FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2011 AND 2010

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

Years Ended December 31, 2011 and 2010
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia Petroleum Corporation:

We have audited the accompanying statements of net assets of Federated States of Micronesia (FSM) Petroleum Corporation (the Company), a component unit of the FSM National Government, as of December 31, 2011 and 2010, and the related statements of revenue, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2011 and 2010, and changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 28, 2012, 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* and should be considered in assessing the results of our audit.

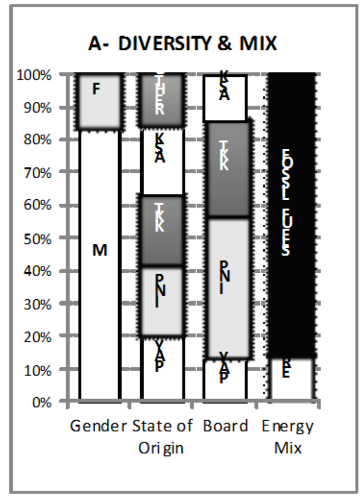
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 to 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basis financial statements in an appropriate operational, economic, or historical context. This supplementary information is the responsibility of the Company's management. 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.

Deloitte & Touche LLP

June 28, 2012

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 it has sufficient resources to maintain assets, train people, hold strategic oil inventories, and provide petroleum products in full, on-time, and to international specifications.



We utilise workplace diversity (refer A) to capitalize on the talents of our employees from diverse backgrounds. These differences enrich, expand, and provide the competitive edge needed to address the challenges that face the business into the future.

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, or laterally into alternative energy technologies with an aim of improving the energy security of the nation. This continues to be a challenge given the significant reliance on fossil fuels compared to renewable energy (RE) recorded within the country (refer A).

BUSINESS PLANNING

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

The Company has an annual business plan that sits within a multi-year development window defined by our Mission and Vision Statements. In 2011, the Company's first five year Strategic Plan was adopted. It highlights significant opportunities for organic growth, greater operational efficiency, and synergistic value creation from regional expansion.

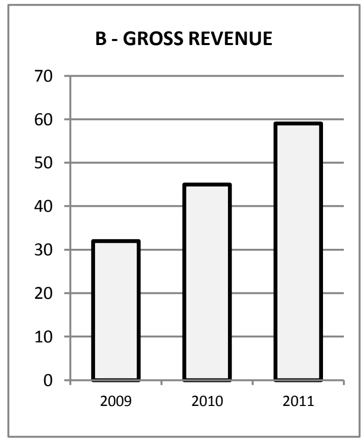
Our results have again demonstrated the strength of a simple business model that is committed to a long-term vision, investing with discipline and improving operational efficiency. As a result, we consistently generate more income from an efficient capital base. We deliver industry-leading financial and operating results that grow long-term shareholder value.

RISK MANAGEMENT

A comprehensive assessment of high risks within the business has been completed for each operating unit and for the enterprise as a whole. 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.

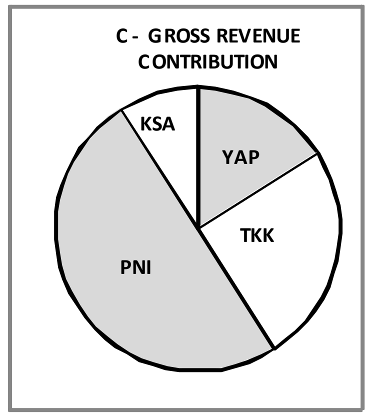
SUMMARY OF OPERATIONS

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. Gross revenues for FY11 were $59.2 million. Gross revenue contributions (refer C) were Kosrae State 9%, Yap State 16%, Chuuk State 25% and Pohnpei State 50%, with a product mix of automotive diesel oil 53%, unleaded petrol (or gasoline) 34%, home kerosene and Jet A1 of 10%, and other revenues of 3%.



