

POHNPEI FISHERIES CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 2002

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, 2002, and the related statements of revenues, expenses and changes in deficit 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.

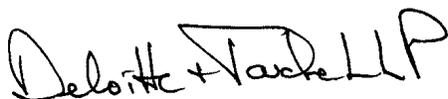
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Pohnpei Fisheries Corporation as of September 30, 2002, 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 \$2,604,698. 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.

As discussed in note 11 to the financial statements, the Corporation changed its method of accounting for nonexchange transactions to conform with Government Accounting Standards Board Statement No. 33.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 22, 2004, 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.



September 22, 2004

POHNPEI FISHERIES CORPORATION

Balance Sheet
September 30, 2002

ASSETS

Current assets:	
Cash and cash equivalents	\$ 9,898
Accounts receivable, net	28,560
Inventory, at lower of cost or market	32,492
Prepaid expenses	<u>452</u>
Total current assets	71,402
Fixed assets held for sale	44,103
Property and equipment, net	<u>1,760,990</u>
	\$ <u><u>1,876,495</u></u>

LIABILITIES AND FUND DEFICIENCY

Current liabilities:	
Current installments of long-term debt	\$ 40,000
Accounts payable	<u>996,400</u>
Total current liabilities	1,036,400
Long-term debt, excluding current installments	<u>3,444,793</u>
Total liabilities	<u>4,481,193</u>
Commitment	
Fund deficiency:	
Contributed capital	3,096,649
Deficit	<u>(5,701,347)</u>
Total fund deficiency	<u>(2,604,698)</u>
	\$ <u><u>1,876,495</u></u>

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Statement of Revenues, Expenses, and Changes in Deficit Year Ended September 30, 2002

Revenues:	
Charges for goods and services	\$ 717,843
Cost of sales	<u>1,044,575</u>
Gross loss	<u>(326,732)</u>
General and administrative expenses:	
Salaries and wages	107,593
Depreciation	42,842
Travel and entertainment	12,718
Professional services	5,609
Communications	5,321
Repair and maintenance	4,951
Utilities	2,500
Marketing	395
Training	300
Taxes	214
Other	9,955
Total general and administrative expenses	<u>192,398</u>
Loss from operations	(519,130)
Nonoperating (expenses) revenues:	
Interest expense	(875)
Miscellaneous income	<u>132,051</u>
Net loss	(387,954)
Deficit at beginning of year	<u>(2,216,744)</u>
Deficit at end of year	<u><u>\$ (2,604,698)</u></u>

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Statement of Cash Flows Year Ended September 30, 2002

Cash flows from operating activities:	
Cash received from customers	\$ 770,953
Cash paid to suppliers and employees	<u>(777,848)</u>
Net cash used in operating activities	<u>(6,895)</u>
Cash flows from capital and related financing activities:	
Acquisition of fixed assets	<u>(3,472)</u>
Cash flows from noncapital financing activities:	
Repayments of notes payable	(14,230)
Payment of interest expense	(875)
Receipt of miscellaneous income	<u>5,131</u>
Net cash used in noncapital financing activities	<u>(9,974)</u>
Net decrease in cash and cash equivalents	(20,341)
Cash and cash equivalents at beginning of year	<u>30,239</u>
Cash and cash equivalents at end of year	<u><u>\$ 9,898</u></u>
<u>Reconciliation of loss from operations to net cash used in operating activities:</u>	
Loss from operations	\$ (519,130)
Adjustment to reconcile loss from operations to net cash used by operating activities:	
Depreciation	361,139
Changes in working capital:	
Decrease in accounts receivable	53,110
Decrease in inventory	84,919
Increase in prepaid expenses	(40)
Increase in accounts payable	<u>13,107</u>
Net cash used in operating activities	<u><u>\$ (6,895)</u></u>

Non-cash transactions:

The Corporation transferred fixed assets with a net book value of \$573,011 to Pohnpei Utilities Corporation (PUC) to satisfy accounts payable of \$699,931.

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2002

(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 of Directors (BOD).

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 Cash Equivalents

For the purposes of the balance sheet and the statement of cash flows, cash and cash 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, 2002

(1) Summary of Significant Accounting Policies, 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 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).

New Accounting Standards

In fiscal year 2003, the Corporation will implement GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis* as subsequently amended by Statement No. 37 and Statement No. 38, *Certain Financial Statement Disclosures*. For fiscal year 2004, the Corporation will be implementing GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* and GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*. For fiscal year 2005, the Corporation will be implementing GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The Corporation has not evaluated the financial statement impact of GASB Statement Nos. 34, 37, 38, 39, 40 and 42.

