

**THE DIVING SEAGULL, INC.  
(A COMPONENT UNIT OF THE STATE OF YAP)**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REPORT**

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**YEARS ENDED SEPTEMBER 30, 2008 AND 2007**

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of  
The Diving Seagull, Inc.:

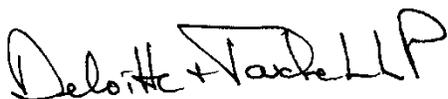
We have audited the accompanying statements of net assets of The Diving Seagull, Inc. (the Company), a component unit of the State of Yap, as of September 30, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit 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, such financial statements, present fairly, in all material respects, the financial position of The Diving Seagull, Inc. as of September 30, 2008 and 2007 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 2 - 3 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Company's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated June 25, 2009 on our consideration of The Diving Seagull, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



June 25, 2009

## THE DIVING SEAGULL, INC.

### Management Discussion and Analysis Year Ended September 30, 2008

The Yap State Government was required to adopt the provisions of the Government Accounting Standards Board (GASB). The Diving Seagull, Inc. is accounted for and is reported as a component unit of the State of Yap.

In 2008, the Company's total net assets increased to from \$6,498,728 to \$6,869,088. Depreciation expenses for all assets; leased fishing vessel and purse net, leasehold improvements, computers, office furniture and vehicle also increased to \$1,145,040 during the fiscal year ended September 30, 2008, as a consequence of the Bareboat Charter Agreement, which has been extended for another 20 years, with which this year would be in its 7th year, upon inception in July 2002.

In 2005, the Company reported bad debts expense from an impairment loss on Palau Micronesian Airlines, \$300,000 of which is for bad debts and \$250,000 was for an impairment loss on an investment. Palau Micronesian Air suspended operations on December 23, 2004 to recognize and restore its business strategy. The note receivable went into effect in June 2005; however, to this date, there has been no payment or communication with The Diving Seagull, Inc. Management is attempting through our legal counsel to collect from PMAir. The collection of the receivable is considered the first priority of The Diving Seagull, Inc.

Operating revenues generated from fish sales of \$8,256,692 increased by 50.3% due to fish price increases, an increase in fish volume, and due to a minimal rejection rate. These factors contributed to the increase in fish sales revenues.

Income from operations in the fiscal year ended September 30, 2008 was \$1,067,616. In 2007 income from operations was \$460,044.00. There is an increased shown this year due to an increase in revenues and a increase in cost of sales.

The Company's operating cash flows totaled \$1,329,028 in 2008 and \$902,676 in 2007. During the year ended September 30, 2008, total cash and equivalents increased from \$1,451,688 to \$2,295,170. The increase in cash and equivalents is due to a fish price increase to \$1,800 per metric ton during the 2008 fiscal year.

In 2007, the FSM Development Bank disbursed \$1.3 million to pay dry-docking costs in Cairns, Australia. The Board decided to obtain another loan from the same bank for an additional \$1.37 million, both of which, were to be paid off within the next 5 years. The purpose of these loans was for dry-docking the FV Mathawmarfach at Tropical Reef Shipyard, in Cairns, Australia.

The following table summarizes the financial condition and results of operation of the Company for the fiscal years ended 2008, 2007 and 2006.

Assets:	2008	2007	2006
Property and equipment, net	\$ 1,212,126	\$ 2,355,297	\$ 911,388
Current assets	5,605,242	4,091,711	3,571,564
Other assets	<u>51,720</u>	<u>51,720</u>	<u>51,030</u>
Total assets	\$ <u>6,869,088</u>	\$ <u>6,498,728</u>	\$ <u>4,533,982</u>
Liabilities and Net Assets:			
Long-term debt	\$ 1,471,875	\$ 1,946,445	\$ 633,515
Current portion of long-term debt	512,737	415,084	159,859
Other current liabilities	<u>552,313</u>	<u>720,079</u>	<u>665,185</u>
Total liabilities	\$ <u>2,536,925</u>	\$ <u>3,081,608</u>	\$ <u>1,458,559</u>

