

The Diving Seagull, Inc.
(A Component Unit of the State of Yap)

Financial Statements and
Independent Auditor's Reports
as of and for the Years Ended
September 30, 2011 and 2010



FORTENBERRY & BALLARD, PC
CERTIFIED PUBLIC ACCOUNTANTS

The Diving Seagull, Inc.

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FORTENBERRY & BALLARD, PC
CERTIFIED PUBLIC ACCOUNTANTS
INDEPENDENT AUDITOR'S REPORT

The Board of Directors
The Diving Seagull, Inc.

We have audited the accompanying statements of net assets of The Diving Seagull, Inc., a component unit of Yap State Government, as of September 30, 2011 and 2010, 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 Diving Seagull's management. Our responsibility is to express an opinion on these financial statements based on our audit. As discussed in Note 11 to the financial statements, the Company has restated its 2010 financial statements to correct errors discovered during the year ended September 30, 2011.

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. 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Diving Seagull, Inc., as of September 30, 2011 and 2010, and the results of its operations, changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 15, 2012 on our consideration of The Diving Seagull'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 over 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 6 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.

FORTENBERRY & BALLARD, PC

March 15, 2012

1929 SPILLWAY ROAD, BRANDON, MISSISSIPPI 39047
TELEPHONE (601) 992-5292 FAX (601)992-2033
P.O. BOX A, KOLONIA, POHNPEI FM 96941, TELEPHONE (691) 320-8657

MANAGEMENT'S DISCUSSION AND ANALYSIS

THE DIVING SEAGULL, INC.
(A COMPONENT UNIT OF THE STATE OF YAP)
Management Discussion and Analysis
Year Ended September 30, 2011

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

In 2011, the Company's total assets increased from \$10,215,602 (as restated) in 2010 to \$11,157,243. Total net property and equipment, including leased fishing vessel and purse net, lease hold improvements, computers, office furniture and vehicle decreased to \$5,146,481 during the fiscal year ended September 30, 2011, as a consequence of the Bareboat Charter Agreement which has been extended to another 20 years, making this year its 9th year, upon inception in July 2002.

Fishing Vessel Mathawmarfach anticipated her next dry dock in 2013 during the time of the floating aggregate device closure policy (FAD), which commences during July through September of each year thereon. The Floating Aggregate Device (FAD) closure program was newly implemented as a conservation method of the species that have economic value and also served as conservatory measures that would impact the operation of fishing activities in the Western Pacific region in the coming years to come.

The Vessel Yap Seagull, which was newly purchased in February 2010, initially operated at a loss, but with a strategy to continue operational until it generates profits for the next three years. Many changes, from crewing to replacement of engines and parts, have demonstrated to be workable approached during its second year in operational. The result of these activities has proven the vessel can show a profit, if it continues to maintain its same course.

Operating revenues generated from fish sales of \$12,019,924 increased by 70% due to the increased number of boats, number of fishing trips, and increased fish prices. Gross profit also increased to \$2,293,655 due to decreased cost of sales and increase in fish prices. The most major portion of cost of sales was fuel (\$4,849,434) and crew wages (\$1,428,201).

The net income from operations in the fiscal year ended September 30, 2011 was \$2,001,584. In 2010, the loss from operations, as restated, was \$1,132,980. There was an increase shown this year due to increased fishing with two operational vessels for the year and increased fish prices.

In 2011, total liabilities and net assets were \$11,157,243 as compared to \$10,215,602 in 2010. These amounts increased over 9% from 2010 to 2011, due to increased fish sales revenue. The table on the following page summarizes the financial condition and results of operations of the Company for the fiscal years ended 2011, 2010, and 2009.