(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, 2002, is presented below:

Accounts receivable	\$ 169,424
Allowance for doubtful accounts	<u>(140,864)</u>
Accounts receivable, net	\$ <u>28,560</u>

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2002

(3) Inventory

A summary of inventory on hand as of September 30, 2002, is presented below:

Finished goods inventory	\$ 28,551
Packaged materials	<u>3,941</u>
	\$ <u>32,492</u>

(4) Property and Equipment

A summary of the Corporation's property and equipment at September 30, 2002, is as follows:

	<u>Estimated Useful Life</u>	
Contributed assets	3 – 15 years	\$ 10,521,293
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>40,436</u>
		12,782,966
Accumulated depreciation		<u>(11,021,976)</u>
Property and equipment, net		\$ <u>1,760,990</u>

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

(5) Long-Term Debt

A summary of long-term debt as of September 30, 2002, is as follows:

Notes payable to Pohnpei State Government consists of \$2,450,000 borrowed under a medium-term note program, noninterest bearing with repayments not to begin until the Corporation has accumulated retained earnings of at least \$2,000,000; and \$979,793 for the transfer of notes payable to Caroline Fisheries Corporation, with no specified credit term.	\$ 3,429,793
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>
	3,484,793
Less current installments	<u>(40,000)</u>
	\$ <u>3,444,793</u>

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2002

(5) Long-Term Debt, Continued

As the payments on the notes payable to Pohnpei Economic Development Authority are in default, the entire principal balance has been classified as current. Future interest expense attached to the notes payable to FSM National Government could not be determined as there is no specified repayment term.

Notes payable to Pohnpei Economic Development Authority amounting to \$40,000 mature in 2004, while maturities for notes payable to Pohnpei State Government and FSM National Government amounting to \$3,444,793 could not be determined as there are no specific repayment periods.

(6) Contributions

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. The Corporation does not pay rent for the use of this land.

(7) Related Party Transactions

The Corporation has recorded payables of \$777,522 and \$87,022 as of September 30, 2002 due to the Pohnpei State Economic Development Authority and Pohnpei Utilities Corporation, respectively, which are related component units of Pohnpei State Government.

On August 21, 1998, notes payable to Caroline Fisheries Corporation were transferred to Pohnpei State Government as a result of the "Agreement for the Restructuring of Caroline Fisheries Corporation," of which details were only concluded in fiscal year 2002.

In February 2002, the Corporation transferred title to its wastewater treatment plant with a net book value of \$573,011 to Pohnpei Utilities Corporation in cancellation of accounts payable of \$699,931. The Corporation recognized miscellaneous income of \$126,920 on the transfer.

The Corporation provides wastewater treatment to a commercial hotel which is owned by a member of its BOD. 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. As a result of the transfer of the wastewater treatment facility as discussed in the previous paragraph, the Corporation ceased billing the hotel in March 2002. The Corporation recorded \$1,651 as operating revenues from this agreement during 2002 and the related accounts receivable balance, as of September 30, 2002, amounted to \$27,388.

A member of the BOD is also a senior member of management of the FSM Development Bank.

(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.

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2002

(9) Going Concern

As of September 30, 2002, the Corporation has accumulated a deficit of \$2,604,698. Management will attempt to return the Corporation to profitability by securing a steady supply of fish and by reducing its cost of operations.

(10) Commitment

In September 2002, Federated States of Micronesia Development Bank (FSMDB) approved a loan to the Corporation amounting to \$187,041 due in monthly installments of \$4,655 with a 9% interest, and a term of 4 years, beginning June 2003, ending June 2007. Loan drawdowns are to be made only upon presentation of pro-forma invoices or bona-fide receipts of the procurement. On March 13, 2003, the Corporation received its first drawdown from the loan. A member of the Corporation's BOD is a senior loan officer of FSMDB.

(11) Adoption of New Accounting Principle

Effective October 1, 2001, the Corporation adopted GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions." GASB No. 33 establishes more uniform revenue recognition criteria and financial reporting standards regarding the timing of recognition of the results of nonexchange transactions involving cash and other financial and capital resources. The provisions of GASB No. 33 were applied to all periods presented. Implementation of GASB No. 33 had no material impact on the 2002 financial statements.



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 Pohnpei Fisheries Corporation, a component unit of Pohnpei State Government, as of and for the year ended September 30, 2002, and have issued our report thereon dated September 22, 2004. 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

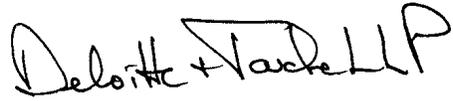
As part of obtaining reasonable assurance about whether Pohnpei Fisheries Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards*, which is described in the accompanying Schedule of Findings and Questioned Costs as Finding No. 02-02.

