

POHNPEI FISHERIES CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 2001



INDEPENDENT AUDITORS' REPORT

Board of Directors
Pohnpei Fisheries Corporation:

We have audited the accompanying balance sheet of Pohnpei Fisheries Corporation, a component unit of Pohnpei State Government, as of September 30, 2001, and the related statements of revenues, expenses and changes in fund deficiency and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following two paragraphs, 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 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.

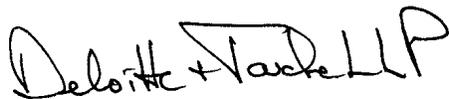
Pohnpei Fisheries Corporation did not conduct a physical count of its inventory as of September 30, 2000. We were unable to determine, by means of other audit procedures, if material variances existed between actual inventory on hand and the amount recorded at September 30, 2000. Because the inventory balance as of September 30, 2000 enters materially into the determination of cost of sales for the year ended September 30, 2001, we were unable to determine, by means of other audit procedures, the propriety of the cost of sales balance for the year ended September 30, 2001.

Pohnpei Fisheries Corporation has recorded a note payable in the amount of \$979,793 to Caroline Fisheries Corporation (CFC), a related component unit of Pohnpei State Government. CFC confirms that the note payable has been extinguished; however, it is not able to provide details of this transaction. CFC has not been able to provide information related to such debt extinguishment, and consequently, the entire amount is included within long-term debt as of September 30, 2001. We are therefore unable to determine, by means of other audit procedures, the propriety of long-term debt for the year ended September 30, 2001.

In our opinion, except for adjustments, if any, which may be required had we been able to verify the propriety of cost of sales and long-term debt as of and for the year ended September 30, 2001, the accompanying financial statements present fairly, in all material respects, the financial position of Pohnpei Fisheries Corporation as of September 30, 2001, and the result 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.

The accompanying financial statements have been prepared assuming the Corporation will continue as a going concern. As discussed in note 9 to the financial statements, the Corporation has incurred losses from operations and has accumulated a deficit of \$5,313,393. These conditions raise substantial doubt about the Corporation's ability to continue as a going concern. Management's plans concerning these matters are also described in note 9. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 15, 2002 on our consideration of the Pohnpei Fisheries Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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March 15, 2002

POHNPEI FISHERIES CORPORATION

Balance Sheet
September 30, 2001

ASSETS

Current assets:	
Cash and equivalents	\$ 30,239
Accounts receivable, net (notes 2 and 7)	81,670
Inventory, at lower of cost or market (note 3)	117,411
Prepaid expenses	412
Total current assets	<u>229,732</u>
Fixed assets held for sale	44,103
Property and equipment, net (note 4)	<u>2,691,668</u>
	<u><u>2,965,503</u></u>

LIABILITIES AND FUND DEFICIENCY

Current liabilities:	
Current installments of long-term debt (note 5)	\$ 1,049,023
Accounts payable (note 7)	1,683,224
Total current liabilities	<u>2,732,247</u>
Long-term debt, excluding current installments (note 5)	<u>2,450,000</u>
Total liabilities	<u>5,182,247</u>
Fund deficiency:	
Contributed capital	3,096,649
Deficit	(5,313,393)
Total fund deficiency	<u>(2,216,744)</u>
Contingencies (notes 8 and 9)	\$ <u><u>2,965,503</u></u>

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Statement of Revenues, Expenses, and Changes in Fund Deficiency Year Ended September 30, 2001

Revenues:	
Charges for goods and services (note 7)	\$ 1,171,805
Cost of sales	<u>1,466,126</u>
Gross loss	<u>(294,321)</u>
General and administrative expenses:	
Depreciation	159,122
Salaries and wages	85,525
Bad debts	18,781
Communications	5,663
Travel and entertainment	4,935
Repair and maintenance	1,082
Rent	545
Taxes	471
Marketing expenses	42
Other	7,984
Total general and administrative expenses	<u>284,150</u>
Loss from operations	(578,471)
Nonoperating (expenses) revenues:	
Interest expense, net	(10,562)
Miscellaneous income	<u>10,921</u>
Net loss	(578,112)
Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	<u>356,661</u>
Increase in deficit	(221,451)
Deficit at beginning of year	<u>(5,091,942)</u>
Deficit at end of year	<u>(5,313,393)</u>
Contributed capital at beginning of year	3,453,310
Less: depreciation on contributed assets	<u>(356,661)</u>
Contributed capital at end of year	<u>3,096,649</u>
Total fund deficiency at end of year	<u>\$ (2,216,744)</u>

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Statement of Cash Flows Year Ended September 30, 2001