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

Management Discussion and Analysis
Year Ended September 30, 2011

<u>Assets</u>	2011	2010 (as restated)	2009
Property & equipment, net	\$ 5,146,481	\$ 5,646,174	\$ 1,554,594
Current assets	3,934,353	2,499,401	4,968,656
Other assets	2,076,409	2,070,027	2,252,380
Total Assets	<u>\$ 11,157,243</u>	<u>\$ 10,215,602</u>	<u>\$ 8,775,630</u>
<u>Liabilities and Net Assets</u>			
Liabilities:			
Long-term debt, net of current portion	\$ 3,368,421	\$ 4,132,808	\$ 2,349,927
Current portion of long-term debt	884,141	1,248,023	1,016,717
Other current liabilities	1,903,778	1,660,690	568,524
Total Liabilities	<u>6,156,340</u>	<u>7,041,521</u>	<u>3,935,168</u>
Net Assets:			
Invested in capital assets, net of related debt	976,771	516,638	618,667
Restricted-expendable	2,076,289	2,070,027	2,052,380
Unrestricted	1,947,843	587,416	2,169,415
Total Net Assets	<u>5,000,903</u>	<u>3,174,081</u>	<u>4,840,462</u>
Total Liabilities and Net Assets	<u>\$ 11,157,243</u>	<u>\$ 10,215,602</u>	<u>\$ 8,775,630</u>
<u>Revenue, Expenses, and Changes in Net Assets</u>			
Operating revenues	\$ 12,266,007	\$ 7,061,151	\$ 6,104,827
Cost of sales	(9,972,352)	(7,805,664)	(5,156,952)
Operating expenses	(292,071)	(388,467)	(486,366)
Net operating revenues	<u>\$ 2,001,584</u>	<u>\$ (1,132,980)</u>	<u>\$ 461,509</u>

Management's Discussion and Analysis for the year ended September 30, 2011 is set forth in the Company's report on the audit of financial statement, which is dated March 15, 2012. That Discussion and Analysis explains the major factors impacting the 2011 financial statement and can be viewed at the FSM Office of the Public Auditor's Web Site.

Additional questions or comments, can be addressed to Carmen Kigimnang at Diving Seagull, Email address: car@mail.fm.

Plan of Action for 2012- Economic outlook

1. 2012 dry dock
2. 2nd boat in operational
3. Control and minimized cost
4. Training of staff
5. Work policies and regulation
6. Loan payoff

FINANCIAL STATEMENTS

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

Exhibit A

Statement of Net Assets

As of September 30, 2011 and 2010 (as restated)

<u>ASSETS</u>	2011	2010 (as restated)
Current Assets:		
Cash and cash equivalents	\$ 1,749,088	\$ 282,349
Short-term investments	1,566,000	1,566,000
Investments	449,934	475,598
Employee and director receivables	72,951	134,158
Other receivables, net	1,011	1,012
Prepaid expenses	95,369	40,284
Total current assets	3,934,353	2,499,401
Restricted cash and cash equivalents	2,076,289	2,070,027
Other assets	120	-
Property & equipment, net	5,146,481	5,646,174
Total Assets	\$ 11,157,243	\$ 10,215,602
<u>LIABILITIES & NET ASSETS</u>		
Current liabilities:		
Current portion of long- term debt	\$ 884,141	\$ 1,248,023
Accounts payable	1,260,355	826,891
Net payable to broker	2,851	141,825
Accrued expenses	640,572	691,974
Total current liabilities	2,787,919	2,908,713
Long-term debt, net of current portion	3,368,421	4,132,808
Total liabilities	6,156,340	7,041,521
Net assets:		
Invested in capital assets, net of related debt	976,771	516,638
Restricted, expendable	2,076,289	2,070,027
Unrestricted	1,947,843	587,416
Total net assets	5,000,903	3,174,081
Total Liabilities & Net Assets	\$ 11,157,243	\$ 10,215,602

See accompanying notes to financial statements.

