

PIONEER OIL AND GAS

FINANCIAL STATEMENTS

September 30, 2012 and 2011



PIONEER OIL AND GAS
INDEX TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and
Stockholders of Pioneer Oil and Gas

We have audited the accompanying balance sheets of Pioneer Oil and Gas as of September 30, 2012 and 2011, and the related statements of operations, stockholders' equity, and 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. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, the financial statements referred to above present fairly, in all material respects, the financial position of Pioneer Oil and Gas as of September 30, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Jones Simkins, P.C.

JONES SIMKINS, P.C.

Logan, Utah

January 10, 2013

PIONEER OIL AND GAS
BALANCE SHEETS
September 30, 2012 and 2011

| <u>Assets</u> | <u>2012</u> | <u>2011</u> |
|---|---------------------|------------------|
| Current assets: | | |
| Cash | \$ 2,729,540 | 3,522,165 |
| Investments, available for sale | 219,994 | 1,236,485 |
| Receivables | 91,877 | 906,114 |
| Resale leases, at lower of cost or market | 1,269,750 | 2,000,154 |
| Total current assets | 4,311,161 | 7,664,918 |
| Property and equipment, net | 369,741 | 81,915 |
| Deferred income taxes | 193,000 | 193,000 |
| Other assets | 660,217 | 660,217 |
| | <u>\$ 5,534,119</u> | <u>8,600,050</u> |
| <u>Liabilities and Stockholders' Equity</u> | | |
| Current liabilities: | | |
| Payables and accrued expenses | \$ 98,048 | 476,247 |
| Deferred income taxes | 8,000 | 11,000 |
| Total current liabilities | 106,048 | 487,247 |
| Asset retirement obligation | 28,159 | 18,685 |
| Total liabilities | 134,207 | 505,932 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, par value \$.001 per share, 50,000,000 shares authorized; 6,048,425 and 7,703,895 shares issued and outstanding, respectively | 6,048 | 7,704 |
| Additional paid-in capital | 55,970 | 1,705,784 |
| Stock subscription receivable | (347,159) | - |
| Accumulated other comprehensive income | 15,518 | 20,414 |
| Retained earnings | 5,669,535 | 6,774,523 |
| | 5,399,912 | 8,508,425 |
| Less treasury stock, 0 and 414,327 shares at cost, respectively | - | (414,307) |
| Total stockholders' equity | 5,399,912 | 8,094,118 |
| | <u>\$ 5,534,119</u> | <u>8,600,050</u> |

The accompanying notes are an integral part of these financial statements.

PIONEER OIL AND GAS
STATEMENTS OF OPERATIONS
Years Ended September 30, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|--|-----------------------|------------------|
| Revenue: | | |
| Oil and gas sales | \$ 692,988 | 794,225 |
| Royalty revenue | <u>275,050</u> | <u>459,961</u> |
| | <u>968,038</u> | <u>1,254,186</u> |
| Costs and expenses: | | |
| Cost of operations | 226,231 | 123,702 |
| General and administrative expenses | 735,120 | 826,686 |
| Exploration costs | 334,150 | 326,834 |
| Lease rentals | 33,964 | 163,611 |
| Loss on impairment of resale leases | 763,965 | 713,430 |
| Depreciation, depletion and amortization | <u>106,184</u> | <u>2,631</u> |
| | <u>2,199,614</u> | <u>2,156,894</u> |
| Loss from operations | <u>(1,231,576)</u> | <u>(902,708)</u> |
| Other income (expense): | | |
| Gain on disposal of oil and gas properties | - | 209,713 |
| Interest income | 32,579 | 19,729 |
| Interest expense | (57) | - |
| Other | <u>94,066</u> | <u>11,365</u> |
| | <u>126,588</u> | <u>240,807</u> |
| Loss before benefit for income taxes | (1,104,988) | (661,901) |
| Benefit for income taxes | <u>-</u> | <u>(273,000)</u> |
| Net loss | <u>\$ (1,104,988)</u> | <u>(388,901)</u> |
| Net loss per common share: | | |
| Basic | \$ <u>(0.15)</u> | <u>(0.05)</u> |
| Diluted | \$ <u>(0.15)</u> | <u>(0.05)</u> |
| Weighted average common shares: | | |
| Basic | <u>7,399,000</u> | <u>7,689,000</u> |
| Diluted | <u>7,399,000</u> | <u>7,689,000</u> |

The accompanying notes are an integral part of these financial statements.

