

THE DIVING SEAGULL, INC.

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

YEARS ENDED SEPTEMBER 30, 2005 AND 2004

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying balance sheets of the Diving Seagull, Inc. (the Company) as of September 30, 2005, and the related statement of revenues, expenses and changes in net assets and cash flows for the year 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 audit. The 2004 financial statements were audited by other auditors who, in their report dated July 25, 2005, indicated that they were unable to satisfy themselves with respect to the carrying value of property and equipment of approximately \$1.2 million and crew wages payable of approximately \$120,000.

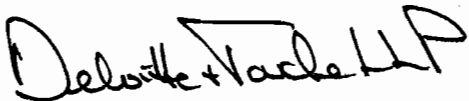
We conducted our audit in accordance with auditing standards generally accepted in the United States and standards for financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2005 financial statements referred to in the first paragraph, present fairly, in all material respects, the financial position of the Diving Seagull, Inc. as of September 30, 2005 and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We also audited the adjustments described in Note 11 that were applied to restate the 2004 financial statements to correct an error. In our opinion, such adjustments are appropriate and have been properly applied.

Management's discussion and analysis on pages 3 and 4 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 consist 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 May 17, 2006 on our consideration of the Diving Seagull, Inc.'s internal control over financial reporting and our tests of its compliance with certain 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.

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

May 17, 2006

DIVING SEAGULL, INC.

Management Discussion and Analysis Year Ended September 30, 2005

The Yap State Government was required to adopt the provisions of the Government Accounting Standard Board. Diving Seagull, Inc. was determined for accounting and reporting to be a component unit of the State of Yap. Because of these changes, the following is the Company financial performance to be reported to the State of Yap for the year ended September 30, 2005.

In 2005, the Company showed a slight increase in its total current assets to \$3,210,927. Depreciation expense for all assets; leased fishing vessel and purse seine net, lease hold improvement, computers, office furniture and vehicle has also slightly increased to \$131,712 for fiscal year ended September 30, 2005, as a consequence of the Bareboat Charter Agreement, which has been extended for another 20 years.

In 2004, the Company has shown on its books bad debt expense and an impairment loss from Palau Micronesian Airlines; \$300,000 of which is for bad debt and \$250,000 is for impairment loss on the investment. Palau Micronesian Air (PMAir) suspended operations on December 23, 2004 to reorganize and restructure its business strategy. The note receivable went in effect in June 2005; however, to this date, there has been no payment or communication to Diving Seagull, Inc. The staff is still keeping with the notion to collect from PMAir. It is considered a first priority of Diving Seagull, Inc.

In 2002, the FSM Development Bank disbursed \$1,152,778 to pay dry-docking cost incurred in New Zealand. Currently, the long-term loan balance has been reduced to \$772,838, while the Company deliberates whether to pay it off and save on the interest expense. Interest saving could range from \$200,000 to \$300,000. A final decision has not been reached as of September 30, 2005.

The following table summarizes the financial condition and results of operations of the Company for 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Assets:		
Property and equipment, net	\$ 1,051,206	\$ 1,182,328
Current assets	3,210,927	2,777,541
Other assets	<u>50,556</u>	<u>50,461</u>
	\$ <u>4,312,689</u>	\$ <u>4,010,330</u>
Liabilities and Net Assets:		
Long-term debt, FSMDB loan	\$ 772,838	\$ 873,780
Current portion of long-term debt	100,942	92,577
Other current liabilities	415,980	555,837
Net assets:		
Invested in capital assets	1,051,206	1,182,328
Unrestricted	<u>1,971,723</u>	<u>1,305,808</u>
	\$ <u>4,312,689</u>	\$ <u>4,010,330</u>

DIVING SEAGULL, INC.

Management Discussion and Analysis Year Ended September 30, 2005

	<u>2005</u>	<u>2004</u>
Revenues, Expenses, and Changes in Net Assets:		
Operating revenues	\$ 5,113,127	\$ 4,452,272
Cost of sales	(3,844,084)	(3,305,073)
Operating expenses	<u>(736,203)</u>	<u>(816,037)</u>
Net operating revenues	<u>532,840</u>	<u>331,162</u>
Interest income and other	85,775	10,144
Interest expense and other	<u>(83,822)</u>	<u>(98,513)</u>
Net other income and (expenses)	<u>1,953</u>	<u>(88,369)</u>
Changes in net assets	\$ <u>534,793</u>	\$ <u>242,793</u>

Operating revenues generated from fish sales at \$5,103,243 had increased by 15% due to the fish price that had increased and have increased the fish volume and minimized rejection rate. All these factors contributed to the 15% increase in fish sales revenues.