International Oil Prices

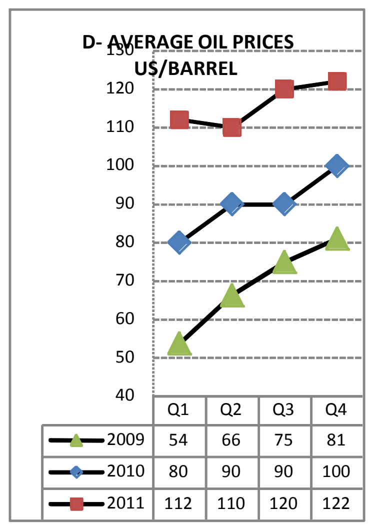
International oil prices continued to press upwards throughout 2011 over 2010. The average oil price increased steadily from $100/bbl at the end of 2010, to a high exceeding $120/bbl (refer D). In 2011, the cost of importing oil to meet the energy requirements of the nation increased in excess of $9MM, and almost $20MM since 2010. The growth of our gross revenues bear a direct correlation to international oil prices as a result of our domestic price policy framework.



Domestic Pricing Arrangements

We continue to utilize a Pricing Policy Framework (PPF) that converts these cost increases into domestic prices. There are no cross subsidies within the PPF, and our prices in each State reflect the costs of procuring, financing, storing, handling and distribution of fuels in that State.

Throughout 2011, the PPF adopted a monthly price change to public utilities and large contract markets and quarterly price changes to service stations. This strategy provided consumers with stable, and reasonable energy prices for homes, business, and government through the price spikes over the period.



Financial Condition

The financial statements reveal that the Company continues 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. The reinvestment program has positively impacted our overall debt-to-equity ratio, decreasing from a high of 75% in 2009 to 25% in 2011. The following table summarizes the Company financial position for calendar year 2011, 2010 and 2009, respectively.

Assets:	**2011**	**2010**	**2009**
Property, plant and equipment	$ 8,707,118	$ 7,042,956	$ 5,787,083
Cash and cash equivalents	6,201,192	7,626,408	1,687,075
Inventory on hand	7,956,135	5,730,415	5,600,568
Receivables and other current assets	3,586,182	2,548,482	3,040,277
Total Assets	$ 26,450,627	$ 22,948,261	$ 16,115,003
Current liabilities	$ 2,636,275	$ 1,866,394	$ 1,560,014
Notes payable - long term	4,071,272	5,561,268	4,729,453
	6,707,547	7,427,662	6,289,467
Net assets:			
Invested in capital assets, net of related debt	6,055,923	3,420,136	1,158,500
Unrestricted	13,687,157	12,100,463	8,667,036
	19,743,080	15,520,599	9,825,536
Total Liabilities and Net Assets	$ 26,450,627	$ 22,948,261	$ 16,115,003

Revenues, Expenses and Changes in Net Assets:	**2011**	**2010**	**2009**
Operating revenues and others	$ 59,207,576	$ 51,540,037	$ 41,960,542
Cost of goods sold	(47,881,765)	(39,776,511)	(30,050,741)
Gross margin	11,325,811	11,763,526	11,909,801
Operating expenses	(7,004,264)	(5,802,508)	(5,060,999)
Non-operating expenses	(99,066)	(265,955)	(506,150)
Changes in net assets	$ 4,222,481	$ 5,695,063	$ 6,342,652

Major changes in the balance sheet components for CY11 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 Notes with banks remained at a zero balance in CY2011, as a result of prudent cash management, and all cash surpluses generated from the operation were used to retire the short-term notes with BOG and FSMDB.

b) at the end of December 31, 2011, the Company's Long-Term Notes with Bank of Guam for the initial acquisition of fixed assets from Mobil Oil Micronesia Inc. amounted to:

- $2,651,195, of which $526,586 was classified as the current portion of the Note. The principal amount paid during CY2011 was $971,625.