PIONEER OIL AND GAS
STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended September 30, 2012 and 2011

| | Common Stock | | Additional | Stock | Accumulated | | Retained | Treasury Stock | | |
|---|--------------|----------|--------------|--------------|---------------|----|-------------|----------------|------------|--------------|
| | Shares | Amount | Paid-in | Subscription | Other | | Earnings | Shares | Amount | Total |
| | | | Capital | Receivable | Comprehensive | | | | | |
| | | | | | Income | | | | | |
| Balance at October 1, 2010 | 7,673,265 | \$ 7,673 | \$ 1,585,543 | \$ (21,397) | \$ 23,261 | \$ | 7,163,424 | (6,000) | \$ (5,560) | \$ 8,752,944 |
| Comprehensive loss: | | | | | | | | | | |
| Net loss | - | - | - | - | - | | (388,901) | - | - | (388,901) |
| Unrealized holding loss, net of tax effects | - | - | - | - | (2,847) | | - | - | - | (2,847) |
| Total comprehensive loss | | | | | | | | | | (391,748) |
| Issuance of common stock to ESOP | 30,630 | 31 | 25,392 | (25,423) | - | | - | - | - | - |
| Stock option compensation expense | - | - | 94,849 | - | - | | - | - | - | 94,849 |
| Purchase of treasury stock | - | - | - | - | - | | - | (414,327) | (414,307) | (414,307) |
| Sale of treasury stock to ESOP | - | - | - | (5,560) | - | | - | 6,000 | 5,560 | - |
| Payments on stock subscription receivable | - | - | - | 52,380 | - | | - | - | - | 52,380 |
| Balance at September 30, 2011 | 7,703,895 | 7,704 | 1,705,784 | - | 20,414 | | 6,774,523 | (414,327) | (414,307) | 8,094,118 |
| Comprehensive loss: | | | | | | | | | | |
| Net loss | - | - | - | - | - | | (1,104,988) | - | - | (1,104,988) |
| Unrealized holding loss, net of tax effects | - | - | - | - | (4,896) | | - | - | - | (4,896) |
| Total comprehensive loss | | | | | | | | | | (1,109,884) |
| Purchase and retirement of stock | (1,655,470) | (1,656) | (1,649,814) | - | - | | - | - | - | (1,651,470) |
| Sale of treasury stock to ESOP | - | - | - | (414,307) | - | | - | 414,327 | 414,307 | - |
| Payments on stock subscription receivable | - | - | - | 67,148 | - | | - | - | - | 67,148 |
| Balance at September 30, 2012 | 6,048,425 | \$ 6,048 | \$ 55,970 | \$ (347,159) | \$ 15,518 | \$ | 5,669,535 | - | \$ - | \$ 5,399,912 |

The accompanying notes are an integral part of these financial statements.

PIONEER OIL AND GAS
STATEMENTS OF CASH FLOWS
Years Ended September 30, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|----------------------------|-------------------------|
| Cash flows from operating activities: | | |
| Net loss | \$ (1,104,988) | (388,901) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Gain on disposal of oil and gas properties | - | (209,713) |
| Gain on sale of investments | (72,226) | - |
| Reduction of ARO due to property sale | - | (33,163) |
| Depreciation, depletion and amortization | 106,184 | 2,631 |
| Accretion expense | 1,206 | 1,568 |
| Employee benefit plan expense | 67,127 | 65,311 |
| Deferred income taxes | - | (218,000) |
| Interest income | (11,598) | (1,312) |
| Stock based compensation | - | 94,849 |
| (Increase) decrease in: | | |
| Receivables | 814,237 | (75,240) |
| Resale leases | 730,404 | 691,021 |
| Other assets | - | (657,987) |
| Increase (decrease) in: | | |
| Payables and accrued expenses | <u>(7,236)</u> | <u>(225,357)</u> |
| Net cash provided by (used in) operating activities | <u>523,110</u> | <u>(954,293)</u> |
| Cash flows from investing activities: | | |
| Purchases of investments, available for sale | (18,950) | (195,411) |
| Proceeds from sale of investments, available for sale | 1,099,771 | 200,000 |
| Acquisition of property and equipment | (385,742) | - |
| Proceeds from sale of producing property | <u>-</u> | <u>528,521</u> |
| Net cash provided by investing activities | <u>695,079</u> | <u>533,110</u> |
| Cash flows from financing activities: | | |
| Payable - common stock repurchase | (293,744) | (5,825) |
| Purchase of common and treasury stock | (1,651,470) | (414,307) |
| Payment of dividends | <u>(65,600)</u> | <u>(6,400)</u> |
| Net cash used in financing activities | <u>(2,010,814)</u> | <u>(426,532)</u> |
| Net decrease in cash | (792,625) | (847,715) |
| Cash, beginning of year | <u>3,522,165</u> | <u>4,369,880</u> |
| Cash, end of year | <u><u>\$ 2,729,540</u></u> | <u><u>3,522,165</u></u> |

The accompanying notes are an integral part of these financial statements.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 1 – Organization and Summary of Significant Accounting Policies

Organization

The Company is incorporated under the laws of the state of Utah and is primarily engaged in the business of acquiring, developing, producing and selling oil and gas properties to companies located in the continental United States.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

Investments

The Company classifies its investments as “available for sale.” Securities classified as “available for sale” are carried in the financial statements at fair value. Realized gains and losses, determined using the specific identification method, are included in operations; unrealized holding gains and losses are reported as a separate component of accumulated other comprehensive income (loss). Declines in fair value below cost that are other than temporary are included in operations.

