FEDERATED STATES OF MICRONESIA PETROLEUM CORPORATION

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED DECEMBER 31, 2018 AND 2017 (AS RESTATED)

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

Years Ended December 31, 2018 and 2017
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Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3973
USA

Tel: +1 (671) 646-3884
Fax: +1 (671) 649-4265

www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Federated States of Micronesia Petroleum Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Federated States of Micronesia (FSM) Petroleum Corporation (the Company) and its discretely presented component unit, collectively a component unit of the FSM National Government, as of and for the years ended December 31, 2018 and 2017, 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, 2018 and 2017, 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

As discussed in Note 12 to the financial statements, the 2017 financial statements have been restated to correct an error. 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 8 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 July 9, 2019, 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 solely 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 the effectiveness of the Company's 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

July 9, 2019

STRATEGIC OBJECTIVES

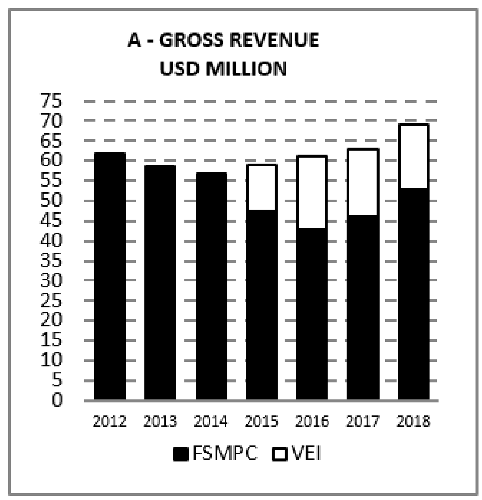
The primary long-term role and function of the Federated States of Micronesia Petroleum Corporation (FSMPC or "the Corporation") is to secure a stable supply of petroleum products to meet the nation's core energy needs. In addition, as a result of Public Law 18-68 entitled "The Coconut Tree Act", the 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 to ensure 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 and rehabilitate 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, and is the responsible entity for operations in Guam and Nauru. A supply and terminal operating agreement with the Government of Nauru remains in place.

An FSM 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 four States that we operate.

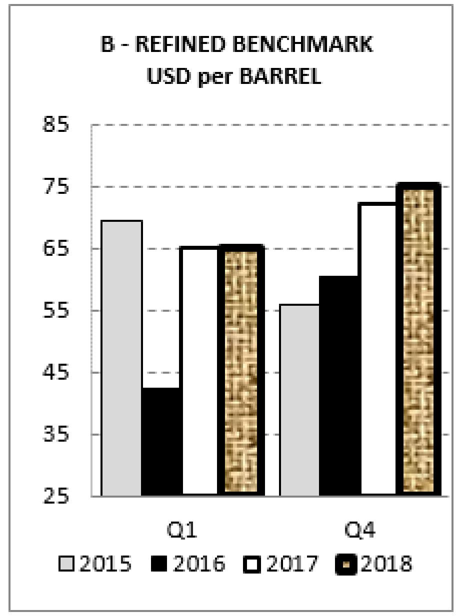
A Nauru Pricing Template (NPT) negotiated with the Government of Nauru provides the mechanism to earn a return-on-investment commensurate with the risks of operating in Nauru. The NPT has a similar stabilization mechanism for domestic prices, and cushion the effect of international volatility.

The Corporation continues to benchmark domestic price competitiveness through comparison of pump prices of island neighbors. Throughout CY18, domestic prices in the FSM remained stable, and by and large remain below benchmark Guam pump prices.

Pricing practices did not change throughout 2018. The PPF and NPT maintained scheduled price adjustments in accordance with various price instruments 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, it is expected to undergo a review in 2019.

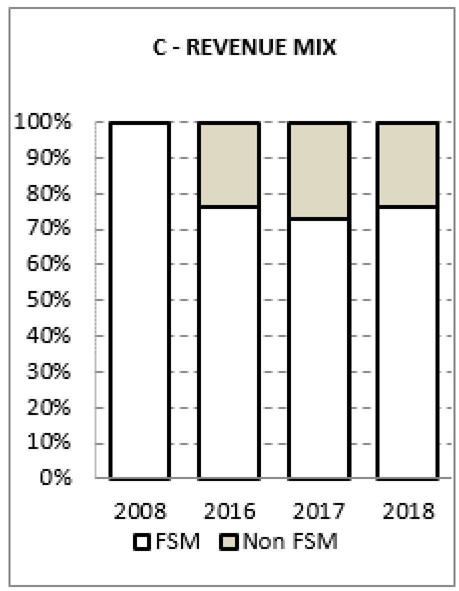
Revenues

Over 97% of the Corporation's revenues remain petroleum fuels related. Revenues are directly linked to the international oil markets and the adjustment mechanisms in the PPF and NPT that accommodates international oil price increases or decreases. Therefore, throughout 2018, revenues have increased with rising global oil prices.



January 2018 started in the mid $US65/bbl. By December 2018, it had reached the mid $70/BBL, closely following the seasonal trends of 2017. The refined product benchmark average for CY2018 was overall higher than 2017 (refer Graph B), corresponding to higher gross revenues, and higher costs of goods for the period.

FSMPC revenues have risen 12% from $47 million in 2017 to $53 million in 2018 (refer Graph A) as higher 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 $16 million improving the revenue mix considerably (refer Graph C).



As a result, the Corporation has managed to retain a consolidated gross revenue of the Group at $69 million. (refer Graph A) with business unit contributions of Kosrae 8%, Yap 10%, Chuuk 21%, Pohnpei 37%, Guam and Nauru 24%. Automotive diesel oil remains the highest revenue component at 44%, followed by unleaded petrol (or gasoline) 34%, and home kerosene and Jet A1 of 16%. Non-fuel related revenues from power plant electricity sales as well as coconut related products are approximately 5% 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 (MOMI), Total Oil Asia Pacific (TOAP), and ExxonMobil Aviation (EMA). Throughout 2018, we maintained Winson Oil (HK) Limited and Pacific Bulk Fuels (NZ) Limited as product suppliers to the Corporation. There were no changes in primary product suppliers in 2018.