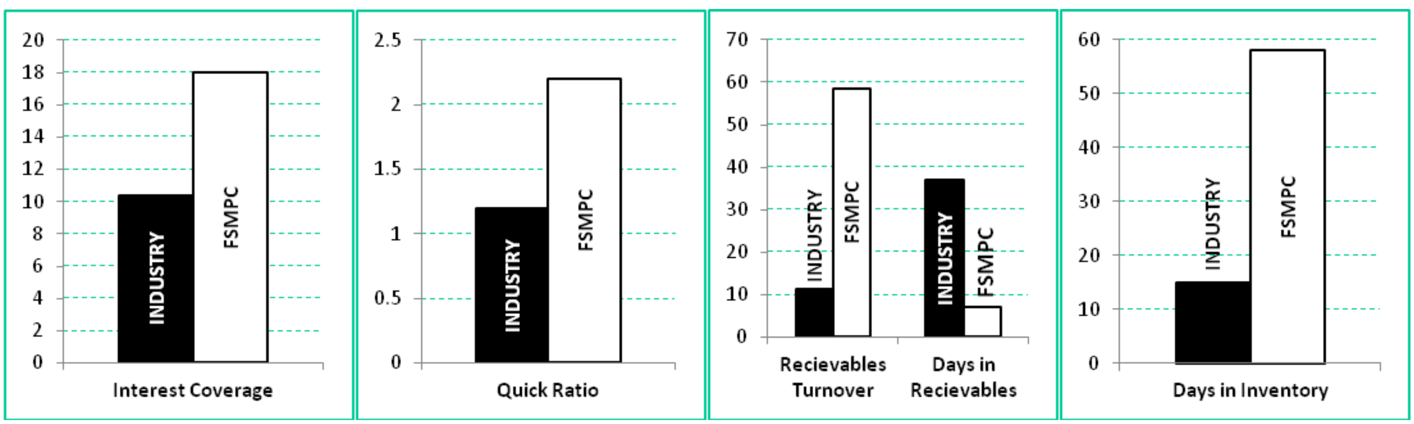
For additional information concerning debt, please refer to Note 5 to the financial statements.

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 $2,075,104 as compared to $9,072,922 for the 12 months of operation in CY2010.

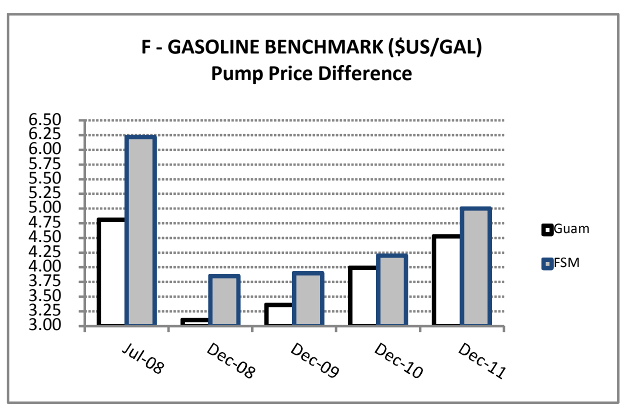
d) $2,329,823 used for capital and related investing activities for the purchase of Property, Plant and Equipment to bring the total investment at December 31, 2011, net to $8,707,118. The Corporation's total investments in Property, Plant and Equipment for 2010 and 2009 were $7,042,956 and $5,787,082, net of accumulated depreciation of $1,202,058 and $597,555, respectively. For more information concerning capital assets, please refer to Note 3 to the financial statements.

Benchmarking of Competitiveness

In 2011, we completed our first triennial analysis of the operational and financial performance of FSMPC and compared it to industry composite data. Research was based on relevant Standard Industrial Classification ("SIC") and North American Industry Classification System ("NAICS") sectors comparable to our operations. From a universe of over 7,730 companies within select industry peer groups, the analysis was narrowed down to those companies with revenues between $25MM - $49.99MM. A total of 255 firms were deemed as similar in nature to enable comprehensive benchmarking. The analysis of our operations included liquidity, activity, coverage, and leverage of the company against the industry average.



Liquidity ratios measure the quality and adequacy of current assets to meet current obligations as they become due. Our high ratios as compared to the Industry demonstrates that the Company now has adequate/sufficient current assets to meet its current obligations and is well placed to commence the necessary investments into renewable energy based technologies to diversify its energy portfolio and business risk.



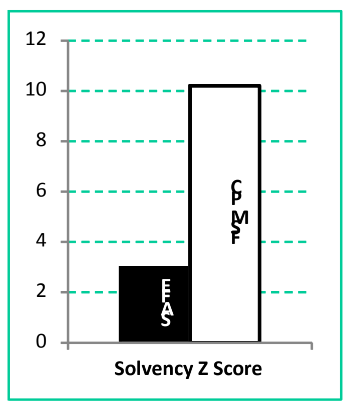
There are several measures used to analyze how well the business is utilizing its assets and how efficiently it is managing the activity of the business. The *receivables turnover* measures the number of times accounts receivables turn over during the year. The *inventory turnover* is a multiple that measures how quickly the Company converts its inventory to sales, and the working capital turnover is a measure of a company's sales to its underlying working capital. This ratio measures how efficiently working capital is employed.