Concentration of Credit Risk

The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

Resale Leases

The Company capitalizes the costs of acquiring oil and gas leaseholds held for resale, including lease bonuses and any advance rentals required at the time of assignment of the lease to the Company. Advance rentals paid after assignment are charged to expense as carrying costs in the period incurred. Costs of oil and gas leases held for resale are valued at lower of cost or net realizable value and included in current assets since they could be sold within one year, although the holding period of individual leases may be in excess of one year. The cost of oil and gas leases sold is determined on a specific identification basis.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
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Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Accounts Receivable

Accounts receivable are recorded when oil and gas is delivered and are presented net of the allowance for doubtful accounts and are generally unsecured. Accounts receivable are carried at their estimated collectible amounts. Credit is generally extended on a short-term basis; thus accounts receivable do not bear interest although a finance charge may be applied to such receivables that are more than thirty days past due. Accounts receivable are periodically evaluated for collectibility based on past credit history with customers. Provisions for losses on accounts receivable are determined based on loss experience, known and inherent risk in the account balance, current economic conditions, and the financial stability of customers.

Oil and Gas Producing Activities

The Company utilizes the successful efforts method of accounting for its oil and gas producing activities. Under this method, all costs associated with productive exploratory wells and productive or nonproductive development wells are capitalized while the costs of nonproductive exploratory wells are expensed.

If an exploratory well finds oil and gas reserves, but a determination that such reserves can be classified as proved is not made after one year following completion of drilling, the costs of drilling are charged to operations. Indirect exploratory expenditures, including geophysical costs and annual lease rentals are expensed as incurred. Unproved oil and gas properties that are individually significant are periodically assessed for impairment of value and a loss is recognized at the time of impairment by providing an impairment allowance. Other unproved properties are amortized based on the Company's experience of successful drillings and average holding period. Capitalized costs of producing oil and gas properties, after considering estimated dismantlement and abandonment costs and estimated salvage values, are depreciated and depleted by the units-of-production method. Support equipment and other property and equipment are depreciated over their estimated useful lives.

On the sale or retirement of a complete unit of a proved property, the cost and related accumulated depreciation, depletion and amortization are eliminated from the property accounts, and the resultant gain or loss is recognized. On the retirement or sale of a partial unit of proved property, the cost is charged to accumulated depreciation, depletion and amortization with a resulting gain or loss recognized in income.

On the sale of an entire interest in an unproved property for cash or cash equivalent, gain or loss on the sale is recognized, taking into consideration the amount of any recorded impairment if the property has been assessed individually. If a partial interest in an unproved property is sold, the amount received is treated as a reduction of the cost of the interest retained.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs are expensed when incurred and betterments are capitalized. When assets are sold, retired or otherwise disposed of the applicable costs and accumulated depreciation, depletion and amortization are removed from the accounts, and the resulting gain or loss is reflected in operations.

Long-Lived Assets

The Company evaluates its long-lived assets in accordance with ASC Topic 360. Long-lived assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that their net book value may not be recoverable. When such factors and circumstances exist, the Company compares the projected undiscounted future cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets and is recorded in the period in which the determination was made.

Revenue Recognition

Revenue is recognized from oil sales at such time as the oil is delivered to the buyer. Revenue is recognized from gas sales when the gas passes through the pipeline at the well head. Revenue from overriding royalty interests is recognized when earned.

The Company does not have any gas balancing arrangements.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions primarily related to oil and gas property reserves and prices, which 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.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Income Taxes

The Company files Federal and state income tax returns in states in which it operates. Deferred income taxes arise from temporary differences resulting from income and expense items reported for financial accounting and tax purposes in different periods. 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. Deferred taxes are classified as current or noncurrent, depending on the classification of the assets and liabilities to which they relate. Deferred taxes arising from temporary differences that are not related to an asset or liability are classified as current or noncurrent depending on the periods in which the temporary differences are expected to reverse. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company considers many factors when evaluating and estimating its tax positions and tax benefits. Tax positions are recognized only when it is more likely than not (likelihood of greater than 50%), based on technical merits, that the positions will be sustained upon examination. Reserves are established if it is believed certain positions may be challenged and potentially disallowed. If facts and circumstances change, reserves are adjusted through income tax expense. The Company recognizes interest expense and penalties related to unrecognized tax benefits in the provision for income taxes.