Income from operation from this fiscal year ended September 30, 2005 was \$532,840 and in 2004, the income from operation was \$331,162. There is an increase shown this year due to expenses slightly decreasing and income slightly increasing.

The Company's cash as of October 1, 2004 totaled \$880,071 as working capital for the next 12 months. Then on September 30, 2005, cash and equivalents increased by 30% from \$880,071 to \$1,140,585.

Although the Company's receivables and payables have increased over last year, it strives to meet its financial obligations to its employees and vendors.

Plan of Action for 2006

1. Review Vessel Management Agreement/Captain's contract
2. Correct deficiencies on vessel petty cash reports
3. Attend offloading of the vessel
4. Initiate new office space
5. Aggressive collection on aging receivables
6. Hiring of General Manager
7. Diversification Plan
8. To procure new Mathawmarfach sister ship

THE DIVING SEAGULL, INC.

Balance Sheets
September 30, 2005 and 2004

<u>ASSETS</u>	<u>2005</u>	<u>2004</u> <u>(As restated)</u>
Current assets:		
Cash and equivalents	\$ 1,090,029	\$ 829,610
Short-term investments	1,566,000	1,566,000
Employee and director receivables	456	5,650
Other receivables	7,285	7,865
Deferred charges	471,236	329,451
Prepaid expenses	75,921	38,965
Total current assets	3,210,927	2,777,541
Restricted cash	50,556	50,461
Property and equipment, net	1,051,206	1,182,328
	\$ 4,312,689	\$ 4,010,330
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current portion of long-term debt	\$ 100,942	\$ 92,577
Accounts payable	89,217	163,040
SA accounts payable	27,604	27,604
Net payable to broker	156,889	130,236
Accrued expenses	142,270	234,957
Total current liabilities	516,922	648,414
Long-term debt, net of current portion	772,838	873,780
Total liabilities	1,289,760	1,522,194
Contingencies and commitments		
Net assets:		
Invested in capital assets	1,051,206	1,182,328
Unrestricted	1,971,723	1,305,808
Total net assets	3,022,929	2,488,136
	\$ 4,312,689	\$ 4,010,330

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u> (As restated)
Operating revenues:		
Fish sales	\$ 5,103,243	\$ 4,450,128
Other revenues	9,884	2,144
Total operating revenues	<u>5,113,127</u>	<u>4,452,272</u>
Cost of sales	<u>3,844,084</u>	<u>3,305,073</u>
Gross margin	<u>1,269,043</u>	<u>1,147,199</u>
Selling, general and administrative expenses:		
Bad debts	300,000	255,219
Impairment loss on investment	250,000	250,000
Payroll, taxes and benefits	86,125	70,595
Travel expenses	21,958	96,129
Office expense	10,228	6,966
Communications and utilities	10,171	11,366
Depreciation	8,758	9,737
Rent expense	5,760	6,173
Contractual services	5,165	54,988
SA expenses	5,159	14,426
Other expenses	3,112	3,994
Survey	2,041	4,713
Insurance	-	734
Miscellaneous expense	27,726	30,997
Total selling, general and administrative expenses	<u>736,203</u>	<u>816,037</u>
Income from operations	<u>532,840</u>	<u>331,162</u>
Nonoperating revenues (expenses):		
Interest expense	(83,822)	(68,295)
Loss on sale of assets	-	(30,218)
Interest and other income	85,775	10,144
Total nonoperating revenues (expenses)	<u>1,953</u>	<u>(88,369)</u>
Change in net assets	534,793	242,793
Net assets at beginning of year	<u>2,488,136</u>	<u>2,245,343</u>
Net assets at end of year	<u>\$ 3,022,929</u>	<u>\$ 2,488,136</u>

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.