## THE DIVING SEAGULL, INC.

### Management Discussion and Analysis Year Ended September 30, 2008

Net assets:	<u>2008</u>	<u>2007</u>	<u>2006</u>
Invested in capital assets	\$1,212,127	\$ 2,355,297	\$ 911,388
Unrestricted	<u>3,120,069</u>	<u>1,061,823</u>	<u>2,164,035</u>
Total net assets	\$ <u>4,332,163</u>	\$ <u>3,417,120</u>	\$ <u>3,075,423</u>

#### Revenues, Expenses, and Changes in Net Assets:

Operating revenues	\$ 8,256,692	\$ 5,501,572	\$ 5,299,294
Cost of sales	6,720,807	(4,687,935)	(5,010,798)
Operating expenses	<u>(468,269)</u>	<u>(353,593)</u>	<u>(253,281)</u>
Net operating revenues	<u>1,067,616</u>	<u>460,044</u>	<u>35,215</u>
Interest income	83,692	84,444	80,285
Interest expense	(190,450)	(202,791)	(63,006)
Loss on investment	<u>(45,815)</u>	<u>-</u>	<u>-</u>
Net interest income (expense)	<u>(152,573)</u>	<u>(118,347)</u>	<u>17,279</u>
Change in net assets	\$ <u>915,043</u>	\$ <u>341,697</u>	\$ <u>52,494</u>

#### Capital Assets and Debt

As stated above, in fiscal year 2007, the Company made significant investment in capital assets for improvement to its chartered ship. Please see additional information concerning capital assets at note 5 to the financial statements.

To finance these improvements, the Company engaged in significant borrowings. Please see note 6 to the financial statements for additional information concerning Company debt.

Management's Discussion and Analysis for the year ended September 30, 2008 is set forth in the Company's report on the audit of financial statements, which is dated June 26, 2009. That Discussion and Analysis explains the major factors impacting the 2008 financial statements and can be viewed at the FSM Office of the Public Auditor's website at [www.fsmpublicauditor.fm](http://www.fsmpublicauditor.fm).

Additional questions concerning the Management Discussion and Analysis may be submitted to Carmen Kigimnang, General Manager – Diving Seagull, Inc. at [car@mail.fm](mailto:car@mail.fm)

#### Plan of Action for 2008 – Economic Outlook

- 1. Aggressive collection on aging receivables*
- 2. Minimize fuel usage per trip*
- 3. Line of Credit assistance*
- 4. Revised business plan*
- 5. Diversification*
- 6. Research land purchases*
- 7. Purchased of 2<sup>nd</sup> boat*
- 8. Training of staff*
- 9. Work policies and regulations*
- 10. Hiring*

## THE DIVING SEAGULL, INC.

Statements of Net Assets  
September 30, 2008 and 2007

<u>ASSETS</u>	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and cash equivalents	\$ 2,295,170	\$ 1,487,985
Time certificates of deposit	2,566,000	1,566,000
Short-term investments	392,711	-
Net receivable from broker	34,549	806,485
Employee and director receivables	23,936	68,545
Other receivables	28,364	25,146
Deferred charges	250,027	123,066
Prepaid expenses	14,485	14,485
Total current assets	5,605,242	4,091,712
Restricted cash and cash equivalents	51,720	51,720
Property and equipment, net	1,212,126	2,355,296
	\$ 6,869,088	\$ 6,498,728
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current portion of long-term debt	\$ 512,737	\$ 415,084
Accounts payable	381,302	380,842
SA accounts payable	-	26,492
Accrued expenses	171,011	312,745
Total current liabilities	1,065,050	1,135,163
Long-term debt, net of current portion	1,471,875	1,946,445
Total liabilities	2,536,925	3,081,608
Contingencies and commitments		
Net assets:		
Invested in capital assets	1,212,127	2,355,297
Unrestricted	3,120,036	1,061,823
Total net assets	4,332,163	3,417,120
	\$ 6,869,088	\$ 6,498,728

See accompanying notes to financial statements.