Earnings Per Share

The computation of basic earnings per common share is based on the weighted average number of shares outstanding during each year.

The computation of diluted earnings per common share is based on the weighted average number of shares outstanding during the year plus the common stock equivalents which would arise from the exercise of stock options and warrants outstanding using the treasury stock method and the average market price per share during the year. Common stock equivalents are not included in the diluted earnings per share calculation when their effect is antidilutive. Common stock equivalents that could potentially dilute earnings per share are common stock options.

Presentation of Sales and Similar Taxes

Sales tax on revenue-producing transactions is recorded as a liability when the sale occurs.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Stock-Based Compensation

The Company has stock-based employee compensation plans, which are described more fully in Note 14. The Company accounts for stock-based compensation in accordance with ASC Topic 718. This topic requires the Company to recognize compensation cost based on the grant date fair value of options granted. During the years ended September 30, 2012 and 2011, the Company recognized \$0 and \$94,849, respectively, of compensation expense related to stock.

Reclassifications

Certain accounts in the 2011 financial statements have been reclassified to conform to the presentation in the 2012 financial statements.

Note 2 – Detail of Certain Balance Sheet Accounts

Receivables consist of the following:

| | <u>2012</u> | <u>2011</u> |
|-------------------------------------|------------------|----------------|
| Accounts receivable | \$ 91,877 | 139,678 |
| Income taxes receivable and prepaid | <u>-</u> | <u>766,436</u> |
| | <u>\$ 91,877</u> | <u>906,114</u> |

Payables and accrued expenses consist of the following:

| | <u>2012</u> | <u>2011</u> |
|------------------------------------|------------------|----------------|
| Accounts payable | \$ 25,980 | 25,948 |
| Accrued expenses | 72,068 | 90,955 |
| Payable - common stock repurchases | - | 293,744 |
| Dividends payable | <u>-</u> | <u>65,600</u> |
| | <u>\$ 98,048</u> | <u>476,247</u> |

The payable – common stock repurchases results from the purchase of fractional shares created in a previous stock split. During 2012, the Company escheated the remaining funds to states for the remaining beneficial owners who could not be located.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
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Note 3 – Investments

Investments are recorded at fair value and consist of the following:

| | <u>2012</u> | <u>2011</u> |
|----------------------------|-------------------|------------------|
| Investments, at cost | \$ 196,476 | 1,205,071 |
| Unrealized holding gain | <u>23,518</u> | <u>31,414</u> |
| Investments, at fair value | \$ <u>219,994</u> | <u>1,236,485</u> |

Changes in the unrealized holding gain on investments classified as available for sale and reported as a separate component of accumulated other comprehensive income are as follows:

| | <u>2012</u> | <u>2011</u> |
|----------------------------|------------------|---------------|
| Balance, beginning of year | \$ 20,414 | 23,261 |
| Unrealized holding loss | (7,896) | (3,847) |
| Deferred income taxes | <u>3,000</u> | <u>1,000</u> |
| Balance, end of year | \$ <u>15,518</u> | <u>20,414</u> |

Note 4 – Fair Value Measurements

The Company's investments are reported at fair value in the accompanying balance sheets. The methods used to measure fair value may produce an amount that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The Company follows a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

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NOTES TO FINANCIAL STATEMENTS
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Note 4 – Fair Value Measurements (continued)

The Company uses the following valuation techniques to measure fair value for its assets and liabilities:

- Level 1 - Quoted market prices in active markets for identical assets or liabilities;
- Level 2 - Significant other observable inputs (e.g. quoted prices for similar items in active markets, quoted prices for identical or similar items in markets that are not active, inputs other than quoted prices that are observable such as interest rate and yield curves, and market-corroborated inputs);
- Level 3 - Unobservable inputs for the asset or liability, which are valued based on management's estimates of assumptions that market participants would use in pricing the asset or liability.