Investment and Business Planning

The Statement of General Business Principles (SGBP) in 2018 is to accommodate an additional corporate value, and a new stakeholder group – farmers and small producer groups. 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 2018.

The Strategy Execution Team (SET) has now been resourced and is executing the various initiatives within the 2016 Strategic Plan. An annual business planning process has been maintained and supported by Programs that have a three-year planning, outcomes, and deliverables horizon. These core business processes are now under oversight and a continuous improvement cycle.

The Board and Management continue to investigate options to outsource activities, enter into equipment leasing arrangements, utilize joint ventures to meet much of the capital requirements of the business, as well as to transfer risks to entities that are more equipped to manage them. The Investment Appraisal Framework adopted by the Board in 2015 remains in place. The appraisal framework provides clear guidelines to management for all investments made by the Corporation.

Risks & Risk Management

The risk management system is designed for compliance with the ISO31000:2009 international standard for Risk Management. The organizational risk architecture has been established with a Board Committee on Risk and Audit (CoRA) who are accountable for enterprise level risks, remedial action plans, and business internal controls. The risk architecture, strategy and protocols used across the business are in a constant oversight and continuous improvement process.

Risks and uncertainties that face the business include:

- *Talent and the Talent Pipeline*: The commercial structure, as well as the technology utilized in the domestic energy sector is changing rapidly. An agile, adaptive team is required as the sector, and the business transforms;

- *Extreme weather events and natural disasters*: Environmental risks are of a growing risk value in our operations due to both likelihood and consequence;

- *Substitute energy products and alternatives*. Renewable energy for baseload electricity applications in small island states are now a commercially viable, and a financial imperative. This will threaten the extant business models of power utilities and fossil fuel suppliers alike;

- *Low or no cost energy transformation capital*. A significant inflow of aid has been targeted within the 2018 Energy Master Plan. The master plan seeks to reduce diesel fuel consumption for power generation by up to eighty (80%) over the coming decade. It will be difficult for the Corporation to transform its business model by offering commercially competitive renewable energy alternatives against these projects;

- *Cyber security and Cyber Attacks* are increasing in frequency and complexity. The Corporation has continued to be subject to an increased number of attacks in recent years. Technology remains a primary enabler of our competitiveness and any threat to our applications or the network will only increase the complexity, and costs of doing business; and

- *Aging petroleum distribution infrastructure.* The assets of the Corporation are aging, and while petroleum products remain the primary energy driver of the economy, need to undergo various upgrades to meet the current code requirements for such facilities.

Organizational resources continue to be allocated primarily towards risk management, and to reduce uncertainty in the business. The organizational risk architecture demonstrates five (5) levels of assurance that supports enhanced oversight of major and significant risks in the business.

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, improvements 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 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 and for the years ended December 31, 2018, 2017, and 2016.

	2018	2017 (As Restated)	2016 (As Restated)
Assets:			
Capital assets, net	$ 22,051,917	$ 18,938,830	$ 16,350,090
Current and other assets	43,357,970	39,923,374	33,167,589
Total assets	$ 65,409,887	$ 58,862,204	$ 49,517,679
Liabilities and Net Position:			
Current liabilities	$ 8,866,386	$ 8,159,099	$ 5,659,971
Noncurrent liabilities	8,277,261	4,067,394	2,284,049
Net position:			
Net investment in capital assets	14,705,464	16,071,791	16,350,090
Unrestricted	33,560,776	30,563,920	25,223,569
Total net position	48,266,240	46,635,711	41,573,659
Total liabilities and net position	$ 65,409,887	$ 58,862,204	$ 49,517,679
Revenues, Expenses and Changes in Net Position:			
Operating revenues	$ 52,845,891	$ 47,017,995	$ 42,763,730
Cost of goods sold	(36,676,238)	(30,419,682)	(25,871,124)
Gross profit	16,169,653	16,598,313	16,892,606
Operating expenses	(14,014,857)	(11,828,896)	(12,124,975)
Nonoperating (expenses) revenues	(524,267)	292,635	115,595
Change in net position	$ 1,630,529	$ 5,062,052	$ 4,883,226

Major changes in the profit and loss and statement of net position components for CY18 are a result of:

a) The Corporation increased its one-year term Line of Credit with Bank of Guam (BOG) from $10M to $11M. The short term note with banks remained at a zero balance in CY2018 as a result of prudent cash management. The Corporation continues to invest its operating surplus into capital expenditure to reduce operating risks and strengthen oil distribution infrastructure, into strategic oil inventory to increase the energy security of the nation, and to execute its strategy (VT2025) for the long term sustainability of the Corporation;

b) The higher operating expenses for 2018 are directly attributed to the support required for the various strategic planning initiatives implemented during the year. 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 2018 was $3,275,146 as compared to $6,516,303 in 2017;

c) A total of $619,830 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, 2018 and 2017 were $22,051,917 and $18,938,830, respectively.

CAPITAL ASSETS AND DEBT MANAGEMENT

Capital Assets and Long-Term Debt: At the end of CY2018, the Corporation had $22 million invested in capital assets. This represents an increase in net capital assets (including additions and deletions) of $3.1 million or 16% over the previous year. For additional information about the Corporation's capital assets, refer to Note 3 to the financial statements.

The Corporation had a long-term debt of $7.3 million outstanding at December 31, 2018. In 2018, the Corporation entered into a $5M bank loan for the purpose of financing the construction of capital asset projects. For additional information about the Corporation's long-term debt, refer to Note 6 to the financial statements.