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

Exhibit B

Statement of Activities

September 30, 2011 and 2010 (as restated)

	2011	2010 (as restated)
Operating revenues:		
Fish sales	\$ 12,019,924	\$ 7,061,151
Other revenues	246,083	-
Total operating revenues	12,266,007	7,061,151
Cost of sales	9,972,352	7,805,664
Gross margin	2,293,655	(744,513)
Selling, general and administrative expenses:		
Payroll, taxes and benefits	93,478	90,961
Professional fees	22,367	27,500
Travel	92,405	77,099
Board fees and expenses	19,550	27,700
Bank loan fees	7,036	71,920
Communications and utilities	14,684	16,072
Rent	14,448	14,448
Office expense	17,604	51,568
Depreciation	6,800	8,806
Miscellaneous	3,699	2,393
Total selling, general and administrative expenses	292,071	388,467
Income from operations	2,001,584	(1,132,980)
Nonoperating revenues (expenses):		
Interest expense	(345,984)	(290,176)
Investment income	90,476	101,763
Gain/ (loss) on investments	(25,664)	8,702
Total nonoperating revenues (expenses), net	(281,172)	(179,711)
Change in net assets	1,720,412	(1,312,691)
Net assets at beginning of year	3,174,081	4,840,462
Prior period adjustment	106,410	(353,690)
Net assets at beginning of year restated	3,280,491	4,486,772
Net assets at end of year	\$ 5,000,903	\$ 3,174,081

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.
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Exhibit C

Statement of Cash Flows

September 30, 2011 and 2010 (as restated)

	2011	2010
Cash flows from operating activities:		
Cash received from customers and others	12,188,241	\$ 7,611,806
Cash payments to suppliers for goods and services	(7,438,236)	(5,105,326)
Cash payments to boat crew and employees for services	(1,495,343)	(1,558,992)
Net cash provided by operating activities	3,254,662	947,488
Cash flows from investing activities:		
Acquisition of property and equipment	(203,735)	(4,975,584)
Short - term investments and time certificate of deposit transactions	-	2,237,280
Interest received and gain on investments	64,812	101,763
Net cash used in investing activities	(138,923)	(2,636,541)
Cash flows from capital and related financing activities:		
Principal repayments of long - term debt	(1,328,269)	(985,813)
Payments received on loan	38,500	
Interest paid on long - term debt	(359,231)	(290,176)
Proceeds from issuance of long - term debt	-	3,092,914
Net cash (used in) provided by capital and related financing activities	(1,649,000)	1,816,925
Net change in cash	1,466,739	127,872
Cash and equivalents at beginning of year	282,349	154,477
Cash and equivalents at end year	\$ 1,749,088	\$ 282,349
Reconciliation of income from operating to net cash provided by operating activities:		
Operating income	\$ 2,001,584	\$ (1,132,980)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	703,428	883,412
Prior period adjustment	106,410	(353,690)
(Increase)/ Decrease in Assets and Increase/ (Decrease) in Liabilities:		
Employee and director receivables	61,207	(96,242)
Other receivables	1	25,088
Prepaid expenses	(55,085)	(5,112)
Net receivable from broker	-	534,846
Accounts payable	433,464	539,763
Net payable to broker	(138,974)	141,825
Accrued expenses	142,627	410,578
Net cash provided by operating activities	\$ 3,254,662	\$ 947,488

See accompanying notes to financial statements.

NOTES TO THE FINANCIAL STATEMENTS

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

Notes to Financial Statements

September 30, 2011 and 2010

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 (five, as of October 4, 2011) 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 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. The Company also purchased another fishing vessel, the Yap Seagull, in February 2010.

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.

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- d. *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 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, therefore the Company is a component unit of the State, and these shares are not presented in the accompanying balance sheets.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The Diving Seagull, an enterprise fund, is accounted for on a flow of economic resources measurement focus and a determination of net income and capital maintenance. With this measurement focus, all assets and all liabilities associated with the operation of this fund are included on the balance sheet. The Diving Seagull uses the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized at the time liabilities are incurred, regardless of the timing of the related cash flows.

