

**NATIONAL FISHERIES CORPORATION
FEDERATED STATES OF MICRONESIA**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

SEPTEMBER 30, 2006 AND 2005

INDEPENDENT AUDITORS' REPORT

The Board of Directors
National Fisheries Corporation:

We were engaged to audit the accompanying statement of net assets of the National Fisheries Corporation (NFC) and subsidiaries, a component unit of the Federated States of Micronesia National Government, as of September 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of NFC's management.

Because of inadequacies in the accounting records, detailed records supporting cash, accounts receivable, inventory, investment, fixed assets, accounts payable, accrued liabilities, lease payable, sales, and other income net, were not available for the audit. We were not able to perform alternative procedures to satisfy ourselves about the amounts at which cash, accounts receivable, inventory, investment, fixed assets, inter-company receivables and payables, accounts payable, accrued liabilities, lease payable, sales and other income net are recorded. Additionally, the aforementioned accounts materially impact the statement of revenues, expenses and changes in net assets.

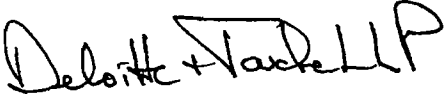
Financial statements supporting NFC's investment in Micronesia Longline Fishing Company (MLFC), Yap Fishing Corporation, Yap Fresh Tuna, Inc, Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture Inc. at September 30, 2006 and 2005, were not available.

Due to the matters set forth in the second and third paragraphs, we are not in a position to, and we do not express an opinion on the accompanying financial statements.

The accompanying financial statements have been prepared assuming that NFC will continue as a going concern. As discussed in note 7 to the financial statements, NFC has incurred substantial losses from operations. This condition raises substantial doubt about its ability to continue as a going concern.

The Management Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of NFC's management. 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 our report dated January 10, 2008, on our consideration of NFC's internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.


January 10, 2008

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Management Discussion and Analysis September 30, 2006 and 2005

This section of the National Fisheries Corporation's (NFC) annual audit report presents the Management's Discussion and Analysis (MD & A) for the fiscal year ended September 30, 2006. MD & A is supplementary information required by the new Government Accounting Standards Board Statement 34 (GASB 34) on reporting model. The preparation of MD & A is the responsibility of the management of NFC, and it is designed to help the readers in understanding the accompanying financial statements and the accompanying notes to the financial statements.

Background

The National Fisheries Corporation is a government owned corporation, created under Public Law No. 3-14 by the 3rd Congress of the Federated States of Micronesia. The main purpose of NFC is to promote the development of the fishing industry in the FSM. NFC is also involved in ancillary activities that support commercial fishery activities. It is for this purpose that NFC initially engaged itself with its subsidiaries; Yap Fresh Tuna Inc. (YFTI), Chuuk Fresh Tuna Inc. (CFTI), Kosrae Sea Ventures Inc. (KSVI) and Micronesia Longline Fishing Co. (MLFC). However, due to the drastic decline in the number of vessels utilizing YFTI and CFTI, NFC was forced to venture into the actual operation of longline fishing vessels, trading of fishing supplies and airfreight business.

Micronesia Longline Fishing Co. (MLFC) being NFC's fishing arm is operating nine longline fishing vessels. Fish catch are shipped via airfreight to Japan for auction on the sashimi market. NFC itself is managing and operating its own fishing vessel, however, its major source of income comes from the airfreight business, issuing of permits to foreign fishing companies and trading of baitfish and fishing supplies.

Overview of Fiscal Year 2006

In FY 2006, the financial statements of NFC are presented as consolidated balances including the balances of Corporate, Fishing operations, Airfreight operations, Transshipment operations and Baitfish services. Excluded from the statements are those of Micronesia Longline Fishing Co. (MLFC) and all NFC's subsidiaries namely: YFTI, CFTI, and KSVI. The accounts of NFC are organized as a proprietary fund. Proprietary funds are used by governmental units that are operated in a manner similar to private business enterprises.

NFC's budget is prepared by management with the concurrence of the board of directors. The budget is then forwarded to the President's budget committee which in turn submits it to Congress for approval.

