

POHNPEI FISHERIES CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 2003

INDEPENDENT AUDITORS' REPORT

Board of Directors
Pohnpei Fisheries Corporation:

We have audited the accompanying statement of net assets of Pohnpei Fisheries Corporation, a component unit of Pohnpei State Government, as of September 30, 2003, and the related statements of revenues, expenses and changes in net liabilities 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.

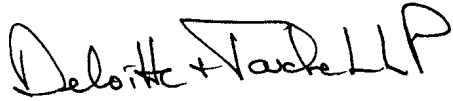
In our opinion the accompanying financial statements present fairly, in all material respects, the financial position of Pohnpei Fisheries Corporation as of September 30, 2003, and the result of its operations and its cash flows for the year then ended in conformity with accounting principles generally 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 net liabilities of \$3,121,398. 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 1 to the financial statements, the Corporation adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB Statement No. 38, *Certain Financial Statements Note Disclosures*, as of October 1, 2002.

The Management Discussion and Analysis on pages 1 to 4 is not a required part of the basis financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the 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 October 6, 2004, on our consideration of the Pohnpei Fisheries Corporation's internal control over financial reporting and our tests of its compliance and other matters. The purpose of that report is to describe the scope of our 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 read in conjunction with this report in considering 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.

October 6, 2004

POHNPEI FISHERIES CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2003

Our discussion and analysis of the Pohnpei Fisheries Corporation's financial performance provides an overview of the Corporation's financial activities for the fiscal year ended September 30, 2003. Please read it in conjunction with the Corporation's financial statements, which follow this section.

Financial Highlights

- For the fiscal year ended September 30, 2003, the Corporation's total net liabilities increased by \$516,700 or 16% from the prior year.
- During the year, the Corporation's operating revenues totaled to \$632,141 against operating expenses of \$1,132,491.
- The Corporation's export sales of fish amounted to \$280,920 or 74% of the total fish sales or 44% of the total operating revenues.

Overview of the Financial Statements

The financial statements presented herein include all of the activities of the Pohnpei Fisheries Corporation (the "Corporation"). Included in this report are the Statement of Net Assets and the Statement of Activities. These financial statements present the complete financial picture of the Corporation from the economic resources measurement focus using the accrual basis of accounting. These statements include all assets and liabilities using the accrual basis of accounting and all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

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 Corporation operates like a private business enterprise, it charges its customers for the services it provides.

The Corporation's budget is prepared by management and approved by the board of directors annually. The budget contains the projected revenues, expenses and capital expenditures. Budgeted and actual results are compared quarterly.

The Corporation's sources of revenues are:

- Ice sales- the Corporation provides ice flakes to longline fishing vessels. Volume of ice sales is dependent mainly on the number of fishing vessels doing transshipment in Pohnpei. Ice sales is one of the major sources of the Corporation's revenues.
- Fish sales- the Corporation sells processed loins, steaks and by- products. Most of the loins and steaks are exported but also sold locally. All by- products sales are made locally but can be exported if there is an interested customer. Fish sales is the other major source of Corporation's revenues. Raw materials that are placed in process are purchased and supply is also dependent on the fishing vessels conducting transshipment in Pohnpei.
- Engineering services fees- the Corporation also provides services to the fishing vessels and the public such as repairs, welding, electrical installation and others.
- Agency service fees- services provided mainly to the fishing vessels that call on port of Pohnpei which include immigration, customs, environmental and other offices clearance.

POHNPEI FISHERIES CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2003

A Financial Analysis of the Corporation as a Whole

Net Liabilities

The Corporation's net liabilities increased from approximately \$2,604,698 to \$3,121,398 between fiscal years 2002 and 2003.