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 numbers 02-01 through 02-04.

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 conditions described above, in our opinion, are not considered to be material weaknesses.

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.

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

September 22, 2004

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2002

Finding No. 02-01 – Application of Unused Leave Against Advances

Criteria:

Per the Employee Handbook, “vacation time off is paid at the employee’s base rate at the time of vacation. Upon termination of employment, employees shall be paid for accrued vacation...”

Condition:

The Corporation applied unused vacation leave credits to employee advances. However, the Handbook did not state that such application is permissible.

Cause:

The Corporation is of the opinion that unused vacation leave can be convertible to cash. With the current financial situation, the Corporation would not be able to meet unused leave conversion; hence management recommended application of the unused leave credits against the advances.

Effect:

No financial statement effect results from this condition. However, the practice may constitute noncompliance with Corporation policy.

Recommendation:

We recommend that the Corporation request for a board resolution authorizing this practice and include this provision in the Employee Handbook.

Auditee Response:

The Corporation has made some amendments to the Employee Handbook including this policy and it is waiting for board of director’s approval.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2002

Finding No. 02-02 – Compliance with the Terms of Grant Award

Criteria:

As per “Memorandum of Understanding (MOU) Concerning Proceeds From Grant Award,” the Corporation will deposit the \$15,000 grant in a checking account. The Corporation must replenish the account up to the initial \$15,000 provided by the grant.

Condition:

The Corporation deposited the grant in a savings account instead of checking account. Furthermore, the Corporation did not replenish the account. As of September 30, 2002, the bank confirmed a balance of \$3,184 for the account.

Cause:

The Corporation does not have the financial resources to replenish the account.

Effect:

Noncompliance with the provisions of MOU resulted in a classification of the grant to a loan, which may incur 9% annual interest, payable upon notice of election given to the Corporation. However, to date, no notice has been communicated to the Corporation.

Recommendation:

With the current financial status of the Corporation, we recommend that management seek clarification and consideration with the National Government on the 9% interest that could be charged to the Corporation as a result of noncompliance with the MOU.

Auditee Response:

In the first report to the grantor, the Corporation informed the grantor that the grant was deposited to savings account since keeping the grant to a checking account is more costly than in savings account. The Corporation is currently working with the grantor to see the possibility of considering it as pure grant.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2002

Finding No. 02-03 – No Written Documentation for Authorization of General Journal Entries

Criteria:

All journal entries should be properly approved prior to posting.

Condition:

The Corporation does not prepare manual journal vouchers or other forms of documentation requiring documented approval of journal entries. The required approval process for these entries could not be determined.

Cause:

Preparation of journal vouchers or other form of documentation is not included in the Corporation's operational standards.

Effect:

No known financial statement effect results from this condition. However, the Corporation runs a risk of unauthorized postings to the general ledger. Furthermore, this practice leaves no audit trail for auditors to verify approval authority.

Recommendation:

We recommend that the Corporation include in its accounting procedures the preparation of journal vouchers for all general journal entries. Journal vouchers should be pre-numbered and should be approved by a person at a higher corporate level than the one who executes the posting and the preparer of the entry.

Auditee Response:

Some general journal entries are supported by debit or credit memoranda which are approved by Acting Chief Executive Officer and some are reclassification of adjusting entries which are supported by schedules. The Corporation assumes that this practice is enough since it was not a finding in the previous audits, however, the Corporation will follow the recommendation.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2002

Finding No. 02-04 – Non Issuance of Invoice by Vendor to the Corporation

Criteria:

All purchases should be supported by a sales invoice.

Condition:

Purchases made by the Corporation from a particular vendor were not documented by a sales invoice. Instead, a debit note was issued for such purchases. Payments of purchases from this vendor are netted against receivables. Collections then are net of the payment, and official receipts issued by the Corporation to the vendor/customer represent the net amount.

Cause:

There is no known cause as to the rationale for not issuing sales invoices.

Effect:

No known financial statement effect results from this condition.

Recommendation:

We recommend that official receipts, if issued at net, document the calculation in its entirety to properly reflect the taxable nature of the offset.

Auditee Response:

The Corporation already informed the vendors to provide sales invoices to support all purchases of raw materials. The Corporation assumes that this is a normal practice whereby purchase of raw materials is offsetted against sales of ice. In addition, this has been a practice since 1995 and was not cited in previous audits. The Corporation will make sure that this practice will be corrected.