**THE DIVING SEAGULL, INC.**

Statements of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2008 and 2007

	2008	2007
Operating revenues:		
Fish sales	\$ 8,256,692	\$ 5,491,876
Other revenues	-	9,696
Total operating revenues	8,256,692	5,501,572
Cost of sales	6,720,807	4,687,935
Gross margin	1,535,885	813,637
Selling, general and administrative expenses:		
Payroll, taxes and benefits	79,885	74,977
Survey	50,436	41,695
Travel	26,557	100,861
Communications and utilities	14,875	19,107
Rent	12,384	6,192
Office expense	6,973	12,159
Depreciation	11,725	11,588
Miscellaneous	265,434	87,014
Total selling, general and administrative expenses	468,269	353,593
Income from operations	1,067,616	460,044
Nonoperating revenues (expenses):		
Interest expense	(190,450)	(202,791)
Interest income	83,692	84,444
Investment loss	(45,815)	-
Total nonoperating revenues (expenses), net	(152,573)	(118,347)
Change in net assets	915,043	341,697
Net assets at beginning of year	3,417,120	3,075,423
Net assets at end of year	\$ 4,332,163	\$ 3,417,120

See accompanying notes to financial statements.

**THE DIVING SEAGULL, INC.**

Statements of Cash Flows  
Years Ended September 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash received from customers	\$ 9,068,149	\$ 4,537,504
Cash payments to suppliers for goods and services	(5,213,206)	(2,576,978)
Cash payments to boat crew and employees for services	(1,087,389)	(1,057,850)
Net cash provided by operating activities	2,767,554	902,676
Cash flows from investing activities:		
Acquisition of property and equipment	(1,870)	(2,332,688)
Increase in short-term investments and time certificate of deposit	(1,438,526)	-
Interest received from short-term investments	83,691	84,444
Net cash used in investing activities	(1,356,705)	(2,248,244)
Cash flows from capital and related financing activities:		
Principal repayments of long-term debt	(376,917)	(308,471)
Interest paid on long-term debt	(190,450)	(202,791)
Proceeds from issuance of long-term debt	-	1,876,626
Net cash (used in) provided by capital and related financing activities	(567,367)	1,365,364
Net change in cash	843,482	19,796
Cash and equivalents at beginning of year	1,451,688	1,431,892
Cash and equivalents at end of year	\$ 2,295,170	\$ 1,451,688
Reconciliation of income from operations to net cash provided by operating activities:		
Operating income	\$ 1,067,616	\$ 460,044
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	1,145,039	888,779
Changes in assets and liabilities:		
Employee and director receivables	50,609	(52,801)
Other receivables	(3,218)	(479)
Net receivable from Broker	781,936	(806,485)
Deferred charges	(116,662)	358,724
Net payable to broker	-	(157,104)
Accounts payable-SA	(16,492)	-
Accounts payable - other	460	38,440
Accrued expenses	(141,734)	173,558
Net cash provided by operating activities	\$ 2,767,554	\$ 902,676

See accompanying notes to financial statements.

# THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2008 and 2007

## (1) Summary of Significant Accounting Policies

### Reporting Entity

The Diving Seagull, Inc. (the “Company”), a component unit of the State of Yap, was incorporated in Yap in the Federated States of Micronesia on March 17, 1997. The Company is organized primarily to pursue fishing and other fishing related activities by operating fishing vessels, marketing and selling fish, and developing cold storage and/or transshipment facilities. A seven member Board of Directors is responsible for managing the business affairs and directing the daily operations of the corporation.

The Articles of Incorporation authorized the issuance of 6,500,000 shares of common stock at \$1 par value per share. All such shares were issued to the Yap Investment Trust fund, a fund of the State of Yap, under the terms of a twenty-five year lease agreement for use of the fishing vessel, Mathawmarfach, and purse seine fishing net. This Bareboat Charter Agreement expires in March 2022.