Current assets	\$	201,265	
Fixed assets, net		<u>1,493,010</u>	
Total assets		<u>1,694,275</u>	
Current liabilities		1,237,927	
Non- current liabilities		<u>3,577,746</u>	
Total liabilities		<u>4,815,673</u>	
Net liabilities	\$	<u>3,121,398</u>	

Changes in Net Liabilities

For the year ended September 30, 2003, net liabilities of the Corporation changed as follows:

Ice sales	\$	212,422	
Less: Cost of ice sales		<u>(227,613)</u>	\$ (15,191)
Fish sales		378,521	
Less: Cost of fish sales		<u>(751,075)</u>	(372,554)
Engineering services fees			20,598
Agency services fees			20,600
Other income			<u>2,432</u>
Gross revenues(costs)			(344,115)
General and administrative expenses			
Salaries and wages		87,010	
Employees benefits		9,855	
Utilities		5,574	
Supplies		10,104	
Repairs and maintenance		6,353	
Depreciation		5,393	
Insurance		2,522	
Training		400	
Travel and entertainment		5,864	
Board meeting		560	
Professional services		2,874	
Communications		6,977	
Marketing		5,176	
Taxes and licenses		312	
Interest, net		18,782	
Miscellaneous		<u>4,829</u>	<u>172,585</u>
Increase in net assets(liabilities)			\$ (516,700)

POHNPEI FISHERIES CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2003

The Corporation's Ice Sales and Fish Sales activities resulted in an increase in net liabilities of \$15,191 or 3% and \$372,554 or 72%, respectively. Statement of Cost of Ice Sales and Cost of Fish Sales are presented below as support to the Statement of Net Assets (Liabilities) and for analysis of the two major sources of revenues:

Statement of Cost of Ice Sales

Raw materials		\$	8,171
Direct labor			23,634
Production overhead			
Indirect labor	\$	39,392	
Employees benefits		7,360	
Utilities		92,192	
Tools and supplies		10,752	
Petroleum, oil and lubricants		19,511	
Repairs and maintenance		15,022	
Freight and handling		4,418	
Rent		125	
Depreciation		5,971	
Insurance		154	
Taxes and licenses		911	195,808
Cost of ice produced			<u>227,613</u>
Add: Inventory, 10/01/02			-
Ice available for sale			<u>227,613</u>
Less: Inventory, 9/30/03			-
Cost of ice sales			<u><u>\$ 227,613</u></u>

Utilities represents 41% of the total cost of ice produced for fiscal year 2003 while direct and indirect labor represent 28%, petroleum, oil and lubricants represent 9% and others represent 22%.

Statement of Cost of Fish Sales

Raw materials		\$	249,868
Direct labor			56,753
Production overhead			
Indirect labor	\$	43,600	
Employees benefits		11,831	
Utilities		71,704	
Chemicals and supplies		11,321	
Packaging and labeling		22,897	
Freight and handling		47,611	
Repairs and maintenance		403	
Rent		10	
Depreciation		305,845	
Insurance		277	
Taxes and licenses		2,058	517,557
Cost of fish processed			<u>824,178</u>
Add: Inventory, 10/01/02			28,551
			<u>852,729</u>
Less: Inventory, 9/30/03			101,654
Cost of fish sales			<u><u>\$ 751,075</u></u>

POHNPEI FISHERIES CORPORATION

Management's Discussion and Analysis Year Ended September 30, 2003

Depreciation represents 37% of the total cost of fish processed for fiscal year 2003, while raw materials represent 30%, direct and indirect labor represent 12% and others represent 21%.

Long- term Liabilities

As of September 30, 2003, the Corporation's long-term liabilities amounted to \$3,577,746 (net of \$80,860 current portion), of which \$132,953 or 4% increase from prior year represents the balance of the loan from FSM Development Bank, net of \$40,860 current portion.

Contacting the Corporation's Finance Office

This financial report is designed to provide the customers, creditors, investors, board of directors and other interested persons with the general overview of the Corporation's financial activities. Questions or additional financial information can be asked or obtained from Comptroller's Office with the permission of the Chief Executive Officer at P.O. Box 448, Pohnpei, FM 96941.