The following tables provide financial assets carried at fair value:

| | | September 30, 2012 | | |
|--------------------------------------|----|--------------------|-------------|----------------|
| | | Level 1 | Level 2 & 3 | Total |
| Mutual funds: Large cap value | \$ | 11,032 | - | 11,032 |
| Common stocks - Energy | | 197,485 | - | 197,485 |
| Preferreds/Fixed Rate Cap Securities | | 11,477 | - | 11,477 |
| Total assets at fair value | \$ | <u>219,994</u> | <u>-</u> | <u>219,994</u> |

| | | September 30, 2011 | | |
|---------------------------------------|----|--------------------|-------------|------------------|
| | | Level 1 | Level 2 & 3 | Total |
| Mutual funds: Large cap value | \$ | 9,022 | - | 9,022 |
| Three year PIC linked to BANC | | 1,045,400 | - | 1,045,400 |
| Market linked certificates of deposit | | 151,207 | - | 151,207 |
| Common stocks - Energy | | 30,856 | - | 30,856 |
| Total assets at fair value | \$ | <u>1,236,485</u> | <u>-</u> | <u>1,236,485</u> |

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NOTES TO FINANCIAL STATEMENTS
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Note 4 – Fair Value Measurements (continued)

The fair value of common stock is based on the closing price reported on the active market on which the individual securities are traded. The fair value of mutual funds, the three year PIC linked to BANC, and the Preferreds/Fixed rate cap securities is based on the quoted net asset value or unit cost of the shares held by the Company at year end.

Note 5 – Property and Equipment

Property and equipment consists of the following:

| | <u>2012</u> | <u>2011</u> |
|--|-------------------|------------------|
| Oil and gas properties (successful efforts method) | \$ 499,894 | 114,152 |
| Capitalized asset retirement cost | 21,805 | 13,537 |
| Office furniture and equipment | <u>102,429</u> | <u>102,429</u> |
| | 624,128 | 230,118 |
| Less accumulated depreciation, depletion and amortization | <u>(254,387)</u> | <u>(148,203)</u> |
| | <u>\$ 369,741</u> | <u>81,915</u> |

Note 6 – Other Assets

During the year ended September 30, 2011, the Internal Revenue Service (IRS) conducted an audit of the 2007 tax year. The audit resulted in the IRS disallowing the write-off of the cost basis of certain leases held-for-resale because the Company retained an overriding royalty interest on the leases after the sale and the IRS assessed back taxes, interest, and penalties of \$657,987. The Company has taken the position that because the leases are on wildcat acreage and because the amount of estimated future production is unknown, 100% of the cost basis can be depleted.

The Company paid \$657,987 in order to discontinue the accrual of interest and penalties in the event that the Company's ongoing appeal is unsuccessful. The amount is included in other assets.

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Note 7 – Asset Retirement Obligation

The Company has an obligation to plug and abandon certain oil and gas wells it owns. Accordingly, a liability has been established equal to the obligation.

The following is a reconciliation of the aggregate retirement liability associated with the Company's obligation to plug and abandon its oil and gas properties:

| | <u>2012</u> | <u>2011</u> |
|-------------------------------------|------------------|---------------|
| Balance, beginning of year | \$ 18,685 | 52,299 |
| Reduction of obligation due to sale | - | (40,999) |
| Increase in obligations | 8,268 | 5,817 |
| Accretion expense | <u>1,206</u> | <u>1,568</u> |
| Balance, end of year | <u>\$ 28,159</u> | <u>18,685</u> |

Note 8 – Stock Subscription Receivable

The stock subscription receivable consists of a three percent receivable due from the Company's ESOP. The receivable is reduced every six months by the amount of the obligation owed by the Company to the ESOP, less interest (see Note 15). During the years ended September 30, 2012 and 2011, the Company recognized \$11,598 and \$1,312 of interest income related to this note.

Note 9 – Income Taxes

The income tax benefit consists of the following:

| | <u>2012</u> | <u>2011</u> |
|----------|-------------|------------------|
| Current | \$ - | (55,000) |
| Deferred | <u>-</u> | <u>(218,000)</u> |
| | <u>\$ -</u> | <u>(273,000)</u> |

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
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Note 9 – Income Taxes (continued)

The benefit for income taxes differs from the amount computed at federal statutory rates as follows:

| | | | |
|---------------------------------------|----|-----------------|------------------|
| Income tax benefit at statutory rate | \$ | (385,000) | (244,000) |
| State benefit, net of federal benefit | | (40,000) | (27,000) |
| Change in valuation allowance | | 445,000 | - |
| Other | | (20,000) | (2,000) |
| | | <u>(20,000)</u> | <u>(2,000)</u> |
| | \$ | <u>-</u> | <u>(273,000)</u> |

Deferred tax assets (liabilities) are comprised of the following:

| | | | |
|---|----|----------------|----------------|
| Net operating loss carryforward | \$ | 723,000 | 184,000 |
| Intangible drilling costs and depletion | | (89,000) | 6,000 |
| Unrealized holding gain on investments | | (8,000) | (11,000) |
| Asset retirement obligation | | 4,000 | 3,000 |
| | | <u>630,000</u> | <u>182,000</u> |
| Less valuation allowance | | (445,000) | - |
| | \$ | <u>185,000</u> | <u>182,000</u> |

Presented in the financial statements as follows:

| | | | |
|---------------------------|----|----------------|-----------------|
| Deferred income tax asset | \$ | 193,000 | 193,000 |
| Deferred income taxes | | <u>(8,000)</u> | <u>(11,000)</u> |
| | \$ | <u>185,000</u> | <u>182,000</u> |

Tax years 2008, 2009, and 2010 remain open to examination by the Federal Internal Revenue Service and for state taxing authorities.