### Basis of Accounting

The financial statements of the Company have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. Governmental Accounting Standards Board (GASB) Statement No. 20, “*Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*,” requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Company has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The Company adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34 (Basic Financial Statements – Management’s Discussion and Analysis for State and Local Governments). GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into four net asset categories:

- (a) *Invested in capital assets, net of related debt* – Capital assets, net of accumulated depreciation, and outstanding principle balances of debt attributable to the acquisition, construction, or improvement of those assets.
- (b) *Restricted Nonexpendable* – Net assets subject to externally imposed stipulations that require the Company to maintain them permanently.
- (c) *Restricted Expendable* – Net assets whose use by the Company is subject to externally imposed stipulations that can be fulfilled by actions of the Company pursuant to those stipulations or that expire by the passage of time.
- (d) *Restricted Unrestricted* – Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2008 and 2007

(1) Summary of Significant Accounting Policies, Continued

Basis of Accounting, Continued

The Company's 6,500,000 shares of authorized, issued and outstanding common stock with par value of \$1 per share represent capital net assets. However, since all shares are held by the State and since the Company is a component unit of the State, these shares are not presented in the accompanying balance sheets.

Operating and Non-Operating Revenue and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of the Company. Non-operating revenues and expenses result from capital and financing activities, costs and related recoveries from natural disasters, and certain other non-recurring income and costs.

New Accounting Standards

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2008 and 2007

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

Cash and Equivalents

Cash includes cash on hand as well as cash in various bank accounts and time certificates of deposits with an initial maturity date of three months or less. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified as short-term investments.

Investments

Investments and related investment earnings and losses are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. Routine maintenance and repairs are expensed as incurred. Depreciation is recorded in the financial statements under the straight-line method based on the estimated useful lives of the assets as follows:

Computer and office furniture and equipment	3-5 years
Leased equipment	5-20 years
Leasehold improvements	3-10 years
Vehicles	5 years

Leased assets and leasehold improvements are capitalized over the lesser of the useful life or the lease term. Capitalization thresholds are \$1,000 for leasehold improvements and \$500 for all other assets.

Revenue Recognition

The Company's primary source of revenue is derived from the sale of fish. Sales of fish are only considered earned upon offloading the catch to a designated third party. The sales are estimated, less a provision for rejected fish, based on broker commitments per ton and are adjusted upon receipt of a final settlement from the broker.

Other revenue is recorded when earned and measurable.

THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2008 and 2007

(1) Summary of Significant Accounting Policies, Continued

Translation of Foreign Currencies

Gains and losses that arise from exchange rate changes on transactions denominated in a currency other than U.S. dollars are included in the statement of income as incurred.

Use of Estimates

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

Deferred Charges

Direct costs incurred for ongoing fishing trips are recognized as deferred charges. Deferred charges primarily comprise fuel inventory on hand, crew salaries, license fees, port fees, and other direct expenses related to the trip, but exclude depreciation.

Allowance for Doubtful Accounts

The Company establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends, and other information.

(2) Deposits

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The deposit and investment policies of the Company are governed by its enabling legislation. The Board of Directors is required to engage one or more fund custodians to assume responsibility for the physical possession of the Company's investments.

A. Deposits:

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by the Company or its agent in the Company's name;
- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Company's name;
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Company's name and non-collateralized deposits.

THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2008 and 2007

(2) Deposits, Continued

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. 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. The Company does not have a deposit policy for custodial credit risk.

As of September 30, 2008 and 2007, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit was \$4,912,890 and \$3,105,705, respectively, and the corresponding bank balances were \$5,046,758 and \$3,168,247, respectively. Of the bank balances, \$3,111,944 and \$1,476,134, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008 and 2007, bank deposits in the amount of \$153,448 and \$141,955, respectively, were FDIC insured. The Company does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. The Company has not experienced any losses on such accounts and management believes it is not exposed to any significant credit risk on its deposits.