POHNPEI FISHERIES CORPORATION

Statement of Net Assets
September 30, 2003

ASSETS

Current assets:		
Cash and cash equivalents	\$	20,278
Accounts receivable, net		55,212
Inventory, at lower of cost or market		<u>125,775</u>
Total current assets		201,265
Fixed assets held for sale		44,103
Property and equipment, net		<u>1,448,907</u>
	\$	<u><u>1,694,275</u></u>

LIABILITIES AND NET LIABILITIES

Current liabilities:		
Current installments of long-term debt	\$	80,860
Accounts payable		<u>1,157,067</u>
Total current liabilities		1,237,927
Long-term debt, excluding current installments		<u>3,577,746</u>
Total liabilities		<u>4,815,673</u>
Contingencies		
Net liabilities		<u>(3,121,398)</u>
	\$	<u><u>1,694,275</u></u>

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Statement of Revenues, Expenses, and Changes in Net Liabilities Year Ended September 30, 2003

Revenues:	
Charges for goods and services	\$ 632,141
Cost of sales	<u>978,688</u>
Gross loss	<u>(346,547)</u>
General and administrative expenses:	
Salaries, wages and benefits	96,865
Communications	6,977
Repair and maintenance	6,353
Travel and entertainment	5,864
Utilities	5,574
Depreciation	5,393
Marketing expenses	5,176
Professional services	2,874
Training	400
Taxes	312
Other	<u>18,015</u>
Total general and administrative expenses	<u>153,803</u>
Loss from operations	(500,350)
Nonoperating (expenses) revenues:	
Interest expense, net	(18,782)
Miscellaneous income	<u>2,432</u>
Net loss	(516,700)
Net liabilities at beginning of year	<u>(2,604,698)</u>
Net liabilities at end of year	<u><u>\$ (3,121,398)</u></u>

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Statement of Cash Flows Year Ended September 30, 2003

Cash flows from operating activities:	
Cash received from customers	\$ 605,489
Cash paid to suppliers and employees	<u>(757,889)</u>
Net cash used in operating activities	<u>(152,400)</u>
Cash flows from capital and related financing activities:	
Acquisition of fixed assets	<u>(5,125)</u>
Cash flows from noncapital financing activities:	
Proceeds from loan	187,041
Repayments of loan	(13,228)
Payment of interest expense	(8,340)
Receipt of miscellaneous income	<u>2,432</u>
Net cash provided in noncapital financing activities	<u>167,905</u>
Net increase in cash and cash equivalents	10,380
Cash and cash equivalents at beginning of year	<u>9,898</u>
Cash and cash equivalents at end of year	<u><u>\$ 20,278</u></u>
<u>Reconciliation of loss from operations to net cash used in operating activities:</u>	
Loss from operations	\$ (500,350)
Adjustment to reconcile loss from operations to net cash used in operating activities:	
Depreciation	317,208
Changes in working capital:	
Increase in accounts receivable	(26,652)
Increase in inventory	(93,283)
Decrease in prepaid expenses	452
Increase in accounts payable	<u>150,225</u>
Net cash used in operating activities	<u><u>\$ (152,400)</u></u>

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2003

(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 accounting policies of the Corporation conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. 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 Principles 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.

GASB has issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements. The Corporation is required to adopt GASB Statement No. 34, as amended by GASB Statement No. 37, and certain provisions of GASB Statement No. 38 in fiscal year 2003.

To conform with the requirements of GASB 34, fund deficiency has been reclassified into net liabilities. Net liabilities are reported as restricted when constraints are imposed by third parties or enabling legislation. All of the Corporation's net liabilities are unrestricted.

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

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, 2003

(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. Repair and maintenance costs are expensed as incurred. The estimated useful lives of these assets are as follows:

Contributed assets	3 – 15 years
Machinery and equipment	3 – 7 years
Buildings	10 years
Vehicles	5 – 10 years
Furniture and fixtures	3 – 5 years

Inventories

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

Operating and Non-Operating Revenue and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of the managed fish processing plant and the cold storage facility. Non-operating revenues and expenses result from financing activities and other non-recurring income and costs.

New Accounting Standards

For fiscal year 2004, the Corporation will be implementing GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. For fiscal year 2005, the Corporation will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)* and 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. 39, 40 and 42.