Statements of Cash Flows
Years Ended September 30, 2005 and 2004

	2005	2004 (As restated)
Cash flows from operating activities:		
Receipts from customers	\$ 5,139,780	\$ 4,782,563
Cash payments for goods and services	(2,733,710)	(2,578,999)
Cash payments to boat crew and employees	(1,504,342)	(1,251,472)
Net cash provided by operating activities	901,728	952,092
Cash flows from investing activities:		
Contributions to PMAir	(550,000)	(500,000)
Interest income	85,775	10,144
Purchase of time certificates of deposit	-	(1,566,000)
Net cash used for investing activities	(464,225)	(2,055,856)
Cash flows from noncapital financing activities:		
FSMDB loan principal repayments	(92,577)	(108,096)
Interest paid	(83,822)	(68,295)
FSMDB loan proceeds	-	739,399
Net cash (used in) provided by noncapital financing activities	(176,399)	563,008
Cash flows from capital financing activities:		
Acquisition of property and equipment	(590)	(348,568)
Proceeds from sale of asset	-	25,000
Net cash used in capital financing activities	(590)	(323,568)
Net change in cash	260,514	(864,324)
Cash and equivalents at beginning of year	880,071	1,744,395
Cash and equivalents at end of year	\$ 1,140,585	\$ 880,071
Reconciliation of income from operations to net cash provided by operating activities:		
Operating income	\$ 532,840	\$ 331,162
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	131,712	138,445
Bad debt expense	300,000	250,000
Impairment loss on investment	250,000	250,000
Changes in assets and liabilities:		
Account receivable	-	203,388
Employee and director receivables	5,194	176
Accounts receivable - other	580	(7,867)
Deferred charges	(141,785)	(329,451)
Prepaid expense	(36,956)	47,447
Net payable to broker	26,653	104,374
Accounts payable-SA	-	(40,409)
Accounts payable - other	(73,823)	(4,905)
Accrued expenses	(92,687)	9,732
Net cash provided by operating activities	\$ 901,728	\$ 952,092

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2005 and 2004

(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 Company utilizes accounting principles generally accepted in the United States of America as applicable to proprietary funds of governmental entities. Such funds are accounted for using the flow of economic resources measurement focus. Thus, revenues are recorded when earned and liabilities at the time expenses are incurred.

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 DSI to maintain them permanently.
- (c) *Restricted Expendable* – Net assets whose use by the DSI 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 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.

GASB 34 establishes a new financial reporting model that includes management’s discussion and analysis, which is required supplementary information to the basic financial statements, and the presentation of net assets and changes in net assets.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

Basis of Accounting, Continued

GASB Statement No. 38 requires certain note disclosures to be made in the notes to the financial statement concurrent with the implementation of Statement No. 34. While this statement did not affect amounts reported in the financial statements of the Company, certain note disclosures have been added or amended.

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 90 days or less. The majority of the Company's bank accounts are with federally insured banks. Approximately \$178,208 of such deposits are subject to coverage by federal insurance with the remaining balance exceeding insurable limits. There are no significant differences between cash balances per book and per bank.

Short-term investments of \$1,566,000 represents a certificate of deposit with an initial maturity date of one year with a non-federally insured local credit union.

Therefore, these deposits are exposed to custodial credit risk.

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 equipment	3-5 years
Leased equipment	5 years
Leasehold improvements	up to 20 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.

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.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

Basis of Accounting, Continued

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 crew salaries, license fees, port fees and other direct expenses related to the trip, but exclude depreciation.

(2) Net Payable to Broker

Approximately 100% and 98% of fish sales in the years ended September 30, 2005 and 2004 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 payable of \$156,889 and \$130,236 at September 30, 2005 and 2004, respectively.

(3) Notes and Other Receivables

Outstanding balances from notes and other receivables due the Company from various parties are detailed below:

	<u>2005</u>	<u>2004</u>
Palau Micronesia Air (PMAir)	\$ 550,000	\$ 250,000
Fishing companies	55,234	55,234
Micronesian Petroleum Company (MPC) Yap	40,631	40,631
National Fisheries Corporation (NFC)	<u>3,477</u>	<u>3,477</u>
	649,342	349,342
Less: allowance for doubtful accounts	<u>(649,342)</u>	<u>(349,342)</u>
	\$ <u>-</u>	\$ <u>-</u>

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2005 and 2004

(4) Property and Equipment

Property and equipment consist of the following at September 30, 2005 and 2004:

	Beginning Balance Oct. 1, 2004	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2005
Leased fishing vessel and purse seine net	\$ 6,345,962	\$ -	\$ -	\$ 6,345,962
Leasehold improvements	1,552,372	-	-	1,552,372
Computer and office furniture and equipment	21,014	590	-	21,604
Vehicle	<u>34,804</u>	<u>-</u>	<u>-</u>	<u>34,804</u>
Total cost	7,954,152	590	-	7,954,742
Less accumulated depreciation	<u>(6,771,824)</u>	<u>(131,712)</u>	<u>-</u>	<u>(6,903,536)</u>
	<u>\$ 1,182,328</u>	<u>\$ (131,122)</u>	<u>\$ -</u>	<u>\$ 1,051,206</u>
	Beginning Balance Oct. 1, 2003	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2004
Leased fishing vessel and purse seine net	\$ 6,341,635	\$ 345,961	\$ (341,634)	\$ 6,345,962
Leasehold improvements	1,552,372	-	-	1,552,372
Computer and office furniture and equipment	20,055	2,607	(1,648)	21,014
Vehicle	<u>34,804</u>	<u>-</u>	<u>-</u>	<u>34,804</u>
Total cost	7,948,866	348,568	(343,282)	7,954,152
Less accumulated depreciation	<u>(6,921,443)</u>	<u>(138,446)</u>	<u>288,065</u>	<u>(6,771,824)</u>
	<u>\$ 1,027,423</u>	<u>\$ 210,122</u>	<u>\$ (55,217)</u>	<u>\$ 1,182,328</u>