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 Utilities Corporation (PUC), Kosrae Utilities Authority (KUA), Yap State Public Service 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]. This has remained largely unchanged throughout 2018, with the exception of YSPSC that has seen a reduction in fuel sales as a result of the energy efficiency and renewable energy projects commissioned in 2017/18. An increase in these types of aid funded energy efficiency and renewable energy projects have been planned over the coming decade. If the projects are implemented as per the 2018 FSM Energy Master Plan, we anticipate a significant reduction of diesel sales to the power utilities.

[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

A partnership with the Micronesian Conservation Trust (MCT) was formalized to aid in the delivery of community awareness activities, and farmer registration for the Coconut for Life program. Early reports indicate positive response from participating communities on the proposed coconut trading framework, and in particular, the Participatory Guarantee System (PGS) specifically designed to aid in the coordination of farmers and management of community-based enterprises. In 2018, the focus has been on the trial of the framework, and registration of farmers and pilot PGS's, and the registration of community enterprises throughout the State of Pohnpei. It is expected that in 2019, we should see a sustainable and steady increase in coconut production by smallholder farmers, and an increase in trade with formalized community-based enterprises, and ultimately an increase in the sale and export of value added products manufactured at the Pohnpei facility. The engagement process will continue in the States of Chuuk and Kosrae in 2019, to commissioning of the new integrated coconut processing facility on Tonoas, Chuuk.

A Bill for an Act entitled the "Transformation Act" is with the FSM Congress, and it seeks to provide further support for a cleaner, greener economy. The proposed Act provides clarity and direction on the role of the FSMPC moving into the next decade, and the need to transform its business model from a successful fossil fuel importer and distributor to that of: i) a low cost carbon free energy supplier, and ii) an exporter of high value agriculture products. It is in these areas that the Corporation can obtain organic growth, as well as contribute to the economic development within the FSM.

Management's Discussion and Analysis for the year ended December 31, 2017 is set forth in the report on the audit of FSMPC's financial statements, which is dated June 28, 2018. That Discussion and Analysis explains the major factors impacting the 2017 financial statements and may be obtained from the contact shown 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.

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

Statements of Net Position
December 31, 2018 and 2017

ASSETS		2018		2017 (As Restated)
Current assets:				
Cash and cash equivalents	$	20,018,916	$	16,697,519
Trade receivables		1,772,508		1,545,563
Due from component unit		1,931,856		1,504,747
Other receivables		88,091		92,560
Inventory, net		7,716,159		6,031,288
Prepaid expenses		1,631,661		2,275,885
Total current assets		33,159,191		28,147,562
Investments		2,131,619		2,300,339
Prepaid expenses, net of current portion		959,823		892,584
Due from component unit, net of current portion		6,539,391		7,988,129
Other noncurrent asset		567,946		594,760
Capital assets:				
Nondepreciable capital assets		8,785,660		7,087,413
Other capital assets, net of accumulated depreciation		13,266,257		11,851,417
	$	65,409,887	$	58,862,204

LIABILITIES AND NET POSITION		2018		2017 (As Restated)
Current liabilities:				
Current portion of long-term debt	$	816,575	$	547,028
Accounts payable - fuel		3,761,344		3,597,309
Accounts payable - other		882,254		1,065,112
Accrued liabilities and others		3,406,213		2,949,650
Total current liabilities		8,866,386		8,159,099
Long-term debt, net of current portion		6,529,878		2,320,011
Due to States and the FSM National Government		1,747,383		1,747,383
Total liabilities		17,143,647		12,226,493
Commitments and contingencies				
Net position:				
Net investment in capital assets		14,705,464		16,071,791
Unrestricted		33,560,776		30,563,920
Total net position		48,266,240		46,635,711
	$	65,409,887	$	58,862,204

See accompanying notes to financial statements.

VITAL ENERGY, INC.

Statements of Net Position
December 31, 2018 and 2017
Discretely Presented Component Unit

ASSETS	2018	2017
Current assets:		
Cash	$ 6,116,731	$ 8,896,598
Time certficates of deposit	400,000	400,000
Trade receivables	446,655	276,060
Inventory	7,886,225	5,616,378
Prepaid expenses	334,529	318,508
Total current assets	15,184,140	15,507,544
Deferred tax asset	133,000	-
Property and equipment, net	217,193	139,045
	$ 15,534,333	$ 15,646,589
LIABILITIES AND NET POSITION		
Current liabilities:		
Accounts payable	$ 2,406,999	$ 79,542
Accrued liabilities and others	794,066	1,072,434
Current portion of long-term debt	480,000	480,000
Due to primary government	1,931,856	1,504,747
Income tax payable	-	46,000
Other current liabilities	3,372	53,333
Total current liabilities	5,616,293	3,236,056
Deferred tax liability	-	8,000
Long-term debt, net of current portion	1,200,000	1,680,000
Due to primary government, net of current portion	6,539,391	7,988,129
Other noncurrent liability	682,141	463,844
Total liabilities	14,037,825	13,376,029
Commitments and contingencies		
Net position:		
Net investment in capital assets	217,193	139,045
Unrestricted	1,279,315	2,131,515
Total net position	1,496,508	2,270,560
	$ 15,534,333	$ 15,646,589

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, 2018 and 2017

	2018	2017 (As Restated)
Operating revenue:		
Sales and service income	$ 52,444,478	$ 46,738,447
Other	401,413	279,548
	52,845,891	47,017,995
Cost of goods sold	36,676,238	30,419,682
Gross profit	16,169,653	16,598,313
Operating expenses:		
Salaries and benefits	3,329,943	2,793,617
Depreciation and amortization	1,986,158	1,929,811
Taxes	1,409,540	1,212,082
Professional fees	1,403,202	1,240,935
Rent	1,184,880	1,022,226
Repairs and maintenance	1,123,858	674,019
Staff travel, training and development	867,456	802,972
Communications	478,545	321,841
Corporate governance	431,646	272,142
Insurance	364,159	310,789
Contracted services	345,641	301,407
Office supplies	234,518	176,303
Utilities	210,267	169,692
Fuel	71,452	65,569
Miscellaneous	573,592	535,491
Total operating expenses	14,014,857	11,828,896
Operating income	2,154,796	4,769,417
Nonoperating (expenses) revenues:		
Investment (losses) income	(168,719)	292,575
Interest (expense) income, net	(355,548)	60
Total nonoperating (expenses) revenues, net	(524,267)	292,635
Change in net position	1,630,529	5,062,052
Net position at beginning of year, as previously reported	46,635,711	42,498,783
Overstatement of inventory (Note 12)	-	(925,124)
Net position at beginning of year, as restated	46,635,711	41,573,659
Net position at end of year	$ 48,266,240	$ 46,635,711

See accompanying notes to financial statements.