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2003

(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 at September 30, 2003, is presented below:

Accounts receivable - trade	\$ 191,613
Advances to employees	3,841
Others	622
Allowance for doubtful accounts	<u>(140,864)</u>
Accounts receivable, net	\$ <u>55,212</u>

(3) Inventory

A summary of inventory as of September 30, 2003, is presented below:

Finished goods inventory	\$ 101,654
Packaged materials	4,764
Packaged materials, in transit	<u>19,357</u>
	\$ <u>125,775</u>

(4) Property and Equipment

A summary of the Corporation's property and equipment at September 30, 2003, is as follows:

	Beginning Balance October 1, <u>2002</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Ending Balance September 30, <u>2003</u>
Contributed assets	\$ 10,521,293	\$ -	\$ -	\$ 10,521,293
Machinery and equipment	1,852,369	3,125	-	1,855,494
Buildings	282,463	-	-	282,463
Vehicles	86,405	-	-	86,405
Furnitures and fixtures	<u>40,436</u>	<u>2,000</u>	<u>-</u>	<u>42,436</u>
	12,782,966	5,125	-	12,788,091
Accumulated Depreciation	<u>(11,021,976)</u>	<u>(317,208)</u>	<u>-</u>	<u>(11,339,184)</u>
	\$ <u>1,760,990</u>	\$ <u>(312,083)</u>	\$ <u>-</u>	\$ <u>1,448,907</u>

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

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2003

(5) Long-Term Debt

A summary of long-term debt as of September 30, 2003, 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 net assets of at least \$2,000,000; and \$979,793 for transfer of notes payable to Caroline Fisheries Corporation, with no specified credit terms.	\$ 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 Federated States of Micronesia Development Bank (FSMDB), collateralized by the existing assets of the Corporation, due in monthly installments of \$4,655, with 9% interest and a term of 4 years beginning June 2003, ending May 2007.	173,813
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>
	3,658,606
Less current installments	<u>(80,860)</u>
	<u>\$ 3,577,746</u>

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 maturities of the above September 30, 2003 notes payable are as follows, except for the notes payable to Pohnpei State Government and FSM National Government amounting to \$3,444,793, which could not be determined as there is no specific repayment period:

	<u>Principal</u>	<u>Interest</u>
2004	\$ 80,860	\$ 17,214
2005	45,757	7,111
2006	50,050	1,301
2007	<u>37,146</u>	<u>-</u>
	<u>\$ 213,813</u>	<u>\$ 25,626</u>

POHNPEI FISHERIES CORPORATION

Notes to Financial Statements
September 30, 2003

(5) Long-Term Debt, Continued

Changes in long-term debt for the year ended September 30, 2003 are as follows:

	Outstanding September 30, <u>2002</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2003</u>	<u>Current</u>	<u>Noncurrent</u>
Notes payable to Pohnpei State Government	\$ 3,429,793	\$ -	\$ -	\$ 3,429,793	\$ -	\$ 3,429,793
Notes payable to Pohnpei Economic Development Authority	40,000	-	-	40,000	-	40,000
Notes payable to FSMDB	-	187,041	(13,228)	173,813	80,860	92,953
Notes payable to FSM National Government	<u>15,000</u>	<u>-</u>	<u>-</u>	<u>15,000</u>	<u>-</u>	<u>15,000</u>
	\$ <u>3,484,793</u>	\$ <u>187,041</u>	\$ <u>(13,228)</u>	\$ <u>3,658,606</u>	\$ <u>80,860</u>	\$ <u>3,577,746</u>

(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 \$178,454 as of September 30, 2003 due to the Pohnpei State Economic Development Authority and Pohnpei Utilities Corporation, respectively, which are related component units of Pohnpei State Government.

A member of the Board is a senior member of management of FSMDB.

(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, 2003

(9) Going Concern

As of September 30, 2003, the Corporation has accumulated net liabilities of \$3,121,398. Management will attempt to return the Corporation to profitability by securing a steady supply of fish and by reducing its cost of operations.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING, COMPLIANCE AND OTHER MATTERS 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, 2003, and have issued our report thereon dated October 6, 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.

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 an opinion 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 03-01 through 03-10.

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 caused by error or fraud 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.

Compliance and Other Matters

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 number 03-02.

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

Deloitte + Tatchell LLP

October 6, 2004

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-01 – Conversion of Unused Leave Credit to Cash or Application 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:

Unused vacation leave is either paid out to the employee or applied against employee advances. However, the Handbook did not state that such practice is permissible.