As of September 30, 2012, the Company has net operating loss (NOL) carryforwards of approximately \$1,817,000. If substantial changes in the Company's ownership should occur there would be an annual limitation of the amount of NOL carryforwards which could be utilized. Also, the ultimate realization of these carryforwards is due, in part, on the tax law in effect at the time, and future events, which cannot be determined.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 10 – Sales to Major Customers

The Company had oil and gas sales to major customers during the years ended September 30, 2012 and 2011, which exceeded ten percent of total oil and gas sales as follows:

| | <u>2012</u> | <u>2011</u> |
|-----------|-------------|-------------|
| Company A | \$ 452,128 | 323,188 |
| Company B | 230,170 | 608,000 |
| Company C | 96,488 | - |
| Company D | - | 305,654 |

Note 11 – Related Party Transactions

The Company acts as the operator for several oil and gas properties in which employees, officers and other related and unrelated parties have a working or royalty interest. At September 30, 2012 and 2011 there were no related party balances included in accounts payable due to officers as a result of these activities. The Company also is a member in certain limited partnerships and the operator for certain joint ventures formed for the purpose of oil and gas exploration and development.

The Company leases its office space from certain officers of the Company on a month-to-month basis. The lease requires monthly rental payments of \$2,500 plus all expenses pertaining to the office space. Rent expense for the years ended September 30, 2012 and 2011 was approximately \$30,000 each year.

The Company has a stock subscription receivable from the ESOP (see Note 8).

Note 12 – Supplemental Disclosures of Cash Flow Information

During the year ended September 30, 2012, the Company:

- Recorded a decrease of investments of \$7,896, a change in unrealized holding gain of \$4,896, and a change in investment related deferred income taxes of \$3,000.
- Sold 414,327 shares of treasury stock to the Company's ESOP at a cost of \$414,307 in exchange for a \$11,619 reduction to ESOP payable and a \$402,688 increase to stock subscription receivable.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 12 – Supplemental Disclosures of Cash Flow Information (continued)

- Recorded capitalized asset retirement costs and asset retirement obligation of \$8,268 due to drilling activities.

During the year ended September 30, 2011, the Company:

- Recorded a decrease of investments of \$3,847, a change in unrealized holding gain of \$2,847, and a change in investment related deferred income taxes of \$1,000.
- Sold 6,000 shares of treasury stock to the Company's ESOP at a cost of \$5,560 in exchange for a stock subscription receivable.
- Issued 30,630 shares of common stock to the Company's ESOP in exchange for a stock subscription receivable of \$25,423.
- Reduced cost of operations by \$33,163 as a result of oil and gas properties with an asset retirement obligation of \$40,999 and net capitalized asset retirement costs of \$7,836 being sold.
- Recorded capitalized asset retirement costs and asset retirement obligation of \$5,817 due to drilling activities.

Operations reflect actual amounts paid for interest and income taxes approximately as follows:

| | <u>2012</u> | <u>2011</u> |
|--------------|-------------|-------------|
| Interest | \$ 57 | - |
| Income taxes | \$ - | 657,987 |

Note 13 – Fair Value of Financial Instruments

None of the Company's financial instruments, which are current assets and liabilities that could be readily traded, are held for trading purposes. Detail on investments is provided in Note 4. The Company estimates that the fair value of all financial instruments at September 30, 2012 and 2011 does not differ materially from the aggregate carrying value of its financial instruments recorded in the accompanying balance sheet.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 14 – Stock Options

The Company has adopted a stock option plan (the Plan). Under the Plan, the Company may issue shares of the Company's common stock or grant options to acquire the Company's common stock from time to time to employees, directors, officers, consultants or advisors of the Company on the terms and conditions set forth in the Plan.

The fair value of each option granted during 2011 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

| | |
|---------------------------------|-----------|
| Expected dividend yield | - |
| Expected stock price volatility | 54% |
| Risk-free interest rate | 1.94% |
| Expected life of options | 9.9 years |

The weighted average fair value of each option granted during 2011 was approximately \$0.35.