VITAL ENERGY, INC.

Statements of Revenue, Expenses, and Changes in Net Position
Years Ended December 31, 2018 and 2017
Discretely Presented Component Unit

	2018	2017
Operating revenue:		
Sales and service income	$ 16,147,079	$ 16,567,138
Cost of sales and services	(13,113,281)	(13,184,689)
Gross profit	3,033,798	3,382,449
Operating expenses:		
Rent	543,539	576,304
Insurance	478,102	474,485
Corporate office shared services	383,171	224,280
Salaries and benefits	346,031	444,519
Professional fees	251,284	383,331
Gross revenue/receipt tax	173,322	178,017
Repairs and maintenance	140,112	129,808
Travel and entertainment	113,918	167,471
Contracted services	112,218	147,841
Communications	88,390	85,280
Staff training and development	63,644	23,838
Depreciation and amortization	60,278	73,430
Utilities	55,083	107,554
Fuel	48,053	34,256
Bank charges	35,842	57,013
Office supplies	18,629	34,392
Bad debt	18,288	-
Guam income tax (benefit) expense	(119,954)	40,446
Miscellaneous	95,390	90,575
Total operating expenses	2,905,340	3,272,840
Operating income	128,458	109,609
Nonoperating (expenses) revenues, net:		
Foreign exchange	(1,072,551)	733,765
Other income	103,275	-
Interest income	66,766	200,288
Total nonoperating (expenses) revenues, net	(902,510)	934,053
Change in net position	(774,052)	1,043,662
Net position at beginning of year	2,270,560	1,226,898
Net position at end of year	$ 1,496,508	$ 2,270,560

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, 2018 and 2017

	2018	2017 (As Restated)
Cash flows from operating activities:		
Cash received from customers	$ 52,618,947	$ 47,712,305
Cash paid to suppliers for goods and services	(46,013,858)	(38,402,385)
Cash paid to employees for services	(3,329,943)	(2,793,617)
Net cash provided by operating activities	3,275,146	6,516,303
Cash flows from capital and related financing activities:		
Proceeds from long-term debt	5,000,000	3,000,000
Repayment of long-term debt	(520,586)	(132,961)
Acquisition of capital assets	(5,099,244)	(4,518,551)
Net cash used for investing activities	(619,830)	(1,651,512)
Cash flows from investing activities:		
Collections from related parties	1,021,629	2,834,644
Investment (loss) income	(355,548)	60
Net cash provided by investing activities	666,081	2,834,704
Net change in cash	3,321,397	7,699,495
Cash and cash equivalents at beginning of year	16,697,519	8,998,024
Cash and cash equivalents at end of year	$ 20,018,916	$ 16,697,519
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 2,154,796	$ 4,769,417
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	1,986,158	1,929,811
(Increase) decrease in assets:		
Trade receivables	(226,945)	694,310
Other receivables	4,469	(7,556)
Inventory and related deposit with supplier	(1,684,871)	(434,462)
Prepaid expenses	576,985	(1,755,891)
Other assets	26,814	(94,760)
Increase (decrease) in liabilities:		
Accounts payable	(18,823)	1,797,610
Accrued liabilities and others	456,563	154,490
Due to States and primary government	-	(536,666)
Net cash provided by operating activities	$ 3,275,146	$ 6,516,303

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 operation in the Republic of Nauru for the purpose of providing fuel supply and distribution in Nauru under an agreement with the Government of Nauru (GON). Vital's main operations are in Guam and Nauru effective June 2015. Copies of Vital's financial statements can be obtained by contacting Vital management. Vital's significant notes are summarized in Note 2K.

(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, 2018 and 2017, total carrying amounts of cash and cash equivalents were $20,018,916 and $16,697,519, respectively, and the corresponding bank balances were $20,032,476 and $17,223,075, respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2018 and 2017, 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, 2018 and 2017, investments at fair value are as follows:

	2018	2017
Fixed income securities:		
Domestic fixed income	$ 478,941	$ 495,666
International fixed income	207,799	205,829
	686,740	701,495
Other investments:		
Common equities	887,663	1,020,710
Exchange traded funds	508,989	539,007
Money market funds	48,227	39,127
	1,444,879	1,598,844
	$ 2,131,619	$ 2,300,339

As of December 31, 2018, 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	$ 207,799	$ 207,799	$ -	$ -	$ -
Corporate bonds	200,506	14,664	14,726	145,761	25,355
U.S. Government Agency Bonds	278,435	-	177,511	61,013	39,911
	$ 686,740	$ 222,463	$ 192,237	$ 206,774	$ 65,266

(2) Summary of Significant Accounting Policies, Continued

B. Investments, Continued

As of December 31, 2017, 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	$ 205,829	$ 205,829	$ -	$ -	$ -
Corporate bonds	213,784	-	14,456	168,731	30,597
U.S. Government Agency Bonds	281,882	-	159,280	80,578	42,024
	$ 701,495	$ 205,829	$ 173,736	$ 249,309	$ 72,621

The Company's exposure to credit risk at December 31, 2018 and 2017, was as follows:

Moody's Rating	2018	2017
AAA	$ 278,436	$ 281,882
A2	44,887	43,943
A3	72,862	108,407
BAA1	40,167	30,740
BAA2	28,570	15,291
BAA3	14,019	15,403
Not rated	207,799	205,829
	$ 686,740	$ 701,495

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, 2018 and 2017:

		Fair Value Measurements Using		
	December 31, 2018	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	$ 686,740	$ -	$ 686,740	$ -
Equity securities	887,663	887,663	-	-
Exchange-traded funds	508,989	508,989	-	-
Total investments by fair value level	2,083,392	$ 1,396,652	$ 686,740	$ -
Investments measured at amortized cost:				
Money market funds	48,227			
	$ 2,131,619			

(2) Summary of Significant Accounting Policies, Continued

B. Investments, Continued

	December 31, 2017	Fair Value Measurements Using: 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	$ 701,495	$ -	$ 701,495	$ -
Equity securities	1,020,710	1,020,710	-	-
Exchange-traded funds	539,007	539,007	-	-
Total investments by fair value level	2,261,212	$ 1,559,717	$ 701,495	$ -
Investments measured at amortized cost:				
Money market funds	39,127			
	$ 2,300,339			

C. Accounts Receivable

Accounts receivable are due from businesses and individuals located in the FSM 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, 2018 and 2017, accounts receivables are net of an allowance of $5,822 and $0, respectively.

D. Inventory

Inventory is substantially carried at the lower of cost (moving average cost) or market value. At December 31, 2018 and 2017, inventory consists of the following:

	2018	2017
Inventory on hand:		
Fuel	$ 6,600,341	$ 5,046,232
Lubricants	484,522	398,375
Chemicals	83,042	86,226
Others	450,784	457,054
	7,618,689	5,987,887
Inventory in transit:		
Fuel	148,057	93,988
	7,766,746	6,081,875
Less allowance for obsolescence	(50,587)	(50,587)
	$ 7,716,159	$ 6,031,288

(2) Summary of Significant Accounting Policies, Continued

E. Prepaid Expenses

Advance payments relating to goods and services not yet received are recorded as prepaid expenses. Prepayments that are expected to be utilized beyond one year, mainly relating to prepaid land leases (see Note 10), are presented as noncurrent assets.

F. 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

G. 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, 2018 and 2017.

H. Taxes

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

I. New Accounting Standards

During the year ended December 31, 2018, the Company implemented the following pronouncements:

- GASB 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.

- GASB Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits).

(2) Summary of Significant Accounting Policies, Continued

I. New Accounting Standards, Continued

- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

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

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 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.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61,* which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 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

J. 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.

K. 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, 2018 and 2017, total carrying amounts of cash and cash equivalents and time certificates of deposits in U.S. denominated bank accounts were $549,000 and $2,652,154, respectively, and the corresponding bank balances were $550,858 and $2,370,875, respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of December 31, 2018 and 2017, bank deposits in the amount of $250,000 were subject to FDIC insurance. Bank balances in excess of FDIC insurance are not collateralized.

Additionally, as of December 31, 2018 and 2017, cash and cash equivalents include deposits in AUD denominated accounts with Bendigo Adelaide Bank Limited (Bendigo), an authorized deposit-taking institution (ADI) subject to the Australian Government Financial Claims Scheme (FCS) of $5,967,731 and $6,644,444, respectively. 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, 2018 and 2017, bank deposits of approximately $176,000 and $192,000, respectively, were subject to FCS guarantee. Balances in excess of FCS guarantee are not collateralized.

Trade Receivables. Vital grants credit to customers, the majority of whom are located in Nauru. Accounts receivable are recorded at the invoiced amount, net of an allowance for doubtful accounts, and do not bear interest. 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, 2018 and 2017, trade receivables are net of an allowance of $17,231 and $0, respectively.

(2) Summary of Significant Accounting Policies, Continued

K. Vital's Accounting Policies, Continued

Due to Primary Government. Due to Primary Government are amounts due to FSM Petroleum Corporation for fuel purchases and advances. Balances with FSMPC are non-interest bearing. The parties agreed that the balance is to be repaid over the remaining term of Vital's Petroleum Supply and Facility Management Agreement with GON through 2025 and accordingly, $1,931,856 and $1,504,747, respectively, are presented as current in the accompanying statements of condition.

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 when charged to customers' charge accounts, when merchandise is delivered to customers, and when title is passed and collectability is reasonably assured. Service income is recognized based on GPA contract through September 30, 2017 (see Note 9), typically earned monthly. Other income, mainly representing cost 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:

Leasehold improvements	11 years
Motor vehicles	5 years
Computer equipment	5 years
Furniture and fixtures	7 years
Machinery and equipment	7 years

Taxes. Vital is taxed and files its income tax return in Guam. The Guam income tax code is similar to that of the United States of America. Vital also pays a Business Profits Tax (BPT) in Nauru under the Republic of Nauru Business Tax Act (the "Act"), which was enacted and became effective in July 2016. BPT is generally 10% of taxable income (increased to 20% effective July 1, 2018), as defined in the Act, for tax payers with annual taxable income under $15 million. BPT is taken as a foreign tax credit (FTC) on the Guam income tax return, with certain limitations. Disallowed FTC in a given tax year, due to difference in statutory tax rates between the jurisdictions, may be carried over up to 10 years. BPT totaled $173,322 and $156,210, respectively, for the years ended December 31, 2018 and 2017 and is included as a component of taxes in Vital's statements of revenues, expenses and changes in net position.

(2) Summary of Significant Accounting Policies, Continued

K. Vital's Accounting Policies, Continued

Taxes, Continued., Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income or expense in the period that includes the enactment date.