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

The Diving Seagull adopted GASB 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 implementation of this statement did not have a material effect on the financial statements of the Company.

The Diving Seagull adopted GASB 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 implementation of this statement did not have a material effect on the financial statements of the Company.

The Diving Seagull adopted GASB 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 implementation of this statement did not have a material effect on the financial statements of the Company.

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The Diving Seagull adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments manage specific risks or make investments – in their financial statements. The implementation of this statement did not have a material effect on the financial statements of the Company.

The Diving Seagull has adopted GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. This statement establishes accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. The implementation of this statement did not have a material effect on the financial statements of the Company.

The Diving Seagull has adopted GASB has issued Statement No. 59, *Financial Instruments Omnibus*. The Statement updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The implementation of this statement did not 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.

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Notes to Financial Statements
September 30, 2011 and 2010

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.

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.

Accrued Expenses

Direct costs incurred for ongoing fishing trips are recognized as accrued expenses. Accrued expenses 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.

Custodial Credit Risk—Deposits: Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered

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by depository insurance and are either uncollateralized, or collateralized with securities 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, 2011, and 2010, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit was \$5,391,377 and \$3,918,376, respectively, and the corresponding bank balances were \$5,810,727 and \$3,894,264, respectively. As of September 30, 2011 and 2010, bank deposits in the amount of \$482,266 and \$451,457, 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.

As discussed in Note 6, Long-Term Debt, of the carrying amounts above, the Company reported restricted cash due to debt instruments of \$2,076,289 at September 30, 2011, and \$2,070,027 at September 30, 2010.

3. Investments

Except for (1) nonparticipating investment contracts and for (2) participating interest-earning investment contract and money market investments that had a remaining maturity at the time of purchase of one year or less, investments are reported at fair value, which is based on quoted market price. Nonparticipating investment contracts such as repurchase agreements and nonnegotiable certificates of deposit are reported at cost. Participating interest earning investment contracts and money market investments that had a remaining maturity at the time of purchase of one year or less are reported at amortized cost.

Interest Rate Risk. Interest Rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. 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.

The following table provides information about the interest rate risks associated with the Company's investments. The investments include certain short-term cash equivalents, various long-term items, and restricted assets by maturity in years.

Investment Type	Fair Value	% of Investments	Interest Rate	Investment maturities in years	
				> 1	1-5
<u>Total Government & Government Sponsored Entity Bonds:</u>					
Federal National Mortgage Assn	\$ 7,827	1.74%	4.625%		\$ 7,827
U.S. Treasury Notes	4,635	1.03%	4.50%		4,635
U.S. Treasury Notes	4,070	0.90%	4.875%	4,070	
Federal National Mortgage Assn	10,796	2.40%	4.375%		10,796

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Federal National Mortgage Assn	10,735	2.39%	4.500%	10,735
U.S. Treasury Notes	10,423	2.32%	4.00%	10,423
U.S. Treasury Notes	19,338	4.30%	1.375%	19,338
U.S. Treasury Notes	10,720	2.38%	3.125%	10,720
U.S. Treasury Notes	20,975	4.66%	2.250%	20,975
U.S. Treasury Notes	<u>6,416</u>	1.43%	2.625%	6,416
Total Government & Government Sponsored Entity Bonds	<u>105,935</u>	23.54%		
<u>Other Investments:</u>				
Equity mutual funds	16,476	3.66%		
Equity securities-- domestic	201,500	44.78%		
Equity securities-- international	41,762	9.28%		
Domestic corporate bonds	<u>82,763</u>	18.39%		
Total Other Investments	<u>342,501</u>	76.12%		
Cash balance	<u>1,498</u>	0.33%		
Total Investments	<u><u>\$ 449,934</u></u>	100.00%		

Concentration of Credit Risk. Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Company. This requirement does not apply to investments issued or explicitly guaranteed by the U.S. government, investments in mutual funds and external investment pools, and other pooled investments. As of September 30, 2011, this requirement did not apply to the Company.