FSMPC is faster than the industry in the collection of its receivables. FSMPC's low inventory turnover multiple indicates that it is converting its inventory into sales at a slower pace than the industry. This is directly related to the high *days in inventory*, and attributed to the significantly long, complex ocean supply chains used for the transportation of petroleum products from Singapore to the FSM. Unlike many of the firms benchmarked against, to maintain freight economics, cargos are received into the locations once a month, and a significant increase in the onshore strategic petroleum reserves.

Petroleum prices are amongst the most easily comparable data around the world, and the company benchmarks domestic price competitiveness (refer F) with main regional centers by comparing public pump prices in Guam and in Samoa. In July 2008, the observable price difference at the pumps was approximately $1.40 per gallon and $1.10 per gallon between FSM, and Guam and Samoa, respectively. At the end of CY08, this was reduced to $0.80 per gallon, end CY09, $0.65 per gallon. In CY10 and CY11 the difference was $0.25 and $0.45 per gallon, respectively, as a result of price timing effects. It is anticipated that the observable price difference will remain within this range for the next 12 months.

Resellers of petroleum products in the FSM continue to make significant returns in comparison with other regional markets (Refer G), presumably due to the fact that in Palau, Guam and Fiji, petroleum wholesalers also retail products through company owned service station outlets, and control retail margins. The Company does not set retail prices or margins in the FSM, and in a number of States, is prohibited from being both a wholesaler and retailer of petroleum products.

The Company continues to be a significant contributor to State and National Governments through gross revenue taxes, import duties, sales taxes, land lease payments and other associated government fees and charges. Total payments for various District, State and National government fees and charges exceeded $3.9 million in CY11. This comprised approximately $2.6 million in the form of gross revenue taxes and import duties, and $1.3 million directly to the various Municipal and State Governments or Agencies for sales taxes and land leases. The pending tax reform which will see introduction of a value added tax (VAT) and net profit tax (NPT) is expected to increase the tax burden as compared to the status quo.

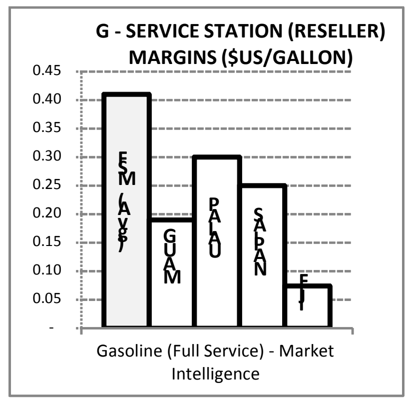


Our final assessment of the Z-score, a figure that indicates the likelihood that a business could fail. The Z-score is calculated using information about the relative levels of a business's assets, sales, profits, etc. This measure is correct about 90% of the time in calculating if a business will go bankrupt within one year. A higher score is a positive sign, with a score over 2.99 meaning the company is "safe". A Z-score of 0 is equal to a 50% probability of bankruptcy. This final assessment demonstrates that the Company, with continuous prudent financial management and investment into risk management and mitigation is an extremely safe investment and operation.

Management's Discussion and Analysis for the period December 31, 2010 is set forth in the report on the audit of FSMPC's financial statements, which is dated March 15, 2011. That Discussion and Analysis explains the major factors impacting the 2010 financial statements and may be obtained from the contact shown on page 9.

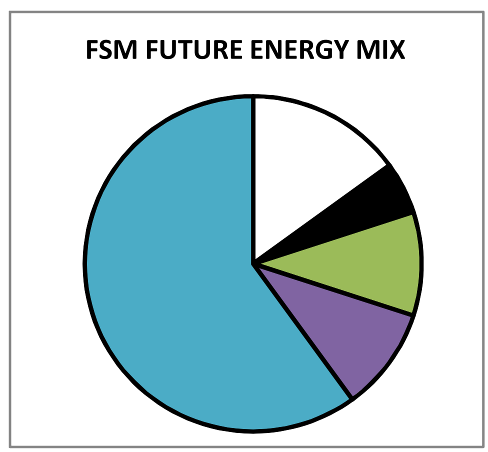
ECONOMIC OUTLOOK

Economic conditions in Europe and North America remain volatile. These are uncertain economic times and there is little hope of conditions improving soon, as global markets continue to adjust. The FSM, like most Pacific Island countries, is geographically challenged and remains dependent on economic assistance from development partners and of course the Compact of Free Association. The Secretariat of the Pacific Community recently released their report indicating that of the 22 countries they serve, at least 10 will not have a viable private sector, a fact that needs to be accepted and understood before large economic development expectations are heaped on growth objectives in the Pacific region.