Financial Highlights

NFC started implementing the new financial reporting standards in accordance with Government Accounting Standards Board (GASB) principles in fiscal year 2003. Adopting the GASB principles provide the new financial reporting of the following three basic financial statements:

1. Statement of Net Assets (SNA)

SNA presents what NFC owns (assets), owes (liabilities) and the net assets (the difference between total assets and total liabilities) at the end of the fiscal year. The "net assets" is one indicator of the current financial condition of NFC, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Management Discussion and Analysis September 30, 2006 and 2005

The Statement of Net Assets at September 30, 2006 consists of the consolidated balances of Corporate, Fishing, Airfreight, Transshipment and Baitfish Services operations of NFC but does not include the MLFC. NFC started the non-inclusion of MLFC's financial data in NFC's consolidated financial statement in fiscal year 2004. In FY2006, MLFC board of directors declared the company (MLFC) to be bankrupt.

Comparative Statement of Net Assets at September 30, 2006, 2005 and 2004 are summarized below:

	<u>FY 2006</u>	<u>FY 2005</u>	<u>FY 2004</u>
Assets:			
Current assets	\$ 187,239	\$ 1,160,215	\$ 1,524,658
Noncurrent asset	<u>719,758</u>	<u>895,842</u>	<u>1,107,816</u>
Total assets	\$ <u>906,997</u>	\$ <u>2,056,057</u>	\$ <u>2,632,474</u>
Liabilities:			
Current liabilities	\$ 4,880,694	\$ 4,859,636	\$ 5,360,285
Noncurrent liabilities	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>4,880,694</u>	<u>4,859,636</u>	<u>5,360,285</u>
Net assets:			
Invested in capital assets, net of related debts	(980,036)	(803,953)	(591,979)
Unrestricted	<u>(2,993,661)</u>	<u>(1,999,626)</u>	<u>(2,135,832)</u>
	<u>(3,973,697)</u>	<u>(2,803,579)</u>	<u>(2,727,811)</u>
Total liabilities and net assets	\$ <u>906,997</u>	\$ <u>2,056,057</u>	\$ <u>2,632,474</u>

Assets: Company total assets of \$906 thousand dollars comprised of \$187 thousand or 21% current assets and \$ 719 thousand or 79% fixed assets.

Current assets: The major portion of the \$187k current assets is in accounts receivable, which accounts for 73% or \$136k. The receivables comprise net trade account receivables, advances receivables, and inter company receivables due from subsidiary companies. Cash account is \$20k or 10% of current assets and the remaining 17 % is inventory of \$30 thousand.

The decline in current assets of \$972k is the net result of the provision for doubtful accounts and inter company receivables due from subsidiary companies. Cash account is \$20k or 10% of current assets and the remaining 17 % is inventory with \$30 thousand.

Noncurrent assets: The total noncurrent assets of \$720k include \$486k of an investment in Chuuk Fresh Tuna, Inc. (CFTI) and \$232k for Company property and equipment, net of accumulated depreciation. The total noncurrent assets declined by \$176k due to depreciation expense.

Liabilities: NFC's liabilities of \$4.880 million are all current consisting of a \$3.6 million loan from the National Government, which comprises 74% of the total NFC liabilities, other account payable and accrued liabilities of \$288k and freight lease of \$992k thousand to APA for lease of an air freighter used by both MLFC and NFC.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Management Discussion and Analysis
September 30, 2006 and 2005

Net Assets: The net deficit as of September 30, 2006 was \$3,973,697, an increase in deficit of \$1,170,118 as compared with September 30, 2005.