Credit Risk. Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Company does not presently have a formal policy that addresses credit risk.

Custodial Credit Risk - Investments. 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 does not have a formal investment policy that addresses custodial credit risk. Based on negotiated trust and custody contracts, all of these investments were held in the Company's custodial financial institutions at September 30, 2011.

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Notes to Financial Statements

September 30, 2011 and 2010

Investment Type	Fair Value	Moody's	S & P	% of Total Investments
U. S. Treasury Securities	\$ 76,577	AAA	AAA	17%
U. S. Government Backed Mortgage Securities	29,358		AAA	7%
Equity Mutual Funds	16,476		unrated	4%
Equity securities-- domestic	201,500		unrated	45%
Equity securities-- international	41,762		unrated	9%
Cash balance	1,498		unrated	>1%
Domestic corporate bonds	11,835	A2	A	3%
Domestic corporate bonds	10,514	A2	A+	2%
Domestic corporate bonds	10,502	AA2	AA+	2%
Domestic corporate bonds	22,578	A3	A-	5%
Domestic corporate bonds	10,324	A1	A	2%
Domestic corporate bonds	5,127	A1	A+	1%
Domestic corporate bonds	11,883	A1	AA	3%
Total	\$ 449,934			100%

4. Net Receivable from/Payable to Broker

Approximately 90% of fish sales in the year ended September 30, 2011, and 100% in 2010, 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 at the years ended September 30, 2011, and 2010, were payables in the amounts of \$2,851 and \$141,825 (as restated), respectively.

5. Property and Equipment

Property and equipment consist of the following as of September 30, 2011 and 2010:

	Beginning Balance Oct. 1, 2010	Transfers and Additions	Transfers and Disposals	Ending Balance Sept. 30, 2011
Leased fishing vessel and purse seine net	\$ 6,821,012	\$ -	\$ -	\$ 6,821,012
Purchased fishing vessel and purse seine net	5,552,316	165,000	-	5,717,316
Leasehold improvements	3,849,555	21,791	-	3,871,346
Vessel improvements	167,598	16,274	-	183,872

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

Notes to Financial Statements

September 30, 2011 and 2010

Office furniture and equipment	33,115	670	-	33,785
Vehicle	26,568	-	-	26,568
	<hr/>	<hr/>	<hr/>	<hr/>
Total cost	16,450,164	203,735	-	16,653,899
Less accumulated depreciation	(10,803,990)	(703,428)	-	(11,507,418)
	<hr/>	<hr/>	<hr/>	<hr/>
Property and equipment, net	\$ 5,646,174	(499,693)	\$ -	\$ 5,146,481
	<hr/>	<hr/>	<hr/>	<hr/>
	Beginning	Transfers	Transfers	Ending
	Balance	and	and	Balance
	Oct. 1, 2009	Additions	Disposals	Sept. 30, 2010
	<hr/>	<hr/>	<hr/>	<hr/>
Leased fishing vessel and purse seine net	\$ 6,821,012	-	\$ -	\$ 6,821,012
Purchased fishing vessel and purse seine net	-	\$5,552,316	-	5,552,316
Leasehold improvements	3,849,555	-	-	3,849,555
Vessel improvements	-	167,598	-	167,598
Office furniture and equipment	32,200	915	-	33,115
Vehicle	26,568	-	-	26,568
Construction in progress	228,667	5,323,649	(5,552,316)	-
	<hr/>	<hr/>	<hr/>	<hr/>
Total cost	10,958,002	11,044,478	(5,552,316)	16,450,164
Less accumulated depreciation	(9,403,408)	(1,400,582)	-	(10,803,990)
	<hr/>	<hr/>	<hr/>	<hr/>
Property and equipment, net	\$ 1,554,594	\$9,643,896	\$(5,552,316)	\$ 5,646,174
	<hr/>	<hr/>	<hr/>	<hr/>

6. 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 and principal are payable in monthly installments of \$26,986, which began January 30, 2007. Part of the 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, 2011, and 2010, the balance of this restricted account was \$55,823, and \$54,927, 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, which began June 15, 2007. The balance at September 30, 2011 was \$98,489.