The FSM economy faces similar challenges, and through the outlook for 2012 onwards is brighter as a result of relatively better global prospects, company projections indicate that growth may be slower than 2011, simply because of what is happening in the rest of the world, the Europe debt situation, the Arab Spring and other geopolitical tensions that affect both the strength of the US dollar and the price of oil in the international market.

The fiscal policies of Guam and the FSM will continue to have an impact on final energy prices to consumers, as the costs of transshipping goods through Guam continue to increase, and as tax reforms provide increases in government general fund revenues.



Energy markets have remained volatile throughout 2008 through 2011. Looking ahead, the long-term outlook is one of growing demand for energy, particularly in Asia, alongside challenges for the industry in meeting this demand. The International Energy Agency's (IEA) Reference Scenario expects global energy demand to increase by around 40% between 2007 and 2030. That scenario also projects that fossil fuels will still be satisfying as much as 80% of the world's energy needs in 2030.

A diverse mix of energy will be required to meet this increased demand, and what is certain is that prices will continue a gradual rise as the global oil supply and demand attempts to achieve equilibrium. For Micronesia, such a mix must include renewable energy sources such as wind, biofuels and solar power, however, even in the most aggressive scenario put forward by the IEA, these forms of energy are estimated to meet no more than 5% of total global demand in 2030.

With appropriate international and development partner assistance, the Company estimates that for the FSM a 45% renewable energy mix can be achieved within 10 years. Alternative energy from domestic resources will prove to make the most significant contribution to a more resilient economy when the Compact Funding with the U.S. ceases. FSMPC expects to play a strategic, if not central, role in this process as the nation's largest supplier of core energy needs now and in the future.

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 Assets
December 31, 2011 and 2010

ASSETS		2011		2010
Current assets:				
Cash	$	6,201,192	$	7,626,408
Trade receivables		1,505,502		593,833
Due from employees		7,716		29,377
Inventory		7,956,135		5,730,415
Deposit with supplier		1,216,265		1,022,678
Prepaid expenses		341,270		387,971
Total current assets		17,228,080		15,390,682
Time certificate of deposit		515,429		514,623
Property and equipment, net		8,707,118		7,042,956
	$	26,450,627	$	22,948,261

LIABILITIES AND NET ASSETS		2011		2010
Current liabilities:				
Current portion of long-term debt	$	526,586	$	456,347
Current portion of due to states and primary government		668,313		-
Accounts payable		306,072		481,326
Accrued liabilities and others		1,135,304		928,721
Total current liabilities		2,636,275		1,866,394
Long-term debt, net of current portion		2,124,609		3,166,473
Due to states and primary government, net of current portion		1,946,663		2,394,795
Total liabilities		6,707,547		7,427,662
Contingencies				
Net assets:				
Invested in capital assets, net of related debt		6,055,923		3,420,136
Unrestricted		13,687,157		12,100,463
Total net assets		19,743,080		15,520,599
	$	26,450,627	$	22,948,261

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 Assets
Years Ended December 31, 2011 and 2010

	2011	2010
Operating revenue:		
Sales and service income	$ 59,060,690	$ 51,366,135
Recovery of bad debts	-	92,545
Other	146,886	81,357
	59,207,576	51,540,037
Cost of goods sold	47,881,765	39,776,511
Gross profit	11,325,811	11,763,526
Operating expenses:		
Taxes	1,721,621	1,499,509
Salaries and benefits	1,098,283	996,704
Depreciation	764,661	604,562
Professional fees	677,437	524,267
Rent	424,464	548,749
Repairs and maintenance	366,281	164,602
Insurance	293,241	302,153
Corporate governance	285,094	108,612
Contracted services	197,666	181,537
Office supplies	174,500	144,819
Staff travel, training and development	164,376	94,058
Communications	153,218	117,836
Utilities	132,982	129,933
Fuel	97,690	72,722
Miscellaneous	452,750	312,445
Total operating expenses	7,004,264	5,802,508
Operating income	4,321,547	5,961,018
Nonoperating expenses:		
Interest expense	(99,066)	(265,955)
Change in net assets	4,222,481	5,695,063
Net assets at beginning of year	15,520,599	9,825,536
Net assets at end of year	$ 19,743,080	$ 15,520,599