2. Summary Statement of Revenues, Expenses and Changes in Net Assets (SRECNA)

The SRECNA provides information on the financial performance for the current fiscal year in terms of revenues and expenses. It presents the operating revenue and expenses and the corresponding net operating results, as well as non-operating revenues and expenses. Below is the comparative summary of SRECNA for fiscal years ended September 30, 2006, 2005 and 2004:

	<u>FY 2006</u>	<u>FY 2005</u>	<u>FY 2004</u>
Sales	\$ 276,808	\$ 1,375,051	\$ 3,368,967
Cost of sales	<u>176,508</u>	<u>1,268,726</u>	<u>2,949,014</u>
Gross profit	100,300	106,325	419,953
Operating expenses	<u>1,494,295</u>	<u>651,738</u>	<u>816,558</u>
Loss from operations	(1,393,995)	(545,413)	(396,605)
Other income (expense)	<u>223,877</u>	<u>469,645</u>	<u>265,130</u>
Decrease in net assets	(1,170,118)	(75,768)	(131,475)
Beginning net assets	(2,803,579)	(2,727,811)	(2,596,336)
Ending net assets	\$ (3,973,697)	\$ (2,803,579)	\$ (2,727,811)

The total sales of \$276,808 are from NFC corporate operational activities only. The decrease of \$1.098 million was due to non operational activities of four main activities consisting of airfreight, baitfish, fishing, and transshipment. The main component of the cost of sales of \$176K are fuel, airfreight fees, and supplies, port and transshipment fees, provisioning, and packing materials.

The operating expenses showed a significant increase due to the provision for doubtful accounts of \$1.02 million.

The total operating expense for the year is \$ 1.494 million. The largest expense is bad debts of \$1.015 million, depreciation expense of \$180k, wages and salaries of \$130k, rental expense of \$50k, travel of \$45k, taxes of \$34k, office expense of \$17k, telephone expense of \$8k and contractual and other expense of \$14k.

The other income of \$223k primarily represents subsidies from the FSM National Government.

3. Summary Statement of Cash Flows (SCF)

SCF presents information about changes in the cash position using the direct method of reporting sources and uses of cash. The direct method reports all major cash inflows and outflows at gross amounts, differentiating these activities into cash flows arising from operating activities, non capital financing and capital and related financing.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Management Discussion and Analysis September 30, 2006 and 2005

Below is the summary statement of cash flows:

	<u>FY 2006</u>	<u>FY 2005</u>	<u>FY 2004</u>
From operating activities	\$ (207,104)	\$ (686,772)	\$ 30,161
Provided by non capital financing activities	135,000	100,000	(300,730)
From capital and related financing activities	<u>88,456</u>	<u>369,645</u>	<u>-</u>
Net decrease in cash and equivalents	16,352	(217,127)	(270,569)
Cash and equivalents at beginning of year	<u>3,471</u>	<u>220,598</u>	<u>491,167</u>
Cash and equivalents at end of year	\$ <u>19,823</u>	\$ <u>3,471</u>	\$ <u>220,598</u>

4. Debt and Capital Asset Activities

No significant debt or capital asset activities occurred during the year ended September 30, 2006. For additional information on fixed assets, please refer to Note 4 to the consolidated financial statements.

Economic Outlook

The Company has incurred substantial losses from its regular operations including investments with Micronesia Longline Fishing Company (MLFC), Kosrae Sea Ventures (KSV) Chuuk Fresh Tuna Inc. (CFTI) and Yap Fishing Corporation (YFC). The accumulated losses of NFC from its investments have severely affected NFC's regular operations. These conditions raise substantial doubt about the company's ability to continue as a going concern. Currently, the Company is dependent on the FSM National Government for its operating budgets. Financial assistance from FSM National Government is needed to rehabilitate and to continue the operations of NFC.

Management's Discussion and Analysis for the year ended September 30, 2005 is set forth in NFC's report on the audit of financial statements, which is dated February 7, 2007. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmpublicauditor.fn.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Net Assets
September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<u>ASSETS</u>		
Current assets:		
Cash	\$ 19,823	\$ 3,471
Accounts receivable, net	93,254	595,278
Due from affiliates, net	-	428,116
Advances receivable (payable)	43,414	(51,325)
Inventory	<u>30,748</u>	<u>184,675</u>
Total current assets	187,239	1,160,215
Investment	486,854	486,855
Property and equipment, net	<u>232,904</u>	<u>408,987</u>
	<u>\$ 906,997</u>	<u>\$ 2,056,057</u>
 <u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Notes payable	\$ 3,600,000	\$ 3,596,149
Accounts payable	367,946	122,394
Lease payable	992,228	992,228
Accrued liabilities	<u>(79,480)</u>	<u>148,865</u>
Total current liabilities	<u>4,880,694</u>	<u>4,859,636</u>
Contingencies		
Net assets:		
Invested in capital assets, net of related debt	(980,036)	(803,953)
Unrestricted	<u>(2,993,661)</u>	<u>(1,999,626)</u>
Total net assets	<u>(3,973,697)</u>	<u>(2,803,579)</u>
	<u>\$ 906,997</u>	<u>\$ 2,056,057</u>

