC insurance are not collateralized.

Cash with Bendigo Adelaide Bank Limited

As of December 31, 2016 and 2015, Vital maintains bank balance of $9,127,427 and $7,810,275, respectively, with Bendigo Adelaide Bank Limited (Bendigo), an authorized deposit-taking institution (ADI) subject to the Australian Government Financial Claims Scheme (FCS). FCS provides guarantee on deposits up to a limit of AUD$250,000 for each account holder, which was extended to branches of Bendigo in Nauru. As of December 31, 2016 and 2015, bank deposits of approximately $180,000 and $183,000, respectively, were subject to FCS guarantee. Balances in excess of FCS guarantee are not collateralized.

Trade Receivables. Trade receivables are uncollected amounts from Guam Power Authority (GPA) (see note 8) and the Government of Nauru, other governmental agencies and businesses located in Nauru. 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. Accounts deemed uncollectible are written-off. At December 31, 2016 and 2015, Vital is of opinion that an allowance for doubtful accounts is not required.

(2) Summary of Significant Accounting Policies, Continued

J. Vital's Accounting Policies, Continued

Due to FSM Petroleum Corporations. Due to FSM Petroleum Corporation are amounts due to FSMPC for fuel purchases and advances. Balances with FSMPC do not have specific payment terms.

Inventory. Inventory mainly represents fuel and is substantially carried at the lower of cost (moving average cost) or market value.

Revenue Recognition. Vital's revenues are derived mainly from sale of fuel. Fuel sales are recognized upon point of sale (cash or credit card sales) or when charged to customers' charge accounts when merchandise is delivered to customers and title is passed and collectability is reasonably assured. Service income is recognized based on existing GPA contract, typically earned monthly. Other income, mainly representing costs reimbursements for major operation and maintenance project activities, is billed and accrued upon completion of the project.

Property and Equipment. Vital 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 vehicles	5 years
Computer equipment	5 years
Furniture and fixtures	7 years
Machinery and equipment	7 years

Taxes. Vital 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.

Income tax expense for the years ended December 31, 2016 and 2015 consisted of the following:

	2016	2015
Current	$ 95,589	$ 24,000
Deferred	19,000	11,000
Total	$ 114,589	$ 35,000

The difference between the effective income tax rate and the statutory rate of 34% in 2016 and 2015 are principally due to correction of prior year accrual and recognition of net operating losses carryovers that were previously fully allowed, respectively.

(2) Summary of Significant Accounting Policies, Continued

J. Vital's Accounting Policies, Continued

Taxes, Continued. At December 31, 2016 and 2015, deferred tax liability of $30,000 and $11,000, respectively, relates mainly to difference in fixed asset depreciation. 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.

K. Reclassifications

Certain balances in the 2015 financial statements have been reclassified to conform with the 2016 financial statement presentation.

(3) Capital Assets

FSM Petroleum Corporation

Capital asset activities for the years ended December 31, 2016 and 2015 are as follows:

	Balance at January 1, 2016	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2016
Buildings	$ 990,486	$ 8,600	$ -	$ 999,086
Motor vehicles	1,173,216	471,617	(161,749)	1,483,084
Plant and equipment	11,787,068	1,269,794	-	13,056,862
Furniture and fixtures	217,973	74,851	-	292,824
Office equipment	4,904,549	160,266	-	5,064,815
Machinery and equipment	742,781	173,450	-	916,231
	19,816,073	2,158,578	(161,749)	21,812,902
Less accumulated depreciation	(6,865,675)	(1,854,881)	83,182	(8,637,374)
	12,950,398	303,697	(78,567)	13,175,528
Construction in progress	3,938,313	1,135,313	(1,899,064)	3,174,562
	$ 16,888,711	$ 1,439,010	$ (1,977,631)	$ 16,350,090