Cause:

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

Effect:

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

Prior Year Status:

This is a carryover finding from the 2002 audit. The 2002 audit report of the Corporation was dated September 22, 2004.

Recommendation:

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

Auditee Response:

It is the opinion of the Auditee that since finding numbers 03-01 to 03-04 are already reflected in auditor report of Fiscal Year 2002, auditee believes it should not be reflected as findings in auditor’s report of Fiscal Year 2003, as the field work of audit of Fiscal Year 2002 and 2003 were conducted at the same time and has not given ample time for the auditee to take corrective actions as recommended.

Auditee believes that if the field work of such audit had taken place after the official output result of Fiscal Year 2002 audit, perhaps the concern findings could have been avoided.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-02 – 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 proceeds in a checking account. The Corporation then has to 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, 2003, 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 MOU provision 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.

Prior Year Status:

This is a prior year carryover finding from the 2002 audit of the Corporation.

Recommendation:

Given 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:

It is the opinion of the Auditee that since finding numbers 03-01 to 03-04 are already reflected in auditor report of Fiscal Year 2002, auditee believes it should not be reflected as findings in auditor’s report of Fiscal Year 2003, as the field work of audit of Fiscal Year 2002 and 2003 were conducted at the same time and has not given ample time for the auditee to take corrective actions as recommended.

Auditee believes that if the field work of such audit had taken place after the official output result of Fiscal Year 2002 audit, perhaps the concern findings could have been avoided.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-03 – 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.

Prior Year Status:

This is a carryover finding from the 2002 audit. The 2002 audit report of the Corporation was dated September 22, 2004.

Recommendation:

We recommend that the Corporation include in its accounting procedure 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 reclassification or 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, 2003

Finding No. 03-04 –Non Issuance of Invoice by Vendor to PFC

Criteria:

All purchases should be supported by a sales invoice.

Condition:

Purchases made by PFC 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 PFC 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.

Prior Year Status:

This is a carryover finding from the 2002 audit of the Corporation.

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:

It is the opinion of the Auditee that since finding numbers 03-01 to 03-04 are already reflected in auditor report of Fiscal Year 2002, auditee believes it should not be reflected as findings in auditor's report of Fiscal Year 2003, as the field work of audit of Fiscal Year 2002 and 2003 were conducted at the same time and has not given ample time for the auditee to take corrective actions as recommended.

Auditee believes that if the field work of such audit had taken place after the official output result of Fiscal Year 2002 audit, perhaps the concern findings could have been avoided.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-05 –Recording of Packaging Materials

Criteria:

Payment of expenses not yet received should be initially recorded as an asset and be subsequently expensed upon receipt or usage.

Condition:

The Corporation initially records payments on purchased materials as an expense. The amount representing prepayment was only reclassified as an asset at the end of the year.

Cause:

This has been the practice of the Corporation.

Effect:

No financial statement effect results from this condition as the amount was subsequently reclassified as an asset at the end of the year. However, internal financial reports issued at the time the payment was made would be inaccurate.

Recommendation:

We recommend that the Corporation cease expensing payments of purchased materials when the items are not yet received.

Auditee Response:

This has been the practice of the Corporation because it does not depart from GAAP and is very useful as far as budget for this account is concerned. The Corporation wants to ensure that actual expenses will not be more than what is budgeted. Moreover, internal financial reports are accurate and serve the purpose of the Corporation.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-06 – Incomplete Documentation of Receiving Report Adjustment

Criteria:

Adjustments to raw materials (fish) based on actual amounts received should be properly documented in the receiving report and/or scaling report to account for the fish received.

Condition:

The Corporation was not billed for certain raw materials documented as received in the receiving report and scaling report. However, no other form of documentation was on file to determine the whereabouts of the items.

Cause:

The Corporation failed to file the documentation to support the adjustment of the items received, as documented in the receiving report and scaling report. The Corporation represented there could be an error in recording the items received.

Effect:

No known financial statement effect results from this condition. However the Corporation runs a risk of opportunity loss, as it appears that certain raw materials that should have been purchased by the Corporation might have been purchased by another person or company.