A schedule of the options outstanding is as follows:

| | <u>Number of Options</u> | <u>Exercise Price Per Share</u> |
|---|------------------------------|-------------------------------------|
| Outstanding at October 1, 2010 | 220,000 | \$0.80 |
| Expired | (220,000) | 0.80 |
| Granted | <u>270,000</u> | 0.55 |
| Outstanding at September 30, 2011 and September 30, 2012 | <u><u>270,000</u></u> | \$0.55 |

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 15 – Stock Based Compensation

The following table summarizes information about common stock options outstanding at September 30, 2012:

| Outstanding | | | Exercisable | | |
|----------------|--------------------|---|---------------------------------|--------------------|---------------------------------|
| Exercise Price | Number Outstanding | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
| <u>\$0.55</u> | <u>270,000</u> | <u>8.86</u> | <u>\$0.55</u> | <u>270,000</u> | <u>\$0.55</u> |

Employee Stock Ownership Plan

The Company has adopted a noncontributory employee stock ownership plan (ESOP) covering all full-time employees who have met certain service requirements. It provides for discretionary contributions by the Company as determined annually by the Board of Directors, up to the maximum amount permitted under the Internal Revenue Code. The plan has received IRS approval under Section 401(A) and 501(A) of the Internal Revenue Code. Pension expense charged to operations for the years ended September 30, 2012 and 2011 was \$67,127 and \$65,311, respectively. All outstanding shares held by the ESOP are included in the calculation of earnings per share.

Note 16 – Employee Benefit Plan

The Company sponsors a 401(k) deferred compensation plan that covers all eligible employees. The Company makes non-elective contributions on behalf of employees at the discretion of management. The amount contributed by the Company to the deferred compensation plan for the year ended September 30, 2012 and 2011 was approximately \$67,000 and \$65,000, respectively.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2012 and 2011

Note 17 – Commitments and Contingencies

Limited Partnerships

The Company has an immaterial interest in a limited partnership drilling program and acts as the general partner. As the general partner, the Company is contingently liable for any obligations of the partnership and may be contingently liable for claims generally incidental to the conduct of its business as general partner. As of September 30, 2012, the Company is unaware of any such obligations or claims arising from this partnership.

Employment Agreements

The Company has entered into severance pay agreements with employees and officers of the Company who also serve as board members. Under the terms of the agreements, a board member who is terminated shall receive severance pay equal to the amount such board member received in salary and bonus for the two years prior to termination.

Litigation

The Company may become or is subject to investigations, claims or lawsuits ensuing out of the conduct of its business, including those related to environmental safety and health, commercial transactions, etc. As of September 30, 2012, the Company is only aware of the pending issue discussed in Note 6, which it believes could have a material adverse effect on its financial position.

Note 18 – Subsequent Events

The Company evaluated its September 30, 2012 financial statements for subsequent events through January 10, 2013, the date the financial statements were available to be issued. The Company is not aware of any subsequent events which would require recognition or disclosure in the financial statements.



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**INDEPENDENT AUDITORS' REPORT
ON SUPPLEMENTARY INFORMATION**

To the Board of Directors and
Stockholders of Pioneer Oil and Gas

We have audited the financial statements of Pioneer Oil and Gas as of and for the years ended September 30, 2012 and 2011, and our report thereon dated January 10, 2013, which expressed an unqualified opinion on those financial statements, appears on page 1. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Supplementary Schedules of Oil and Gas Operations, which are the responsibility of management, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information, except for that portion marked "unaudited," was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. That information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, that information is fairly stated in all material respects in relation to the financial statements as a whole. The information marked "unaudited" has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Jones Simkins, P.C.

JONES SIMKINS, P.C.

Logan, Utah

January 10, 2013

PIONEER OIL AND GAS
SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2012 and 2011

The information on the Company's oil and gas operations as shown in this schedule is based on the successful efforts method of accounting and is presented in conformity with the disclosure requirements of ASC Topic 932.

Capitalized Costs Relating to Oil and Gas Producing Activities

| | <u>2012</u> | <u>2011</u> |
|---|-------------------|-----------------|
| Proved oil and gas properties and related equipment | \$ 422,134 | 47,240 |
| Unproved oil and gas properties | 77,760 | 66,912 |
| Capitalized asset retirement cost | <u>21,805</u> | <u>13,537</u> |
| | 521,699 | 127,689 |
| Accumulated depreciation, depletion and amortization and valuation allowances | <u>(151,959)</u> | <u>(46,088)</u> |
| | <u>\$ 369,740</u> | <u>81,601</u> |

Costs Incurred in Oil and Gas Acquisition, Exploration and Development Activities

| | <u>2012</u> | <u>2011</u> |
|----------------------------|-------------|-------------|
| Acquisition of properties: | | |
| Proved | \$ - | - |
| Unproved | \$ - | - |
| Exploration costs | \$ - | - |
| Development costs | \$ 386,000 | - |