Cash flows from operating activities:	
Cash received from customers	\$ 1,109,584
Cash paid to suppliers and employees	<u>(1,043,344)</u>
Net cash provided by operating activities	<u>66,240</u>
Cash flows from capital and related financing activities:	
Acquisition of fixed assets	<u>(49,512)</u>
Net cash used in capital and related financing activities	<u>(49,512)</u>
Cash flows from noncapital financing activities:	
Repayments of note payable	(26,243)
Payment of interest expense	(10,562)
Miscellaneous income	<u>10,921</u>
Net cash used in noncapital financing activities	<u>(25,884)</u>
Net decrease in cash and equivalents	(9,156)
Cash and equivalents at beginning of year	<u>39,395</u>
Cash and equivalents at end of year	<u><u>\$ 30,239</u></u>
<u>Reconciliation of loss from operations to net cash</u> <u>cash provided by operating activities:</u>	
Loss from operations	\$ (578,471)
Adjustments to reconcile loss from operations to net cash provided by operating activities:	
Depreciation	189,698
Depreciation - contributed assets	356,661
Bad debt	18,781
Changes in working capital:	
Increase in accounts receivable	(62,221)
Increase in prepaid expenses and other assets	(412)
Increase in accounts payable	161,286
Increase in inventory	<u>(19,082)</u>
Net cash provided by operating activities	<u><u>\$ 66,240</u></u>

Non-cash transactions:

The Company returned a fishing vessel with a cost of \$46,650 to the FSM National Government in cancellation of a note payable of the same amount.

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2001

(1) Summary of Significant Accounting Policies

Reporting Entity

The Pohnpei Fisheries Corporation (the Corporation) was established in 1992 by Pohnpei State Law 3L-28-93. The purpose of the Corporation is to operate and manage the fish processing plant, boats owned by the plant and the cold storage facility. The Corporation is a component unit of the Pohnpei State Government.

The affairs of the Corporation are managed by a seven-member board, appointed by Pohnpei State Government. Daily operation of the Corporation is delegated to a chief executive officer, who is hired by and serves at the pleasure of the Board.

Fund Structure and Basis of Accounting

The accounts of the Corporation are organized as a proprietary fund. Proprietary funds are used by governmental units that are operated in a manner similar to private business enterprises. The purpose of a proprietary fund - component unit is to provide periodic determination of revenues, expenses and net income, with maintenance of capital. Proprietary funds are accounted for on the flow of economic resources measurement focus, whereby all assets and liabilities associated with the operations of the funds are included on the balance sheet. This is in contrast to "governmental" fund type accounting, which has a measurement focus on the sources and uses of funds, and includes only current assets and current liabilities on the balance sheet.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. The Corporation uses the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when the related liabilities are incurred, regardless of when cash is received or payment is made.

Accounting Standards

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 Corporation has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

Cash and Equivalents

For the purposes of the balance sheet and the statement of cash flows, cash and equivalents are defined as cash in checking accounts and certificates of deposit with initial maturities of ninety days or less.

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2001

(1) Summary of Significant Accounting Policies, Continued

Management 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 disclosures 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.

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation. Depreciation expense is calculated by the straight-line method over the estimated useful life of the assets. Fixed assets held for resale are not depreciated and are carried at cost.

Inventories

Materials and product inventory are substantially carried at the lower of cost (weighted average method) or market (net realizable value).

(2) Receivables

Receivables are carried at cost, less an allowance for doubtful accounts. The allowance for doubtful accounts is estimated using the valuation method. Accounts determined to be uncollectible are charged against the allowance. Uncollectibility of accounts is determined by management based on the financial condition and responsiveness of the debtors to the Corporation's collection efforts. Receivables are due primarily from businesses and individuals in the United States of America and in Pohnpei, Federated States of Micronesia.

A summary of accounts receivable-trade at September 30, 2001, is presented below:

Accounts receivable-trade	\$ 222,534
Allowance for doubtful accounts	(140,864)
Accounts receivable, net	\$ <u>81,670</u>

(3) Inventory

A summary of inventory on hand as of September 30, 2001, is presented below:

Finished goods inventory	\$ 94,101
Packaged materials	<u>23,310</u>
	\$ <u>117,411</u>

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2001

(4) Property and Equipment

A summary of the Corporation's property and equipment at September 30, 2001, is as follows:

	<u>Estimated Useful Life</u>	
Contributed assets	3 - 15 years	\$ 11,820,052
Machinery and equipment	3 - 7 years	1,852,369
Buildings	10 years	282,463
Vehicles	5 - 10 years	86,405
Furniture and fixtures	3 - 5 years	<u>36,964</u>
		14,078,253
Accumulated depreciation		<u>(11,386,585)</u>
Property and equipment, net		\$ <u>2,691,668</u>

Contributed assets represent the fish processing complex and other assets transferred from Pohnpei State Government during fiscal year 1996.