See accompanying notes to consolidated financial statements.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2006 and 2005

	2006	2005
Sales	\$ 276,808	\$ 1,375,051
Bad debts	(1,015,224)	-
Sales, net	(738,416)	1,375,051
Cost of sales	(176,508)	(1,268,726)
Gross profit (loss)	(914,924)	106,325
Operating expenses:		
Depreciation and amortization	180,357	211,975
Salaries and wages	129,847	224,570
Utilities	50,100	33,098
Rent	44,717	78,678
Travel and entertainment	33,541	20,921
Payroll and other taxes	17,454	22,084
Office expense	7,931	15,619
Telephone and communication	7,733	25,387
Contractual services	5,256	1,764
Repairs and maintenance	1,625	4,061
Representation	32	9,627
Miscellaneous	478	3,954
Total operating expenses	479,071	651,738
Loss from operations	(1,393,995)	(545,413)
Other income (expense):		
FSM National Government operating subsidy	135,000	100,000
Other income, net	88,877	369,645
Total other income, net	223,877	469,645
Decrease in net assets	(1,170,118)	(75,768)
Net assets at beginning of year	(2,803,579)	(2,727,811)
Net assets at end of year	\$ (3,973,697)	\$ (2,803,579)

See accompanying notes to consolidated financial statements.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows
Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Cash received from customers	\$ 389,760	\$ 1,583,507
Cash paid to suppliers and employees	<u>(596,864)</u>	<u>(2,270,279)</u>
Net cash used in operating activities	<u>(207,104)</u>	<u>(686,772)</u>
Cash flows from noncapital financing activities:		
FSM National Government operating subsidies	<u>135,000</u>	<u>100,000</u>
Net cash provided by noncapital financing activities	<u>135,000</u>	<u>100,000</u>
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	(4,274)	-
Other income	<u>92,730</u>	<u>369,645</u>
Net cash provided by capital and related financing activities	<u>88,456</u>	<u>369,645</u>
Net change in cash	16,352	(217,127)
Cash at beginning of year	<u>3,471</u>	<u>220,598</u>
Cash at end of year	<u>\$ 19,823</u>	<u>\$ 3,471</u>
Reconciliation of loss from operations to cash flows used in operating activities:		
Loss from operations	\$ (1,393,995)	(545,413)
Adjustments to reconcile loss from operations to net cash used in operating activities:		
Depreciation and amortization	180,357	211,975
Bad debts	1,015,224	-
(Increase) decrease in assets:		
Accounts receivable	(513,200)	147,061
Advances receivable, net	(94,740)	61,395
Inventory	153,927	(85,731)
Due from affiliates	428,116	24,591
Increase (decrease) in liabilities:		
Accounts payable	245,552	(599,882)
Accrued liabilities	<u>(228,345)</u>	<u>99,232</u>
Net cash used in operating activities	<u>\$ (207,104)</u>	<u>(686,772)</u>

See accompanying notes to consolidated financial statements.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies

Reporting Entity

The National Fisheries Corporation (NFC) was created under FSM Public Law No. 3-14 by the third Congress of the Federated States of Micronesia (FSM).

The purpose of the National Fisheries Corporation is to promote the development of commercial pelagic fisheries and related industries within the Federated States of Micronesia's 200 mile Exclusive Economic Zone. NFC is also involved in ancillary activities that support commercial fishery activities. These activities include technical and infrastructure services, manpower training and other related activities promoting commercial fisheries development.