	Balance at January 1, 2015	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2015
Buildings	$ 800,334	$ 190,152	$ -	$ 990,486
Motor vehicles	1,017,745	155,471	-	1,173,216
Plant and equipment	10,886,784	901,421	(1,137)	11,787,068
Furniture and fixtures	208,942	9,031	-	217,973
Office equipment	3,872,616	1,034,149	(2,216)	4,904,549
Machinery and equipment	674,988	67,793	-	742,781
	17,461,409	2,358,017	(3,353)	19,816,073
Less accumulated depreciation	(5,214,737)	(1,650,938)	-	(6,865,675)
	12,246,672	707,079	(3,353)	12,950,398
Construction in progress	4,445,803	2,831,163	(3,338,653)	3,938,313
	$ 16,692,475	$ 3,538,242	$ (3,342,006)	$ 16,888,711

(3) Capital Assets, Continued

Vital Energy, Inc.

Capital asset activities for the years ended December 31, 2016 and 2015 are as follows:

	Balance at January 1, 2016	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2016
Motor vehicles	$ 33,158	$ 31,151	$ -	$ 64,309
Plant and equipment	1,224	-	(17)	1,207
Computer equipment	165,635	38,494	-	204,129
Furniture and fixtures	9,741	17,878	-	27,619
Machinery and equipment	20,943	16,923	-	37,866
	230,701	104,446	(17)	335,130
Less accumulated depreciation	(70,561)	(60,692)	-	(131,253)
	160,140	43,754	(17)	203,877
Construction in progress	-	19,400	-	19,400
	$ 160,140	$ 63,154	$ (17)	$ 223,277

	Balance at January 1, 2015	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2015
Motor vehicles	$ 33,158	$ -	$ -	$ 33,158
Plant and equipment	-	1,224	-	1,224
Computer equipment	38,302	127,333	-	165,635
Furniture and fixtures	9,741	-	-	9,741
Machinery and equipment	20,943	-	-	20,943
	102,144	128,557	-	230,701
Less accumulated depreciation	(38,727)	(31,834)	-	(70,561)
	$ 63,417	$ 96,723	$ -	$ 160,140

(4) Due to States and the FSM National 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 the FSMNG properly and exclusively for the purchase of products enumerated in a list to be mutually agreed upon between the two governments. The Grant shall be received by the FSMNG in Yen currency, shall be used as described above within a period of twelve months and any excess amounts shall be refunded to the Government of Japan thereafter. The 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 the FSM.

(4) Due to States and the FSM National Government, Continued

In 2009, FSMPC signed a memorandum of agreement with the 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 the FSMNG. FSMPC received the equivalent gallons of fuel from the supplier and this is now maintained as strategic inventory in each State. As of December 31, 2016 and 2015, FSMPC recognized a liability to the States and the FSMNG of $1,784,049.

At December 31, 2016 and 2015, the remaining $500,000 represents a non-interest bearing advance payable to 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, 2017.

(5) Short-Term Borrowings

As of December 31, 2016 and 2015, the Company has a bank line of credit facility (LOC) of $10,000,000 currently expiring on July 30, 2017. 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 interest at the bank's effective reference rate plus 0.75%, with minimum rate of 5.75% per annum, with interest payable monthly and principal due within 180 days. No drawdowns were made against the LOC during the years ended December 31, 2016 and 2015. Furthermore, no borrowings are outstanding against the LOC at December 31, 2016 and 2015.

(6) Changes in Long-Term Liabilities

Changes in long-term liabilities for the years ended December 31, 2016 and 2015 are as follows:

FSM Petroleum Corporation

	Balance at January 1, 2016	Additions	Repayments	Balance at December 31, 2016	Due Within One Year
Due to States and the FSM National Government	$ 2,284,049	$ -	$ -	$ 2,284,049	$ -

	Balance at January 1, 2015	Additions	Repayments	Balance at December 31, 2015	Due Within One Year
Due to States and the FSM National Government	$ 2,284,049	$ -	$ -	$ 2,284,049	$ -

(6) Changes in Long-Term Liabilities, Continued

Vital Energy, Inc.