On October 27, 2009, a new loan in the amount of \$3,000,000 was granted by the Federated States of Micronesia Development Bank, with an interest rate of 9%, to purchase a fishing vessel. Interest and principal are payable in monthly installments of \$38,003, which began on April 25, 2010. The balance at September 30, 2011 was \$2,722,415.

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

Notes to Financial Statements
September 30, 2011 and 2010

On June 16, 2010, a line of credit was issued for working capital from the Federated States of Micronesia Development Bank in the amount of \$500,000, with an interest rate of 9%. At September 30, 2011, the balance of this line of credit was \$0.

On September 29, 2010, a new loan in the amount of \$2,000,000 was granted by the Bank of Guam, with an interest rate of 2.755%, to assist in the purchase of a new vessel after the end of the fiscal year. Interest and principal are payable in monthly installments of \$35,777.94, which began on October 29, 2010. Part of the agreement requires the Company to have on deposit with the Bank of Guam a \$2,000,000 certificate of deposit. The balance of this restricted certificate of deposit at September 30, 2011 was \$2,020,466 and the balance of the loan was \$1,268,265.

All notes are collateralized by a chattel mortgage on all property and equipment, including the fishing vessels Mathawmarfach and Yap Seagull.

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

	<u>2011</u>	<u>2010</u>
Balance at beginning of year	\$5,380,831	\$3,366,644
Additions	-	3,000,000
Payments	<u>(1,128,269)</u>	<u>(985,813)</u>
Balance at end of year	4,252,562	5,380,831
Less current portion	<u>(884,441)</u>	<u>(1,248,023)</u>
Long - term debt	<u>\$3,368,421</u>	<u>\$4,132,808</u>

Future debt service on the above debt above is as follows:

<u>Period Ending</u>	<u>Principal</u>	<u>Interest</u>
9/30/2012	\$ 884,142	\$ 270,324
9/30/2013	654,238	231,132
9/30/2014	721,595	196,889
9/30/2015	290,280	165,756
9/30/16-9/30/20	<u>1,702,307</u>	<u>369,822</u>
Total	<u>\$ 4,252,562</u>	<u>\$ 1,233,923</u>

7. 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 March, 2022. As mentioned in Note 1 to the financial statements, common stock in the amount of \$6,500,000 was issued by the Company as total consideration for the agreement. At the expiration of the charter period, the vessel shall be redelivered (unless lost) to the owner (the "State") at Colonia, Yap, Federated States of Micronesia.

THE DIVING SEAGULL, INC.
(A COMPONENT UNIT OF THE STATE OF YAP)
Notes to Financial Statements
September 30, 2011 and 2010

8. Cost of Sales

The detail of cost of sales for the years ended September 30, 2011 and 2010 are as follows:

	2011	2010
Fuel	\$4,849,434	\$2,698,624
Depreciation	696,628	874,606
Crew salaries and wages	1,428,201	1,371,789
Repair and maintenance, and freight	697,242	856,150
License, agent and port fees	749,906	696,340
Insurance	463,469	402,522
Management fee	262,169	208,207
Salt and provisioning	404,875	253,961
Supplies	33,264	18,709
Crew travel	139,415	135,511
Communications	103,208	194,496
Stevedoring	93,780	75,532
Other vessel expenses	50,761	19,217
	\$9,972,352	\$7,805,664

9. 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.

10. 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.