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, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash received from customers	$ 58,295,907	$ 51,810,730
Cash paid to suppliers for goods and services	(55,215,179)	(41,722,058)
Cash paid to employees for services	(1,005,624)	(1,015,750)
Net cash provided by operating activities	2,075,104	9,072,922
Cash flows from noncapital financing activities:		
Interest paid on bank line of credit facility	-	(11,185)
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(2,329,823)	(1,833,393)
Principal repayment of long-term debt	(971,625)	(1,005,763)
Interest paid on long-term debt	(198,872)	(283,248)
Net cash used for capital and related financing activities	(3,500,320)	(3,122,404)
Net change in cash	(1,425,216)	5,939,333
Cash at beginning of year	7,626,408	1,687,075
Cash at end of year	$ 6,201,192	$ 7,626,408
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 4,321,547	$ 5,961,018
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	764,661	604,562
Purchase of fuel	220,181	1,894,795
(Increase) decrease in assets:		
Trade receivables	(911,669)	270,693
Due from employees	21,661	(19,047)
Inventory and related deposit with supplier	(2,419,307)	445,606
Prepaid expenses	46,701	(333,868)
Increase in liabilities:		
Accounts payable	(175,254)	144,468
Accrued liabilities and others	206,583	104,695
Net cash provided by operating activities	$ 2,075,104	$ 9,072,922

Non-cash operating activity:

In 2011 and 2010, the Company purchased from its supplier the equivalent gallons of fuel in the amount of $220,181 and $1,894,795, respectively, 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

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.

(2) Summary of Significant Accounting Policies

The accounting policies of FSMPC conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. FSMPC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, establish standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following three net asset categories:

- Invested in capital assets, net of related debt: capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

- Restricted: Nonexpendable - Net assets subject to externally imposed stipulations that require the Company to maintain them permanently. As of December 31, 2011 and 2010, the Company does not have nonexpendable restricted net assets. Expendable - Net assets whose use by the Company is subject to externally imposed stipulations that can be fulfilled by actions of the Company pursuant to those stipulations or that expire with the passage of time.

(2) Summary of Significant Accounting Policies, Continued

- Unrestricted: Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Operating and Non-Operating Revenue 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.

Cash and Time Certificates of Deposit

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 assets and of cash flows, cash represents cash on hand and cash in bank accounts. Time certificates of deposit with an original maturity in excess of ninety days are separately classified. As of December 31, 2011 and 2010, the carrying amounts of cash and time certificates of deposit were $6,716,621 and $8,141,031, respectively, and the corresponding bank balances were $6,785,882 and $8,177,890 respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2011 and 2010, bank deposits in the amount of $608,166 and $250,000, respectively, were subject to FDIC insurance. Balances in excess of FDIC insurance are not collateralized.

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.

Inventory

Inventory is substantially carried at the lower of cost (moving average cost) or market.

(2) Summary of Significant Accounting Policies, Continued

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

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 $99,000 and $27,042 for the years ended December 31, 2011 and 2010, respectively.

Taxes

Corporate profits of major corporations are subject to 21 percent income tax in the FSM. Corporations not classified as major corporations are instead imposed a gross receipts tax of 3% on revenues. The Company is responsible for gross receipt taxes, sales taxes and import taxes on its operations in the FSM. The Company is a major corporation. A legal opinion is being sought to state that the Company is not subject to the 21 percent income tax.

New Accounting Standards

During fiscal year 2011, the Company implemented the following pronouncements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.

- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, and Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses 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 provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

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 December 2010, GASB issued 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 provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

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.

Reclassification

Certain account balances in the 2010 financial statements have been reclassified to correspond with the 2011 presentation.