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

Income tax (benefit) expense for the years ended December 31, 2018 and 2017 consisted of the following:

	2018	2017
Current	$ 21,046	$ 62,446
Deferred	(141,000)	(22,000)
Total	$ (119,954)	$ 40,446

In December 2017, the "U.S. Tax Cut and Jobs Act" (TCJA) was signed into law, which includes a change in corporate income tax rate. The change resulted in approximately $5,000 income tax benefit adjustment in 2017 to recorded deferred taxes based on the new tax rate of 21%.

Other than the adjustment in 2017 relating to the TCJA, the differences between the effective income tax rate and the statutory rate of 21% and 34% in 2018 and 2017, respectively, are principally due to correction of prior year accrual, recognition of foreign tax credits for Nauru operations and for 2017, recognition of net operating losses carryovers that were previously fully allowed in 2016.

At December 31, 2018, deferred tax asset of $133,000, relates mainly to unused foreign tax credits for Nauru operations, which expire in 2028. At December 31, 2017, deferred tax liability of $8,000, main relate to difference in fixed assets depreciation.

L. Reclassifications

Certain balances in the 2017 financial statements have been reclassified to conform with the 2018 financial statement presentation.

(3) Capital Assets

FSM Petroleum Corporation

Capital asset activities for the years ended December 31, 2018 and 2017 are as follows:

	Balance at January 1, 2018	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2018
Buildings	$ 1,052,403	$ 89,028	$ -	$ 1,141,431
Motor vehicles	1,511,250	131,353	-	1,642,603
Plant and equipment	13,317,496	689,434	-	14,006,930
Furniture and fixtures	297,781	37,754	-	335,535
Office equipment	5,219,099	2,212,639	-	7,431,738
Machinery and equipment	1,020,573	240,790	-	1,261,363
	22,418,602	3,400,998	-	25,819,600
Less accumulated depreciation	(10,567,185)	(1,986,158)	-	(12,553,343)
	11,851,417	1,414,840	-	13,266,257
Construction in progress	7,087,413	4,811,921	(3,113,674)	8,785,660
	$ 18,938,830	$ 6,226,761	$ (3,113,674)	$ 22,051,917

	Balance at January 1, 2017	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2017
Buildings	$ 999,086	$ 53,317	$ -	$ 1,052,403
Motor vehicles	1,483,084	28,166	-	1,511,250
Plant and equipment	13,056,862	260,634	-	13,317,496
Furniture and fixtures	292,824	4,957	-	297,781
Office equipment	5,064,815	154,284	-	5,219,099
Machinery and equipment	916,231	104,342	-	1,020,573
	21,812,902	605,700	-	22,418,602
Less accumulated depreciation	(8,637,374)	(1,929,811)	-	(10,567,185)
	13,175,528	(1,324,111)	-	11,851,417
Construction in progress	3,174,562	4,504,918	(592,067)	7,087,413
	$ 16,350,090	$ 3,180,807	$ (592,067)	$ 18,938,830

Vital Energy, Inc.

Capital asset activities for the years ended December 31, 2018 and 2017 are as follows:

	Balance at January 1, 2018	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2018
Leasehold improvements	$ -	$ 26,191	$ -	$ 26,191
Motor vehicles	64,309	75,700	-	140,009
Plant and equipment	1,285	-	(104)	1,181
Computer equipment	206,580	8,843	(4,541)	210,882
Furniture and fixtures	34,507	7,788	(555)	41,740
Machinery and equipment	33,276	19,904	(125)	53,055
	339,957	138,426	(5,325)	473,058
Less accumulated depreciation	(200,912)	(60,278)	5,325	(255,865)
	$ 139,045	$ 78,148	$ -	$ 217,193

(3) Capital Assets, Continued

Vital Energy, Inc., Continued

	Balance at January 1, 2017	Transfers and Additions	Transfers and Deletions	Balance at December 31, 2017
Motor vehicles	$ 64,309	$ -	$ -	$ 64,309
Plant and equipment	1,207	78	-	1,285
Computer equipment	204,129	2,451	-	206,580
Furniture and fixtures	27,619	6,888	-	34,507
Machinery and equipment	37,866	810	(5,400)	33,276
	335,130	10,227	(5,400)	339,957
Less accumulated depreciation	(131,253)	(73,430)	3,771	(200,912)
	203,877	(63,203)	(1,629)	139,045
Construction in progress	19,400	-	(19,400)	-
	$ 223,277	$ (63,203)	$ (21,029)	$ 139,045

(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.

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, 2018 and 2017, FSMPC recognized a liability to the States and the FSMNG of $1,247,383.

At December 31, 2018 and 2017, 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, 2019.

(5) Short-Term Borrowings

As of December 31, 2018 and 2017, the Company has a bank standby letter of credit (LC) of $3,000,000 and $7,000,000, respectively, expiring on September 13, 2019 and September 13, 2018, respectively, in favor of Mobile Oil Guam in relation to its fuel purchase agreement. Additionally, the Company also has a standby LC of $6,034,500 for the coconut production facility contractor, currently expires on September 28, 2019.

Additionally, as of December 31, 2018 and 2017, the Company has bank line of credit (LOC) facility of $11,000,000 for working capital and support LC's. The line currently expires on December 27, 2019.

The LOCs and the related long-term obligations 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 LOCs 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 borrowings are outstanding against the LOCs at December 31, 2018 and 2017.