(5) Long-Term Debt

The Company signed a ten-year loan agreement with the Federated States of Micronesia Development Bank (FSMDB) authorizing a maximum loan of \$1,152,778 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 eight-month grace period. Interest and principal are payable in quarterly installments of \$44,100 beginning June 25, 2003. The note is collateralized by a chattel mortgage on all property and equipment, including the fishing vessel Mathawmarfach and a bank account that must always contain a minimum of \$50,000. A total summary of changes in long-term debt is provided below:

	<u>2005</u>	<u>2004</u>
Balance at beginning of year	\$ 966,357	\$ 335,054
Additions	-	739,399
Payments	<u>(92,577)</u>	<u>(108,096)</u>
Balance at end of year	873,780	966,357
Less current portion	<u>(100,942)</u>	<u>(92,577)</u>
Long-term debt	<u>\$ 772,838</u>	<u>\$ 873,780</u>

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2005 and 2004

(5) Long-Term Debt, Continued

Future debt service on the above debt is as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 100,942	\$ 75,459
2007	110,489	65,912
2008	120,610	55,790
2009	131,999	44,401
2010	144,286	32,114
2011 and 2012	<u>265,454</u>	<u>23,108</u>
	\$ <u>873,780</u>	\$ <u>296,784</u>

(6) 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.

(7) Cost of Sales

The detail of cost of sales is provided hereunder:

	<u>2005</u>	<u>2004</u>
Fuel	\$ 1,276,731	\$ 832,336
Crew salaries and wages	1,142,230	1,042,286
License, agent and port fees	275,229	182,240
Repair and maintenance	296,579	272,539
Insurance	246,015	262,881
Management fee	169,400	184,347
Depreciation	122,954	128,708
Salt and provisioning	88,647	118,979
Communications	75,725	67,931
Crew travel	60,625	63,352
Stevedoring	55,321	56,826
Supplies and freight	34,025	83,935
Other vessel expenses	<u>603</u>	<u>8,713</u>
	\$ <u>3,844,084</u>	\$ <u>3,305,073</u>

(8) Contingencies

The Diving Seagull, Inc. (the "Company") is obligated by insurance requirements to have a survey performed by a qualified agent every three to four years. This survey is used to determine whether the vessel should be placed into dry dock for maintenance necessary to meet specifications under all policies. The most recent dry-dock occurred in May 2002.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2005 and 2004

(9) Related Parties

The Diving Seagull, Inc. (the "Company") has entered into significant transactions with the State, as discussed in Note 6. 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.

(10) Impairment of Investment

In September 2004, the Company advanced \$500,000 to Palau Rock Island, a corporation incorporated under the laws of the Republic of Palau and doing business as Palau Micronesia Air (PMAir), a start-up passenger airline. From October 2004 to January 3, 2005, the Company advanced an additional \$550,000 to PMAir. Of the total \$1,050,000 advanced, \$550,000 is subject to a promissory note signed on January 12, 2005, the other \$500,000 is intended to represent an equity investment; however, only 2,500 shares of common stock at \$100 par value per share have been issued to the Company on December 9, 2004. Additional shares have not been received. PMAir has ceased significant operations, has not submitted audited financial statements and has not evidenced an ability to fulfill the going concern assumption. Therefore, these assets are considered to be impaired and an impairment expense has accordingly been recorded.

(11) Restatement

In 2005, it was determined that the Company did not defer costs incurred on fishing voyages that were on going as of September 30, 2004.

Therefore, the 2004 financial statements were restated to recognize deferred charges on the costs incurred for fishing trips that extended over the fiscal year end, for which no revenue had been previously recognized.

The effect of the change is as follows:

	2004 As previously <u>presented</u>	2004 <u>As restated</u>
Deferred charges	\$ -	\$ 329,451
Accounts payable	136,629	163,040
Accrued expenses	132,738	234,957
Cost of sales	3,505,893	3,305,073

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, 2005, and have issued our report thereon dated May 17, 2006. 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.

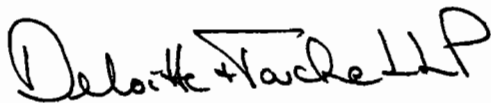
Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Company's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Company in a separate letter dated May 17, 2006.

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 that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the Board of Directors and management of the Company, federal awarding agencies, pass-through entities, cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, flowing style.

May 17, 2006