(5) Notes Payable

A summary of notes payable as of September 30, 2001, is as follows:

FSM Development Bank loan, uncollateralized, interest at 7%, due in monthly installments, beginning December 10, 1996, of \$8,695, revised to \$3,000 beginning June 10, 1998, including interest thereon.	\$ 14,230
Notes payable to Pohnpei State Government for amounts borrowed under a medium-term note program, with repayments not to begin until the Corporation has accumulated retained earnings of at least \$2,000,000.	2,450,000
Notes payable to Caroline Fisheries Corporation, a related component unit of Pohnpei State Government, interest at 9%, due in 32 monthly installments of \$13,683 for the first four months and \$39,582 monthly thereafter commencing in June 1997.	979,793
Notes payable to Pohnpei Economic Development Authority, uncollateralized and without interest, due in equal monthly installments beginning April 30, 1998 of \$20,000.	40,000
Notes payable to FSM National Government for amounts received under a conditional grant award, interest at 9% with no specified repayment term.	<u>15,000</u>
	3,499,023
Less current installments	<u>(1,049,023)</u>
	\$ <u>2,450,000</u>

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2001

(5) Notes Payable, Continued

As the payments on the notes payable to Caroline Fisheries Corporation and Pohnpei Economic Development Authority are in default, the entire principal balance has been classified as current.

Future maturities of the above September 30, 2001 notes payable are as follows:

2002	\$ 1,049,023
2003	-
2004	-
2005	-
Thereafter	<u>2,450,000</u>
	\$ <u>3,499,023</u>

(6) Contributions/Transferred Assets

The Corporation utilizes a fish processing plant and other assets that were previously owned by Pohnpei State Government. During fiscal year 1996, title to the plant and other assets with a book value of \$8,338,881 as of September 30, 1996, was transferred to the Corporation. However, real estate underlying the Corporation's facility is owned by Pohnpei State Government.

(7) Related Party Transactions

The Corporation has recorded payables of \$777,522 and \$700,218 as of September 30, 2001 due to the Pohnpei State Economic Development Authority and Pohnpei Utilities Corporation, respectively, which are related component units of Pohnpei State Government.

The Corporation provides wastewater treatment to a commercial hotel which is owned by a member of its board of directors. An agreement was signed in 1993 to charge a monthly fee of \$330 for the wastewater treatment service. No amount was paid by the hotel nor revenue recorded by the Corporation under this agreement until April 2001, when both parties agreed that the hotel will pay for all amounts due under this agreement. The Corporation recorded \$33,727 as operating revenues from this agreement for the fiscal year ended September 30, 2001 and related accounts receivable amount to \$29,227.

(8) Risk Management

The Corporation purchases commercial insurance to cover its potential risks from workmen's compensation liability. The Corporation is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

(9) Going Concern

As of September 30, 2001, the Corporation has accumulated a deficit of \$5,313,393. Management will attempt to return the Corporation to profitability by securing a steady supply of fish and by reducing its cost of operations.

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2001

(10) Subsequent Event

In February 2002, the Corporation transferred title to its waste water treatment plant with a net book value of \$573,011 to Pohnpei Utilities Corporation in cancellation of accounts payable in the amount of \$699,931.

In March 2002, the Corporation entered into a five-year lease agreement with an entity to lease its building and facilities. The ultimate impact of this matter on the accompanying financial statements and on the Corporation's future operations is uncertain.



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Pohnpei Fisheries Corporation:

We have audited the financial statements of the Pohnpei Fisheries Corporation a component unit of Pohnpei State Government, as of and for the year ended September 30, 2001, and have issued our report thereon dated March 15, 2002, which report was qualified due to an absence of a physical count of inventories and due to our inability to determine whether certain recorded debt was extinguished. 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.

Compliance

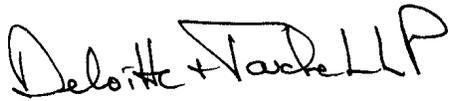
As part of obtaining reasonable assurance about whether Pohnpei Fisheries Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material 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*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pohnpei Fisheries Corporation'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. However, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Pohnpei Fisheries Corporation's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs in finding number 01-1.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions, and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, the reportable condition described above, in our opinion, is not considered to be a material weakness.

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

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March 15, 2002

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2001

Finding No. 01-1 – Employee Contracts

Criteria:

Changes made to employment contracts should be properly documented and acknowledged by the employee to support his concurrence to the change.

Condition:

We noted that one contract employee received a rate reduction. This change was documented in the Company's standard "Personnel Action Form" which was approved by the Acting Chief Executive Officer. However, we noted no written acceptance by the employee acknowledging the rate reduction.

Cause:

The Company is of the opinion that documenting such change in the Personnel Action Form is sufficient since the employee orally agreed to the rate reduction.

Effect:

No financial statement effect results from this condition. However, employee could potentially bring labor action against the Company because both parties are bound by the terms set forth in the employment contract.

Recommendation:

We recommend that the Company immediately revise the employment contract to reflect the pay rate change and have it signed by both parties to avoid potential labor action.

Auditee Response dated May 6, 2002:

Management concurs with the above finding and will revise the contract to reflect the pay rate change and secure the signatures of both parties.