(3) Investments

Investments GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

Category 1 Investments that are insured or registered, or securities held by the governmental entity or its agent in the entity's name; Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the entity's name; or Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the entity's name. GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3. Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Company will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. the Company's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the Company's name by the Company's custodial financial institutions. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2008 and 2007

(3) Investments, Continued

As of September 30, 2008 the fair market value of investments included \$59,857 in mutual funds, \$162,421 in stock, \$77,902 in Government bonds, and \$92,531 in treasury notes. During the year ended September 30, 2008, the Company recorded an investment loss of \$45,815 due to a decline in the fair market value of the investments.

Investment	S&P Rating	Maturity Date	Amount
U.S. government agencies:			
Federal National Mortgage Association	AAA	3/15/2009	\$ 7,077
Federal National Mortgage Association	AAA	10/18/2010	12,236
Federal National Mortgage Association	AAA	7/15/2013	10,244
Federal Home Loan Mortgage Association	AAA	6/15/2009	7,162
Federal Home Loan Mortgage Association	AAA	12/15/2009	15,258
Federal Home Loan Mortgage Association	AAA	12/15/2010	10,334
Federal Home Loan Mortgage Association	AAA	10/15/2014	7,414
Federal Home Loan Mortgage Association	AAA	2/13/2017	8,177
			\$ 77,902

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. There was no interest rate risk for investments as of September 30, 2008. The Company does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

(4) Net Receivable from/Payable to Broker

Approximately 100% of fish sales in the years ended September 30, 2008 and 2007 were conducted with a single broker based in Taiwan. Upon offloading the fish catch from the vessel to a designated third party, the broker pays 95% of the estimated settlement. When the final settlement is determined, the Company may either be entitled to an additional amount due from the broker or be liable for an amount due to the broker. The net broker account is a receivable of \$34,549 at September 2008 and \$806,485 at September 30, 2007.

(5) Notes and Other Receivables

Outstanding balances from notes and other receivables due the Company from various parties are detailed below. As of September 30, 2008, the receivables were written off.

	<u>2008</u>	<u>2007</u>
Palau Micronesia Air (PMAir)	\$ -	\$ 550,000
Fishing companies	-	55,234
Micronesian Petroleum Company (MPC) Yap	-	40,631
National Fisheries Corporation (NFC)	-	3,477
	-	649,342
Less: allowance for doubtful accounts	-	(649,342)
	\$ -	\$ -

THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2008 and 2007

(6) Property and Equipment

Property and equipment consist of the following at September 30, 2008 and 2007:

	Beginning Balance Oct. 1, 2007	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2008
Leased fishing vessel and purse seine net	\$ 6,320,962	\$ -	\$ -	\$ 6,320,962
Leasehold improvements	3,847,985	1,570	-	3,849,555
Computer and office furniture and equipment	31,900	300	-	32,200
Vehicle	<u>26,568</u>	<u>-</u>	<u>-</u>	<u>26,568</u>
Total cost	10,227,415	1,870	-	10,229,285
Less accumulated depreciation	<u>(7,872,119)</u>	<u>(1,145,040)</u>	<u>-</u>	<u>(9,017,159)</u>
	\$ <u>2,355,296</u>	\$ <u>(1,143,170)</u>	\$ <u>-</u>	\$ <u>1,212,126</u>
	Beginning Balance Oct. 1, 2006	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2007
Leased fishing vessel and purse seine net	\$ 6,320,962	\$ -	\$ -	\$ 6,320,962
Leasehold improvements	1,552,372	2,295,613	-	3,847,985
Computer and office furniture and equipment	38,789	6,484	(13,373)	31,900
Vehicle	<u>34,304</u>	<u>26,568</u>	<u>(34,304)</u>	<u>26,568</u>
Total cost	7,946,427	2,328,665	(47,677)	10,227,415
Less accumulated depreciation	<u>(7,035,039)</u>	<u>(884,757)</u>	<u>47,677</u>	<u>(7,872,119)</u>
	\$ <u>911,388</u>	\$ <u>1,443,908</u>	\$ <u>-</u>	\$ <u>2,355,296</u>