Recommendation:

We recommend that proper documentation be maintained on discrepancies between items received and items billed to protect the interests of the Corporation.

Auditee Response:

The file of the documents were provided to the auditor during field work and even sent through courier. The documents support that such items were not delivered to the Corporation because it is marked with the word “MFV.”

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-07 – Fixed Asset Tags

Criteria:

Best practices concerning fixed asset maintenance encourage tagging of fixed assets to provide monitoring and accountability over the assets.

Condition:

The Corporation does not tag its fixed assets as observed during physical inspection.

Cause:

Fixed asset tagging is not part of the Corporation's operational standard.

Effect:

No financial statement effect results from this condition. However, not tagging fixed assets may result in incomplete accounting of the Corporation's assets and potential misappropriations of assets may not be detected.

Recommendation:

We recommend that the Corporation implement tagging of fixed assets to prevent property losses.

Auditee Response:

Auditee has already taken actions of tagging its fixed assets. During the auditor field work, auditee was already in the process of implementing tagging of its fixed assets, however was delayed due to identification of transferred assets classifications and consideration of its tagging system. Auditee would have prompted expeditiously on this matter if it were a concern raised on previous audits.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-08 – Computation of Vacation Leave

Criteria:

Per Employee Handbook, “The amount of paid vacation time increases with the length of their employment as shown in the following... upon initial eligibility – 10 working days per year, after 3 years of service – 15 working days per year and after 8 years of service – 20 working days per year.”

Condition:

The Corporation computes vacation leave for all employees based on a certain percentage multiplied against the actual hours the employee worked during the fiscal year. The percentage varies depending on the number of years an employee has served.

Cause:

The Corporation revised the computation of vacation leave to encourage employees to work instead of taking vacation leave.

Effect:

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

Recommendation:

We recommend that the Corporation request a board resolution and include this matter in the employee handbook.

Auditee Response:

The actions taken in terms of computation of employees leaves hours are based on certain percentage multiplied against the actual hours the employees worked during the fiscal year is more realistic to the Corporation’s nature of operations especially in term of productivity and product quality control. Recommendation of amendments to the employee handbook is already been made pending to board’s adoption.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-09 –Working Hours Adjustment

Criteria:

Per Employee Handbook, "...PFC does not provide pay advances on unearned wages to employees."

Condition:

During a certain pay period in December, the Corporation granted 80 working hours to all employees regardless of the actual time the employee worked. The difference between the 80 working hours and the actual time worked during the pay period is then adjusted in the following pay period. The Handbook did not indicate such practice is permissible.

Cause:

The Corporation implemented this practice as an incentive to its employees during the Christmas Holiday.

Effect:

No financial statement effect arises from this condition. However, such practice constitutes noncompliance with Corporation policy.

Recommendation:

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

Auditee Response:

The practice of providing pay advances on unearned wages are only allowed to the production employees only during Christmas Holidays as an incentive for unfortunate period when employees cannot make 80 hours. However, the Corporation always makes sure the difference between the 80 working hours and the actual time worked is adjusted accordingly following the pay period. It is the intention of the auditee to take actions as recommended for compliance purposes.

POHNPEI FISHERIES CORPORATION

Schedule of Findings and Questioned Costs Year Ended September 30, 2003

Finding No. 03-10 – Employee Advances

Criteria:

Upon termination of employment, employee accountabilities should be settled prior to final clearance and release of final pay.

Condition:

An advance amounting to \$2,182 as of September 30, 2003 is still outstanding from a certain employee who is no longer employed by the Corporation. This advance is currently paid through monthly allotment.

Cause:

There is no known cause as to the rationale for not settling the balance at the time of termination.

Effect:

No financial statement effect results from this condition. However, an opportunity loss exist on the part of the Corporation as the money could have been utilized to meet operating requirements.

Recommendation:

We recommend that the Corporation ensure that prior to the release of final pay, all employees advances are settled.

Auditee Response:

It is always the procedure and practice to settle employee's accountabilities prior to final clearance and release of final pay. However, in this case such employee was the former Controller of PFC in which the auditee realized such outstanding balance after the fact that such employee is already separated his employment status with the Corporation.