	Balance at January 1, 2016	Additions	Reductions	Balance at December 31, 2016	Due Within One Year
Deferred tax liability	$ 11,000	$ 19,000	$ -	$ 30,000	$ -
Other noncurrent liability	653,858	1,658,452	(231,922)	2,080,388	-
	$ 664,858	$ 1,677,452	$ (231,922)	$ 2,110,388	$ -

	Balance at January 1, 2016	Additions	Reductions	Balance at December 31, 2016	Due Within One Year
Deferred tax liability	$ -	$ 11,000	$ -	$ 11,000	$ -
Other noncurrent liability	-	653,858	-	653,858	-
	$ -	$ 664,858	$ -	$ 664,858	$ -

(7) Risk Management

Insurance Risk

FSM Petroleum Corporation

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.

Vital Energy, Inc.

Vital purchases commercial insurance to cover potential risks from managing, operating and maintaining GPA's fuel bulk storage facility and Government of Nauru bulk fuel facilities. Vital is substantially sell-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

Foreign Currency Risk

Vital's transactions in its Nauru branch are settled in a foreign currency. Vital is exposed to the risk of unfavorable changes in the exchange rate that may occur. Vital's foreign currency denominated cash is accumulated in Nauru due to foreign exchange limitations. Vital is currently working with the Government of Nauru and concerned financial institutions to transfer funds from Nauru to FSMPC.

(8) Concentration Risk and Significant Customers

FSM Petroleum Corporation

Revenue from one major customer, Pohnpei Utilities Corporation, for the years ended December 31, 2016 and 2015 approximated 15% and 16%, respectively, of the Company's total revenue, and receivable of $1,017,391 and $734,534 as of December 31, 2016 and 2015, respectively.

(8) Concentration Risk and Significant Customers, Continued

FSM Petroleum Corporation, Continued

The Company purchased substantially all fuel from one supplier in 2016 and 2015.

Vital Energy, Inc.

Guam Power Authority (GPA)

Vital has a contract with GPA to manage, operate and maintain GPA's fuel bulk storage facility from June 1, 2012 to May 31, 2015. GPA elected to extend the contract for an additional two-year term expiring on May 31, 2017. The contract is for an annual fixed fee of $675,273 payable monthly by GPA. Vital 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 revenues of $679,773 and $674,400 were earned from the GPA contract for the years ended December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, Vital has $114,010 and $291,312, respectively, receivable from GPA.

Government of Nauru (GON)

Effective June 1, 2015, Vital entered into a Petroleum Supply and Facility Management Agreement (the Agreement) with the GON for a period of five years, with an option to extend for another five years. Vital was appointed to perform: (a) procure the supply of fuel and delivery to the facilities, (b) operate and maintain the facilities for the receipt, storage and distribution of products, (c) sell and distribute products to meet all inland demand, and (d) provide expert advice, technical assistance and other services as GON may reasonably require in related to the matters of the agreement. Vital uses nine tankers in GON's facilities at the storage terminal located in Aiwo District, Republic of Nauru.

The Agreement allows Vital to charge prices based on Nauru Price Template (NPT). For the years ended December 31, 2016 and 2015, Vital recorded fuel sales of $16.6 million and $10.3 million, respectively. As of December 31, 2016 and 2015, Vital recorded throughput fee liability of $1,547,217 and $653,858, respectively, for the purpose of funding the facilities Compliance and Integrity Projects, which are included in the other noncurrent liability account in the statements of net position.

Vital's revenue from three major customers for the years ended December 31, 2016 and 2015 approximated 67% and 76%, respectively, of Vital's total revenue, and total receivable of $402,663 and $401,139 at December 31, 2016 and 2015, respectively.

Vital purchased substantially all fuel from one supplier in 2016 and 2015.

(9) Commitments and Contingencies

Leases

FSM Petroleum Corporation

The Company leases land, warehouse, airport facilities and other such space through various leases expiring through 2035. 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.