(6) Long-term Debt

FSM Petroleum Corporation

Long-term debt consists of the following at December 31 2018 and 2017:

	2018	2017
A $5,000,000 bank note from the Bank of Guam (BOG) dated December 2017, for capital assets projects. The loan bears interest fixed at 5.75% per annum and is payable in monthly installments of $55,214 beginning January 20, 2018 to December 20, 2027. The loan is 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.	$ 4,606,268	$ -
A $3,000,000 bank note from the FSM Development Bank (FSMDB) dated August 2017, a component unit of the FSM National Government, for capital assets projects. The loan bears interest fixed at 5% per annum and is payable in quarterly installments of $170,461 beginning August 31, 2017 to September 25, 2022. On May 1, 2018 FSMDB, approved FSMPC's request for deferment of principal payment from June 2018 to June 2019. The loan is collateralized by the Company's inventories and related petroleum products.	2,740,185	2,867,039
Total long-term debt	7,346,453	2,867,039
Net of current portion	816,575	547,028
	$ 6,529,878	$ 2,320,011

(6) Long-term Debt, Continued

FSM Petroleum Corporation, Continued

At December 31, 2018, future minimum loan repayments are as follows:

Year Ending December 31,	Principal	Interest	Total
2019	$ 816,575	$ 391,159	$ 1,207,734
2020	1,002,646	341,766	1,344,412
2021	1,058,565	285,847	1,344,412
2022	1,116,542	227,870	1,344,412
2023	1,017,900	166,566	1,184,466
2024-2027	2,334,225	373,721	2,707,946
	$ 7,346,453	$ 1,786,929	$ 9,133,382

Vital Energy, Inc.

In 2017, Vital obtained a $2,400,000 non-interest bearing, uncollateralized advance from its fuel vendor to fund capital project expenditures incurred on behalf of the GON under the Agreement (see Note 9). The advance is payable in equal quarterly installments of $120,000, beginning on September 5, 2017. Future repayments are $480,000 for each of the years ending December 30, 2019 through 2021 and $240,000 for the year ending December 31, 2022.

(7) Changes in Long-Term Liabilities

Changes in long-term liabilities for the years ended December 31, 2018 and 2017 are as follows:

FSM Petroleum Corporation

	Balance at January 1, 2018	Additions	Repayments	Balance at December 31, 2018	Due Within One Year
Due to States and the FSM National Government	$ 1,747,383	$ -	$ -	$ 1,747,383	$ -
Long-term debt	2,867,039	5,000,000	(520,586)	7,346,453	816,575
	$ 4,614,422	$ 5,000,000	$ (520,586)	$ 9,093,836	$ 816,575

	Balance at January 1, 2017	Additions	Repayments	Balance at December 31, 2017	Due Within One Year
Due to States and the FSM National Government	$ 2,284,049	$ -	$ (536,666)	$ 1,747,383	$ -
Long-term debt	-	3,000,000	(132,961)	2,867,039	547,028
	$ 2,284,049	$ 3,000,000	$ (669,627)	$ 4,614,422	$ 547,028

(7) Changes in Long-Term Liabilities, Continued

Vital Energy, Inc.

	Balance at January 1, 2018	Additions	Reductions	Balance at December 31, 2018	Due Within One Year
Deferred tax liability	$ 8,000	$ -	$ (8,000)	$ -	$ -
Long-term note payable	2,160,000	-	(480,000)	1,680,000	480,000
Due to primary government	9,492,876	458,247	(1,500,644)	8,450,479	1,911,088
Other noncurrent liability	463,844	3,976,502	(3,758,205)	682,141	-
	$ 12,124,720	$ 4,434,749	$ (5,746,849)	$ 10,812,620	$ 2,391,088

	Balance at January 1, 2017	Additions	Reductions	Balance at December 31, 2017	Due Within One Year
Deferred tax liability	$ 30,000	$ -	$ (22,000)	$ 8,000	$ -
Long-term note payable	-	2,400,000	(240,000)	2,160,000	480,000
Due to primary government	12,327,520	-	(2,834,644)	9,492,876	1,504,747
Other noncurrent liability	2,080,388	3,291,223	(4,907,767)	463,844	-
	$ 14,437,908	$ 5,691,223	$ (8,004,411)	$ 12,124,720	$ 1,984,747

(8) 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 self-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.

(9) Concentration Risk and Significant Customers

FSM Petroleum Corporation

Revenue from one major customer, Pohnpei Utilities Corporation, for the years ended December 31, 2018 and 2017 approximated 17% and 16%, respectively, of the Company's total revenue, and receivable of $605,054 and $619,212 as of December 31, 2018 and 2017, respectively.

The Company purchased substantially all fuel from one supplier in 2018 and 2017.

Vital Energy, Inc.

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, 2018 and 2017, Vital recorded fuel sales of $15.7 million and $16.0 million, respectively. As of December 31, 2018 and 2017, Vital recorded mooring fees liability of $148,489 and $452,199, respectively, and throughput fee liability of $533,652 and $11,645, respectively, for the purpose of funding the facilities' mooring system repairs and improvements and Compliance and Integrity Projects, which are included in the other noncurrent liability account in the statements of net position.

Additionally, effective November 1, 2018, Vital entered into a Nauru Utilities Corporation (NUC) price subsidy agreement with GON. Under the agreement, the Company charges NUC at fixed price for fuel sales. Difference between the fixed and the actual price are deducted from the mooring fees liability to GON.

Vital's fuel sales from two and three major customers for the years ended December 31, 2018 and 2017, respectively, approximated 66% and 71%, respectively, of Vital's total revenue, and total receivable of $420,078 and $227,662 at December 31, 2018 and 2017, respectively.

Vital purchased substantially all fuel from one supplier in 2018 and 2017.

Guam Power Authority (GPA)

Vital had a contract with GPA to manage, operate and maintain GPA's fuel bulk storage facility which was terminated effective September 30, 2017. Service fee revenues of $511,692 were earned from the GPA contract for the year ended December 31, 2017. In connection with the agreement, Vital is exposed to certain compliance requirements by the U.S. Environmental Protection Agency (USPA) that may result in penalties and fines. At December 31, 2017, Vital had accrued for a potential liability of $190,000, which was ettled for $87,000 through a September 2018 final order.

(10) Commitments and Contingencies

Leases

FSM Petroleum Corporation

The Company leases land, warehouse, airport facilities and other such space through various leases expiring through 2038. 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. In 2018 and 2017, the Company entered into one and sixteen lease agreements, respectively, for land situated on Tonoas Island, Chuuk State, for the new CDU project site. The agreements have an initial term of twenty-years, with certain options to renew, and require an initial seven-year prepayment. At December 31, 2018 and 2017, unamortized balance of prepayments totaling $1,171,755 and $1,086,610, respectively, of which $202,978 and $194,026, respectively, is presented as current in the accompanying statements of net position.