(3) Property, Plant and Equipment

Capital asset activities for the year ended December 31, 2011 are as follows:

	Balance at January 1, 2011	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2011
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) Property, Plant and Equipment, Continued

Capital asset activities for the year ended December 31, 2010 are as follows:

	Balance at January 1, 2010	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2010
Buildings	$ 380,329	$ 14,611	$ -	$ 394,940
Motor vehicles	286,190	261,096	-	547,286
Plant and equipment	4,812,337	25,655	-	4,837,992
Furniture and fixtures	33,026	15,192	-	48,218
Office equipment	862,476	491,618	-	1,354,094
Machinery and equipment	10,280	138,070	-	148,350
	6,384,638	946,242	-	7,330,880
Less accumulated depreciation	(597,555)	(604,562)	-	(1,202,117)
	5,787,083	341,680	-	6,128,763
Construction in progress	-	1,438,616	(524,423)	914,193
	$ 5,787,083	$ 1,780,296	$ (524,423)	$ 7,042,956

(4) Due to States and Primary Government

In 2008, the FSMNG was extended a grant by the Government of Japan amounting to ¥200,000,000 ("the Grant"). The Grant and its 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 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, 2011 and 2010, FSMPC recognized a liability to the States and FSMNG equivalent to the grant amount of $2,114,976 and $1,894,795, 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 statement of net assets.

The rest of the portion of due to primary government represents a $500,000 non-interest bearing advance from the FSM National Government. There is no specific repayment terms associated with the advance and management has classified the advance as long-term since it has no expectation that such will have to be repaid before December 31, 2012. The advance has been deposited in a time certificate of deposit, which has been similarly classified as long-term.

(5) Long-term Debt

Long-term debt consists of the following:

	2011	2010
Note payable to bank 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, unconditionally guaranteed by the FSM National Government. The loan is essentially collateralized by all assets of FSMPC.	$ 2,651,195	$ 3,622,820

Future repayment requirements to maturity for principal and interest are as follows:

Year Ending December 31,	Principal	Interest	Total
2012	$ 526,586	$ 168,796	$ 695,382
2013	564,653	130,729	695,382
2014	605,472	89,910	695,382
2015	649,241	46,141	695,382
2016	305,243	5,665	310,908
	$ 2,651,195	$ 441,241	$ 3,092,436

(6) Short-Term Borrowings

As of December 31, 2011 and 2010, the Company has two bank line of credit facilities (LOC) of $4,300,000. The LOC is evidenced by promissory notes drawn on various dates for various amounts. This line of credit 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.

There were no changes in short-term borrowings for the year ended December 31, 2011.

Changes in short-term borrowings for the year ended December 31, 2010 were as follows:

	Beginning Balance	Increases	Reductions	Ending Balance
Line of credit facility	$ -	$ 2,000,000	$ (2,000,000)	$ -

(7) Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended December 31, 2011 was 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

Changes in long-term liabilities for the year ended December 31, 2010 was as follows:

	Balance at January 1, 2010	Additions	Repayments	Balance at December 31, 2010	Due Within One Year
Note payable	$ 4,628,583	$ -	$ (1,005,763)	$ 3,622,820	$ 456,347
Due to states and primary government	500,000	1,894,795	-	2,394,795	-
	$ 5,128,583	$1,894,795	$(1,005,763)	$ 6,017,615	$ 456,347

(8) Risk Management

The Company has adopted the International Standards Organization 150:31000 (2009) Standards on 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.

(9) Significant Customers

Total revenues from one major customer for the years ended December 31, 2011 and 2010 approximated 20 percent and 18 percent, respectively, of the Company's total revenues.

The Company purchased substantially all fuel from one supplier in 2011 and 2010.

(10) Commitments

Leases

The Company leases land, warehouse, airport facilities and other such space through various leases expiring through 2023. Some lease agreements afford the Company option to renew the lease periods subject to escalation of the lease consideration. Three lease agreements require additional lease payments contingent on the level of gallons sold by the Company from that leased facility.

The future minimum lease payments are as follows:

Year Ending December 31,	
2012	$ 397,204
2013	397,204
2014	330,448
2015	327,854
2016	327,854
2017-2021	1,299,062
2022-2023	271,725
	$ 3,351,351

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.

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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*

Board of Directors
Federated States of Micronesia Petroleum Corporation:

We have audited the financial statements of Federated States of Micronesia Petroleum Corporation (the Company) as of and for the year ended December 31, 2011, and have issued our report thereon dated June 28, 2012. We conducted our audit 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.

Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Company's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting.

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 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free of 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 28, 2012.

This report is intended for the information and use of the Board of Directors, management, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

June 28, 2012

Unresolved Prior Year Findings
Year Ended December 31, 2011

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