Future minimum lease payments are as follows:

Year Ending December 31,	
2017	$ 567,000
2018	504,000
2019	347,000
2020	317,000
2021	320,000
2022-2026	805,000
2027-2031	148,000
2032-2035	70,000
	$ 3,078,000

Vital Energy, Inc.

In connection with Vital's exclusive right to access, use and occupy the GON bulk fuel facilities, Vital is required to pay annual rent fee of $529,168 over the 5-year term of the agreement from June 1, 2015 to May 31, 2020. Future minimum lease payments are as follows:

Year Ending December 31,	
2017	$ 529,168
2018	529,168
2019	529,168
2020	220,487
	$ 1,807,991

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.

(9) Commitments and Contingencies, Continued

Bank Loan

In December 2016, the Company entered into a commitment letter for a $3 million loan with the FSM Development Bank (FSMDB). No loan disbursement was received as of December 31, 2016.

Loan Guarantee

On May 13, 2017, the Company has signed as guarantor to Vital's $2.4 million loan agreement. The loan has $0 outstanding balance as of December 31, 2016.

Litigation

The Company is a defendant in several legal actions. The ultimate outcome is presently undeterminable; however, Company management is of the opinion that resolution of these matters will not have a material effect on the accompanying financial statements.

(10) Related Parties

FSMPC sells fuel to the four utility companies in the FSM namely: Pohnpei Utilities Corporation, Chuuk Public Utility Corporation, Kosrae Utility Authority, and Yap State Public Corporation. Total fuel sales of $13.0 million and $14.9 million was earned from the four utility companies for the years ended December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, FSMPC has total receivables of $1.8 and $1.6 million, respectively, from the four utility companies. In addition, as of December 31, 2016 and 2015, FSMPC has accrued liabilities in the form of letters of credit to the Pohnpei Utilities Corporation and Chuuk Public Utility Corporation totaling $1,006,036 and $626,335, respectively, in connection with fuel purchases price variances, which are included as a component of accrued liabilities and others in the statements of net position.

FSMPC purchased fuel on behalf of Vital in 2015. Total related fuel purchases for the year ended December 31, 2015 are $11,529,188. As of December 31, 2016 and 2015, FSMPC recorded $11,803,666 and $11,530,739, respectively, as a receivable from Vital for fuel purchases which is included as a component of Due from related parties account in the Statements of Net Position. The remaining receivable of $608,858 and $564,260 as of December 31, 2016 and 2015, respectively, included advances and non-fuel disbursements made on behalf of Vital and other related parties.

Additionally, effective June 1, 2016, the Company entered into a Shared Services Agreement (the Agreement) with Vital. Under the agreement, which expires May 31, 2025, the Company charges Vital for certain administrative and support costs. Total costs charged by the Company approximated $107,682 for the year ended 2016 and are included as a component of other income in the accompanying statement of revenues, expenses, and changes in net position.

(11) Coconut Development Unit (CDU)

In June 2014, the FSM Congress approved the integration of FSM CDA into the operations of the Company. The integration occurred effective October 1, 2014 and the Company assumed $148,896 of CDA's September 30, 2014 net position of $229,596. CDU's results of operations for the quarter ended December 31, 2014 resulted in a net loss of $113,185. CDU's financial position and activities as of and for the period ended December 31, 2014 were not material to the Company's financial statements and therefore, were excluded from the Company's financial statements as of December 31, 2014. Effective January 1, 2015, the Company created CDU as a division and accordingly recorded contributions from FSM National Government of $35,711, which is equivalent to the assumed CDA's net position of $148,896, net of CDU's net loss of $113,185 incurred for the period ended December 31, 2014.

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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), which comprise the statement of net position as of December 31, 2016, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 28, 2017.

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as item 2016-002 that we consider to be significant deficiencies.

Deloitte.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as item 2016-001.