The NFC is a component unit (proprietary fund type) of the FSM National Government. The financial statements of the NFC are incorporated into those of the FSM National Government. Debts and obligations of the NFC are not obligations of the FSM National Government unless specifically authorized by the FSM National Government. To date, no such authorization has been made.

Basis of Accounting and Basis of Presentation

National Fisheries Corporation operates as a proprietary fund type component unit of the FSM National Government. This fund type is used to account for those operations that are financed and operated in a manner similar to a private business. Because of its fund type, NFC uses the accrual basis of accounting.

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

Operating and Non-Operating Revenue and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of NFC. Non-operating revenues and expenses result from capital and financing activities, costs and related recoveries from natural disasters, surcharge and certain other non-recurring income and costs.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables recorded in the statement of revenues, expenses and changes in net assets.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies, Continued

Property and Equipment

Property and equipment are stated at cost or estimated historical cost, less accumulated depreciation. Donated fixed assets are recorded at estimated fair market value at the date received. The provision for depreciation is computed by the straight line method over the estimated useful lives of the assets, ranging from 3 to 15 years depending on the nature of the asset. A singular piece of equipment, vehicles, office equipment, etc. that equals or exceeds \$5,000 is capitalized, except for those assets of the investees, where no set threshold for capitalization of fixed assets has been established.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. In accordance with the provisions of Statement of Financial Accounting Standards No. 43, "Accounting for Compensated Absences," no liability is recorded for nonvesting accumulating rights to receive such pay benefits.

Investment and Business Development

NFC, in prior years, has invested in various joint ventures with respective agencies in the four states which are directly involved in the exploitation and development of the FSM's fisheries industry. The NFC involvement in these joint ventures varies in nature.

NFC has previously been directly involved in the management of certain joint ventures through management and marketing agreements entered into with the respective parties. The investment in Kosrae Sea Venture Inc., Chuuk Fresh Tuna Inc.(CFTI), Micronesia Longline Fishing Company (MLFC), and Yap Fishing Corporation are accounted for using the equity method and, accordingly, the carrying values of these investments, with the exception of CFTI, have been reduced to \$0. In 2006 and 2005, financial statements for these joint ventures were not available and, therefore the financial position and results of operations of these joint ventures has not been consolidated with NFC's financial statements.

The investment in Chuuk Fresh Tuna, Inc. is carried at \$486,556. No financial information has been received from this investee and NFC has therefore been unable to determine the carrying value of this investment.

Cash

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by NFC or its agent in NFC's name;

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies, Continued

Cash, Continued

- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in NFC's name; or
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in NFC's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, NFC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution but not in NFC's name. NFC does not have a deposit policy for custodial credit risk.

As of September 30, 2006 and 2005, the carrying amount of NFC's total cash and cash equivalents and time certificates of deposit were \$19,823 and \$14,532, respectively, and the corresponding bank balances were \$38,008 and \$14,523, respectively, all of which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006 and 2005, all bank deposits were FDIC insured. NFC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. NFC has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on its deposits.

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.

Inventory

Inventory of fishing supplies is valued at the lower of cost (first-in, first-out) or market.

Net Assets

NFC has adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement No. 37, "Basic Financial Statements – Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Disclosures". GASB 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies, Continued

- Invested in capital assets, net of related debt:
Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
 - Nonexpendable – Net assets subject to externally imposed stipulations that require NFC to maintain them permanently. For the year ended September 30, 2006 and 2005, NFC does not have nonexpendable net assets.
 - Expendable – Net assets whose use by NFC is subject to externally imposed stipulations that can be fulfilled by actions of NFC pursuant to those stipulations or that expire by the passage of time.
- Unrestricted:
Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

New Accounting Standards

During fiscal year 2006, the Corporation implemented the following pronouncements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its serviced utility has declined significantly and unexpectedly.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*, which improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination of Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2006 and 2005

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

The implementation of these pronouncements did not have a material impact on the accompanying financial statements.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the Corporation.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the Corporation.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, which establishes uniform financial reporting for these types of revenues. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the Corporation.