Future minimum lease payments are as follows:

Year Ending December 31,	
2019	$ 347,000
2020	317,000
2021	320,000
2022	306,000
2023	205,000
2024-2028	1,226,000
2029-2033	1,160,000
2034-2038	776,000
	$ 4,657,000

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,	
2019	$ 529,168
2020	220,487
	$ 749,655

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.

(10) Commitments and Contingencies, Continued

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.

Joint Venture

On April 24, 2018, the Company and SB Energy Corporation signed an indicative term sheet for a Joint Venture (JV) relating to a project to contruct and operate a solar facility and energy storage system in State of Chuuk in the FSM. As of December 31, 2018, final JV agreement is still under negotation and no transactions have been recorded in the accompanying financial statements.

(11) 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 $17.2 million and $15.2 million was earned from the four utility companies for the years ended December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, FSMPC has total receivables of $1 million and $1.1 million, respectively, from the four utility companies. In addition, as of December 31, 2018 and 2017, FSMPC has accrued liabilities in the form of letters of credit to the Pohnpei Utilities Corporation and Chuuk Public Utility Corporation totaling $1,330,800 and $1,206,606, 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. As of December 31, 2018 and 2017, FSMPC recorded $7,650,057 and $9,129,289, 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, of which $1,110,666 and $1,504,748 is presented as current portion as of December 31, 2018 and 2017, respectively. The remaining receivable of $821,190 and $363,587 as of December 31, 2018 and 2017, 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 $383,171 and $224,280 for the years ended December 31, 2018 and 2017, respectively, and are included as a component of other income in the accompanying statements of revenues, expenses, and changes in net position.

(12) Restatement

Subsequent to the issuance of the Company's 2017 financial statements, Company management determined that inventory was overstated by $925,124. As a result of this determination inventory has been restated from the amount previously reported.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3973
USA

Tel: +1 (671) 646-3884
Fax: +1 (671) 649-4265

www.deloitte.com

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

The Board of Directors
Federated States of Micronesia Petroleum Corporation:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Federated States of Micronesia Petroleum Corporation (the Company), which comprise the statement of net position as of December 31, 2018, 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 July 9, 2019.

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 items 2018-002 and 2018-003 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 2018-001.

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

July 9, 2019

Finding No.: 2018-001

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 expenditures tested aggregating $2,154,000. For procurement documents partially provided amounting to $159,555, we are unable to determine whether proper procurement procedures were followed as the entity's procurement policy was only finalized on December 31, 2018 but was not published and fully implemented until fiscal year 2019.

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.

Identification as a Repeat Finding: Finding 2017-001

Auditee Response and Corrective Action Plan: Management concurs with the finding. To complement and strengthen what was rolled out last year by Ultima Training & Consulting Services, the Company has engaged with Procurement and Supply Institute of Asia (PASIA) to produce a procurement policy and provide training for the staff. It is expected to drive Value-for-Money (VFM) and to be compliant with the most recent Multilateral Development Banks harmonized procurement guidelines. The development of the procurement manual is completed and the Company is currently field testing it awaiting official rollout.

Finding No.: 2018-002

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: The following construction in progress matters were noted:

1. Project status reports or equivalent documentation could not be provided timely, which resulted in various adjusting entries during the course of audit through May 2019.

2. Seventeen (17) open projects approximating $1,084,000 with no recent costs incurred was noted as of December 31, 2018. Specifically, two projects with cost of $200,000 is on hold as such ultimate realization is uncertain. Moreover, status reports could also not be provided for two projects with total cost of $277,000 until May 2019.

3. Expense items (e.g., food allowance, travel, hotel expenses and professional fees not directly attributable in bringing the asset to its working condition) approximately amounting to $65,000 was capitalized as CIP. Approximately $8,000 was corrected through adjusting journal entries while the remaining balance is still under review.

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.

Identification as a Repeat Finding: Finding 2017-002

Auditee Response and Corrective Action Plan: Management concurs with the finding. A project management unit called 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. This is a work in progress and it will take several years to institutionalize the project management process already adopted, which will address this audit finding.

Finding No.: 2018-003

Inventory

Criteria: Automated system controls are a key part of a strong internal control environment. They increase efficiency of operations, improve accuracy and help eliminate fraud. An effective automated system control includes policies and procedures related to periodic monitoring of system calculation of unit cost to determine potential system error.

Condition: The following inventory matters were noted:

1. The Company does not perform a regular monitoring of system unit cost calculation. We have noted a system error in calculating the moving average unit cost that resulted in a restatement of 2016 and 2017 financial statements.

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

Cause: The cause of the above condition is lack of periodic monitoring of inventory unit cost calculation.

Effect: The effect of the above condition is a potential misstatement of inventory and related cost of sales.

Recommendation: We recommend that management conduct a comprehensive and periodic review of inventory unit cost calculation. FSMPC should also review all its automated controls in place to early detect and correct any system errors. The Company should also improve control procedures over year-end inventory closing and should implement a process to review inventory balances for lower of cost or market on a regular basis.

Auditee Response and Corrective Action Plan: Management concurs with the finding and have developed a short term solution by utilizing a manual spreadsheet to monitor and reconcile inventory valuation in MAS 500. For the long term, a project to procure a new ERP system is underway and it will address current pain points and future needs of the Company.

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

Schedule of Findings and Responses
December 31, 2018

Summary Schedule of Prior Audit Findings

Finding Number	Finding Title	Status
2017-001	Procurement Documents	Not Corrected or Resolved.
2017-002	Construction-in-Progress (CIP) Project Monitoring	Not Corrected or Resolved.