The Company's Response to Findings

The Company's responses to findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

April 28, 2017

Finding No.: 2016-001

Procurement Documents

Criteria: Procurement transactions shall provide for full and open competition that is best suited to the circumstances.

Condition: Procurement documents evidencing full and open competition or vendor selection were either not provided or partially provided for all twenty nine expenditures tested aggregating $426,936.

Cause: The cause of the above condition is lack of established procurement policies and regulations.

Effect: The effect of the above condition is potential noncompliance with competitive procurement.

Recommendation: We recommend that the Company complete a procurement manual entailing standard procedures to maximize full and open competition.

Prior Year Status: The lack of procurement documentation was reported as a finding in the audits of the Company for 2012 through 2015.

Auditee Response and Corrective Action Plan: Management concurs with the finding. The Company is in the process of progressive rollout of a procurement management system. Project Manager, Ultima Training & Consulting Services has rolled out Phase 1 of the project that saw the establishment of a procurement team that will drive a Value-for-Money (VFM) procurement policy and strategy. The VFM process and procedures is expected to be compliant with the most recent Multilateral Development Banks (MBD) harmonized procurement guidelines.

Finding No.: 2016-002

Construction-in-Progress (CIP) Project Monitoring

Criteria: An effective system of internal control includes policies and procedures related to periodic monitoring of capital project status that includes coordination between project management and the finance and accounting personnel.

Condition: Tests of construction in progress noted the following:

1. Project status reports or equivalent documentation could not be provided timely, which resulted in various adjusting entries during the course of audit in February 2017.

2. A number of open projects of approximately $270,000 with no recent costs incurred were noted as of December 31, 2016, of which three projects totaling $17,000 were found to be completed. This was corrected through adjusting journal entries.

3. Expense items (e.g., food allowance, hotel expenses, travel) of approximately $53,000 were capitalized as CIP. This was corrected through adjusting journal entries.

4. Incorrect completion dates for two projects were noted.

Cause: The cause of the above condition is lack of periodic monitoring of capital projects status between project management and accounting personnel.

Effect: The effect of the above condition is a potential misstatement of capitalized assets and related expenses.

Recommendation: We recommend that management conduct a comprehensive and periodic review of CIP projects. Quarterly reports as to percentage of completion should be obtained from the project managers. FSMPC should also review all project codes to determine those that are no longer relevant and valid. Further, FSMPC should strengthen control procedures over determining and identifying costs that are allowed to be capitalized in accordance with applicable accounting standards.

Prior Year Status: The lack of periodic monitoring of capital projects status between project management and accounting personnel was reported as a finding in the audits of the Company for 2013 through 2015.

Auditee Response and Corrective Action Plan: Management concurs with the finding. A project management unit called the Strategy Execution Team has been established. It is staffed with full time personnel comprising process guidance officers, project managers, project engineers, economists and accountants. The team's primary goal is aimed at improving the effectiveness of results delivery in the company, improve client engagement, and deliver projects on time, on scope and within budget.

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

Unresolved Prior Year Findings
Year Ended December 31, 2016

Summary Schedule of Prior Audit Findings

Findings relating to the financial statements, which are required to be reported in accordance with GAGAS:

Finding No. 2012 – 001, Procurement Documents – Not corrected. Refer to Finding No. 2015-001.

Finding No. 2013 – 001, Procurement Documents – Not corrected. Refer to Finding No. 2015-001.

Finding No. 2013 – 002, CIP Project Monitoring – Not corrected. Refer to Finding No. 2015-002.

Finding No. 2014 – 001, Procurement Documents – Not corrected. Refer to Finding No. 2015-001.

Finding No. 2014 – 002, CIP Project Monitoring – Not corrected. Refer to Finding No. 2015-002.

Finding No. 2015 – 001, Procurement Documents – Not corrected. Refer to Finding No. 2016-001.

Finding No. 2016 – 002, CIP Project Monitoring – Not corrected. Refer to Finding No. 2016-002.