(2) Accounts Receivable

Accounts receivable are net of an allowance for doubtful accounts as follows:

	2006		
	<u>Gross</u>	<u>Allowance</u>	<u>Net</u>
Trade	\$ 1,272,786	\$ 1,179,532	\$ 93,254
Due from affiliates	<u>777,563</u>	<u>777,563</u>	<u>-</u>
	<u>\$ 2,050,349</u>	<u>\$ 1,957,095</u>	<u>\$ 93,254</u>
	2005		
	<u>Gross</u>	<u>Allowance</u>	<u>Net</u>
Trade	\$ 1,199,050	\$ 603,772	\$ 595,278
Due from affiliates	<u>869,536</u>	<u>441,420</u>	<u>428,116</u>
	<u>\$ 2,068,586</u>	<u>\$ 1,045,192</u>	<u>\$ 1,023,394</u>

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2006 and 2005

(3) Related Party Transactions

The Corporation has entered into various transactions with the FSM National Government. Various loans have been obtained from the FSM National Government or the FSM Development Bank, a component unit of the FSM National Government. These loans are disclosed in note 5.

(4) Property and Equipment, Net

Detail of property and equipment, net is as follows:

	Balance at Beginning of <u>Year 2006</u>	<u>Additions</u>	<u>Deletions</u>	Balance at End of Year 2006
Machinery and equipment	\$ 28,424	\$ -	\$ -	\$ 28,424
Fishing vessels – purchased	543,423	-	-	543,423
Fishing vessels – donated	2,351,454	-	-	2,351,454
Fishing equipment – purchased	89,055	-	-	89,055
Fishing equipment – donated	464,099	-	-	464,099
Office furniture and equipment	208,471	4,274	-	212,745
Vehicles	<u>12,745</u>	<u>-</u>	<u>-</u>	<u>12,745</u>
	3,697,671	4,274	-	3,701,945
Less accumulated depreciation	<u>(3,288,684)</u>	<u>(180,357)</u>	<u>-</u>	<u>(3,469,041)</u>
	<u>\$ 408,987</u>	<u>\$ (176,083)</u>	<u>\$ -</u>	<u>\$ 232,904</u>
	Balance at Beginning of <u>Year 2005</u>	<u>Additions</u>	<u>Deletions</u>	Balance at End of Year 2005
Machinery and equipment	\$ 28,424	\$ -	\$ -	\$ 28,424
Fishing vessels – purchased	543,423	-	-	543,423
Fishing vessels – donated	2,351,454	-	-	2,351,454
Fishing equipment – purchased	89,055	-	-	89,055
Fishing equipment – donated	464,099	-	-	464,099
Office furniture and equipment	208,471	-	-	208,471
Vehicles	<u>12,745</u>	<u>-</u>	<u>-</u>	<u>12,745</u>
	3,697,671	-	-	3,697,671
Less accumulated depreciation	<u>(3,076,710)</u>	<u>(211,974)</u>	<u>-</u>	<u>(3,288,684)</u>
	<u>\$ 620,961</u>	<u>\$ (211,974)</u>	<u>\$ -</u>	<u>\$ 408,987</u>

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2006 and 2005

(5) Notes Payable

Notes payable of NFC consist of the following at September 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Loan payable to the FSM National Government due in annual installments of \$44,153, non-interest bearing, collateralized by NFC's shares in YFC, with a term of 16 years, beginning March 1994, ending March 2010.	\$ 750,640	\$ 750,640
Loan payable to the FSM National Government due in annual installments of \$86,639, non-interest bearing, with a term of 13 years, beginning July 1994, ending July 2007.	1,212,940	1,212,940
Loan payable to the FSM National Government due in annual installments of \$23,363, non-interest bearing, with a term of 16 years, beginning September 1994, ending September 2010.	397,176	397,176
Loan payable to FSM National Government due in annual installments of \$29,412, non-interest bearing, with a term of 17 years, beginning October 1995, ending October 2011.	500,000	500,000
Loan payable to the FSM National Government due in annual installments of \$5,000, non-interest bearing, with a term of 20 years, beginning April 1995, ending April 2014.	100,000	100,000
Loan payable to the FSM National Government due in annual installments of \$1,962, non-interest bearing, with a term of 20 years, beginning April 1995, ending April 2014.	39,244	39,244
Loan payable to the FSM National Government due in annual installments of \$5,000, non-interest bearing, with a term of 20 years, beginning November 1994, ending April 2013.	100,000	100,000
Loan payable to the FSM National Government with no terms.	500,000	500,000
Unreconciled difference	<u>-</u>	<u>(3,851)</u>
Total debt of NFC, exclusive of affiliate debt	\$ <u>3,600,000</u>	\$ <u>3,596,149</u>

NFC is in default on its debt issues and therefore, all related debt has been classified as current.