PIONEER OIL AND GAS
SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2012 and 2011

Results of Operations for Producing Activities

| | <u>2012</u> | <u>2011</u> |
|--|-------------------|----------------|
| Oil and gas - sales | \$ 968,038 | 1,254,186 |
| Production costs net of reimbursements | (260,195) | (287,313) |
| Exploration costs | (334,150) | (326,834) |
| Depreciation, depletion and amortization and valuation provisions | <u>(105,871)</u> | <u>(968)</u> |
| Net income before income taxes | 267,822 | 639,071 |
| Income tax provision | <u>91,000</u> | <u>217,000</u> |
| Results of operations from producing activities (excluding corporate overhead and interest costs) | <u>\$ 176,822</u> | <u>422,071</u> |

PIONEER OIL AND GAS
SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2012 and 2011

Reserve Quantity Information (Unaudited)

The estimated quantities of proved oil and gas reserves disclosed in the table below are based on appraisal of the proved developed properties by Fall Line Energy, Inc. Such estimates are inherently imprecise and may be subject to substantial revisions.

All quantities shown in the table are proved developed reserves and are located within the United States. Insignificant amounts of natural gas liquids are included in the gas reserves below.

| | <u>2012</u> | | <u>2011</u> | |
|--|----------------|------------------|----------------|------------------|
| | <u>Oil/NGL</u> | <u>Gas</u> | <u>Oil/NGL</u> | <u>Gas</u> |
| | <u>(bbls)</u> | <u>(mcf)</u> | <u>(bbls)</u> | <u>(mcf)</u> |
| Proved developed and undeveloped reserves: | | | | |
| Beginning of year | 6,556 | 1,217,748 | 24,308 | 1,070,739 |
| Revision in previous estimates | 2,283 | (54,780) | 2,252 | 81,480 |
| Discoveries and extensions | 394 | 96,314 | 753 | 207,604 |
| Purchase in place | - | - | - | - |
| Production | (2,266) | (166,443) | (5,215) | (142,075) |
| Sales in place | - | - | (15,542) | - |
| End of year | <u>6,967</u> | <u>1,092,839</u> | <u>6,556</u> | <u>1,217,748</u> |
| Proved developed reserves: | | | | |
| Beginning of year | 6,556 | 1,217,748 | 24,308 | 1,070,739 |
| End of year | 6,967 | 1,092,839 | 6,556 | 1,217,748 |

PIONEER OIL AND GAS
SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2012 and 2011

Standardized Measure of Discounted Future Net Cash Flows and Changes Therein Relating to
Proved Oil and Gas Reserves (Unaudited)

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|--------------------|
| Future cash inflows | \$ 5,278,000 | 7,285,000 |
| Future production and development costs | (2,020,000) | (2,193,000) |
| Future income tax expense | <u>(1,108,000)</u> | <u>(1,731,000)</u> |
| | 2,150,000 | 3,361,000 |
| 10% annual discount for estimated timing of cash flows | <u>(1,012,000)</u> | <u>(1,726,000)</u> |
| Standardized measure of discounted future net cash flows | <u>\$ 1,138,000</u> | <u>1,635,000</u> |

The preceding table sets forth the estimated future net cash flows and related present value, discounted at a 10% annual rate, from the Company's proved reserves of oil, condensate, and gas. The estimated future net revenue is computed by applying the average prices of oil and gas (including price changes that are fixed and determinable) based upon the prior 12-month period and current costs of development production to estimated future production assuming continuation of existing economic conditions. The values expressed are estimates only, without actual long-term production to base the production flows, and may not reflect realizable values or fair market values of the oil and gas ultimately extracted and recovered. The ultimate year of realization is also subject to accessibility of petroleum reserves and the ability of the Company to market the products.

PIONEER OIL AND GAS
SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2012 and 2011

Changes in the Standardized Measure of
Discounted Future Cash Flows (Unaudited)

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|------------------|
| Balance, beginning of year | \$ 1,635,000 | 1,607,000 |
| Sales of oil and gas produced net of production costs | (459,000) | (813,000) |
| Net changes in prices and production costs | (1,074,000) | (17,000) |
| Extensions and discoveries, less related costs | 337,000 | 998,000 |
| Purchase and sales of minerals in place | - | (1,230,000) |
| Revisions of estimated development costs | - | - |
| Revisions of previous quantity estimate | 791,000 | 914,000 |
| Accretion of discount | 164,000 | 161,000 |
| Net changes in income taxes | <u>(256,000)</u> | <u>15,000</u> |
| Balance, end of year | <u>\$ 1,138,000</u> | <u>1,635,000</u> |