(7) Long-Term Debt

On July 28, 2006, the Company signed a five-year loan agreement with the Federated States of Micronesia Development Bank (FSMDB) authorizing a maximum loan of \$1,300,000 to cover the dry-dock costs of the fishing vessel. The agreement stipulates a 1.5% loan fee and interest rate of 9%. Interest is due monthly during the six-month grace period. Interest and principal are payable in monthly installments of \$26,986 beginning January 30, 2007. Part of the loan agreement requires the Company to establish a joint account with FSMDB and to make deposits therein as required by that agreement. As of September 30, 2008 and 2007, the balance of this restricted account is \$51,720 and \$51,720, respectively.

On February 16, 2007, a new loan was granted by FSMDB amounting to \$1,370,000 to cover additional dry dock costs of the fishing vessel at an interest rate of 9%. Interest and principal are payable in monthly installments of \$28,606 beginning June 15, 2007.

Both notes are collateralized by a chattel mortgage on all property and equipment, including the fishing vessel Mathawmarfach.

THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2008 and 2007

(7) Long-Term Debt, Continued

A summary of changes in long-term debt is provided below:

	<u>2008</u>	<u>2007</u>
Balance at beginning of year	\$ 2,361,529	\$ 793,374
Additions	-	1,876,626
Payments	<u>(376,917)</u>	<u>(308,471)</u>
Balance at end of year	1,984,612	2,361,529
Less current portion	<u>(512,737)</u>	<u>(415,084)</u>
Long-term debt	\$ <u>1,471,875</u>	\$ <u>1,946,445</u>

Future debt service on the above debt is as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 512,737	\$ 154,372	\$ 667,109
2010	560,835	106,274	667,109
2011	613,445	53,664	667,109
2012	<u>297,595</u>	<u>5,558</u>	<u>264,986</u>
	\$ <u>1,984,612</u>	\$ <u>319,868</u>	\$ <u>2,266,313</u>

(8) Lease Commitments

The Company leases the fishing vessel and purse seine fishing net from Yap Investment Trust, a fund of the Yap State Government (the "State"), with a lease term through July 2022. Common stock was issued by the Company as total consideration for the agreement.

(9) Cost of Sales

The detail of cost of sales for the years ended September 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Fuel	\$ 2,590,275	\$ 1,420,951
Depreciation	1,133,314	877,191
Crew salaries and wages	1,038,059	874,738
Repair and maintenance	888,447	398,936
License, agent and port fees	409,241	398,195
Insurance	255,785	229,346
Management fee	155,600	193,342
Salt and provisioning	44,376	86,301
Supplies and freight	49,686	59,929
Crew travel	41,115	58,947
Communications	54,657	51,617
Stevedoring	51,430	35,550
Other vessel expenses	<u>8,822</u>	<u>2,892</u>
	\$ <u>6,720,807</u>	\$ <u>4,687,935</u>

THE DIVING SEAGULL, INC.

Notes to Financial Statements  
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(10) Risk Management

The Company is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Company has elected to purchase commercial insurance for the risks of loss to which it is exposed. The Company claims expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. No losses as a result of these risks have occurred in any of the past three years.

(11) Related Parties

The Company has entered into significant transactions with the State, as discussed in Note 7. Several board members and officers of the Company hold management positions and other positions of influence with the State. Certain officers of the Company represented on the Board of the Yap Investment Trust, the sole owner of the Company, also represent the State on the Board of Palau Micronesia Air.

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

To the Board of Directors of  
The Diving Seagull, Inc.:

We have audited the financial statements of The Diving Seagull, Inc. (the Company), as of and for the year ended September 30, 2008, and have issued our report thereon dated June 25, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting.

A *control deficiency* 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

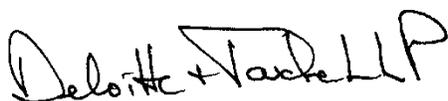
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies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

### Compliance and Other Matters

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

We noted other matters that we reported to management of the Company in a separate letter dated June 25, 2009.

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

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, slightly stylized font.

June 25, 2009