11. Prior Period Adjustments and Restated Financial Statements

Prior Period Adjustments:

At September 30, 2011, a prior period adjustment in the amount of \$106,410 was recorded. The amounts are: \$108,740; a broker receivable amount at September 30, 2009 reported incorrectly, \$(26,490) to establish an allowance for doubtful accounts for a receivable owed by a former director, and \$24,160 to adjust beginning balances of various accounts.

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

Notes to Financial Statements

September 30, 2011 and 2010

At September 30, 2010, a prior period adjustment in the amount of \$(353,690) was recorded. The amounts were: \$147,249; to record expenditures in the correct fiscal year after reconciled bank accounts were adjusted after the completion of the year, and \$(500,939); to adjust the beginning balance in accumulated depreciation for capitalized dry dock costs from prior years.

Restated Financial Statements:

The 2010 financial statements were restated to reflect the following:

<u>Accounts Affected</u>	<u>Debit/ (Credit)</u> <u>2010 Original</u>	<u>Debit/ (Credit)</u> <u>2010 As Restated</u>	<u>Debit/ (Credit)</u> <u>Difference</u>
Broker payable	\$(151,104)	\$(141,825)	\$9,279
Fish sales	(7,051,872)	(7,061,151)	(9,279)

This adjustment was made to correctly report the broker payable balance at September 31, 2010.

Accounts payable	\$(279,244)	\$(826,891)	\$(547,647)
Fuel expense	2,150,977	2,698,624	547,647

This adjustment was to correctly report fuel expense in fiscal year 2010. The 2010 fuel costs were deducted out of fish sale revenue by the purchasing authority in fiscal year 2011, therefore the adjustment was necessary to correctly match income and expenses in the correct fiscal year.

Management fee payable (within accrued payables)	\$(650,184)	\$(691,974)	\$(41,790)
Management fee expense	166,417	208,207	41,790

This adjustment was made to correctly report management fee payable at September 30, 2010.

REPORT REQUIRED BY *GOVERNMENT AUDITING STANDARDS (GAS)*

FORTENBERRY & BALLARD, PC
CERTIFIED PUBLIC ACCOUNTANTS

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

Board of Directors
The Diving Seagull, Inc.

We have audited the financial statements of the The Diving Seagull, Inc. as of and for the year ended September 30, 2011, and have issued our report thereon dated March 15, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Corporation'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 Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or 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.

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

Compliance and Other Matters

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

1929 SPILLWAY ROAD, BRANDON, MISSISSIPPI 39047
TELEPHONE (601) 992-5292 FAX (601)992-2033
P.O. BOX A, KOLONIA, POHNPEI FM 96941, TELEPHONE (691) 320-8657

Auditing Standards.

We noted certain matters that we reported to management of The Diving Seagull, Inc. in a separate letter dated March 15, 2012.

This report is intended solely for the information and use of the Yap Investment Trust board of directors, the board and management of The Diving Seagull, Inc., and is not intended to be and should not be used by anyone other than these specified parties.

FORTENBERRY & BALLARD, PC

March 15, 2012

**SCHEDULE OF FINDINGS
AND SUMMARY OF PRIOR AUDIT FINDINGS**

The Diving Seagull, Inc.
Schedule of Findings and Questioned Costs
For the Years Ended September 30, 2011 and 2010

Section 1: Summary Schedule of Auditor's Results:

Financial Statements:

1. Type of auditor's report issued on the financial statements: Unqualified.
2. Material noncompliance and other matters relating to the financial statements? No.
3. Internal control over financial reporting:
 - a. Material weakness(es) identified? No.
 - b. Significant deficiency(ies) identified that are not considered to be material weaknesses? No.

Section 2: Findings Relating to the Financial Statements: None.

The Diving Seagull, Inc.
Summary of Prior Audit Findings
For the Years Ended September 30, 2011 and 2010

<u>Finding</u>	<u>Status</u>
Finding 2010-1:	Corrected.
Finding 2010-2:	Corrected.