NFC is unable to disclose the amount of affiliate debt due to the absence of financial information from affiliates.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2006 and 2005

(5) Notes Payable, Continued

Changes in debt during the years ended September 30, 2006 and 2005 are as follows:

<u>Balance at Beginning of Year 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at End of Year 2006</u>
\$ <u>3,600,000</u>	\$ <u> -</u>	\$ <u> -</u>	\$ <u>3,600,000</u>
<u>Balance at Beginning of Year 2005</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at End of Year 2005</u>
\$ <u>3,596,149</u>	\$ <u> -</u>	\$ <u> -</u>	\$ <u>3,596,149</u>

(6) Contingencies

NFC is party to various legal proceedings arising from operations. External legal counsel represents that the ultimate outcome of the lawsuits cannot be predicted at this time; therefore, no provision for any related liability has been made in the financial statements.

(7) Going Concern

NFC has incurred substantial losses from operations. This condition raises substantial doubt about the Corporation's ability to continue as a going concern. NFC, as a component unit of the FSM National Government, is dependent on the FSM National Government for its cash flows.

(8) Risk Management

National Fisheries Corporation is substantially self-insured for all risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

(9) Leases Payable

As of September 30, 2006 and 2005, National Fisheries Corporation owed Aero Micronesia, Inc. \$992,228 for the previous lease of an airplane.

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

The Board of Directors
National Fisheries Corporation:

We were engaged to audit the financial statements of the National Fisheries Corporation (NFC), as of and for the year ended September 30, 2006, and have issued our report thereon dated January 10, 2008, which stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the financial statements due to: inadequacies in the accounting records, detailed records regarding cash, accounts receivable, inventory, investment, fixed assets, accounts payable, lease payable, sales, and non-operating income and related supporting data were not available for the audit.

Internal Control Over Financial Reporting

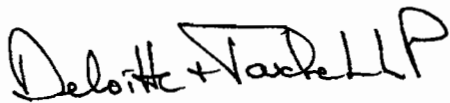
In planning and performing our audit, we considered NFC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the 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 NFC'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 as items 2006-1 through 2006-16.

A material weakness is a reportable 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, of the reportable conditions described above, we believe all findings to be material weaknesses.

Compliance and Other Matters

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

This report is intended solely for the information and use of the Board of Directors and management of NFC, 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 + Stack LLP". The signature is written in a cursive, stylized font.

January 10, 2008

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Absence of Investee's Financial Statements

Finding No. 2006-1

Criteria: Adequate documentation, i.e. investee's audited financial statements, should be available to support amounts reported in the financial statements.

Condition: Financial statements supporting NFC's investment in Chuuk Fresh Tuna, Inc., Yap Fresh Tuna, Inc., Kosrae Sea Venture, Inc., and Micronesia Longline Fishing Corp. are not available for inclusion in the NFC consolidation.

Cause: The cause of this condition is that financial statements from the investees have not been provided.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Prior Year Status: This condition has been reported in prior year audits.

Recommendation: We recommend that management ensure that its investees provide audited financial statements on an annual basis.

Auditee Response: CFTI has already phased out its operations prior to fiscal year 2005. The management is considering writing off its investments in FY08. The Comptroller, Mr. Abiner Robert will present and recommend to the Board plans to seek for additional funding from FSM National Government for a separate audit for all its subsidiary companies in fiscal year 2008.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Receivables

Finding No. 2006-2

Criteria: Adequate documentation, including subsidiary ledgers, should be available to support amounts and items reported in the financial statements.

Condition: No detail supporting \$74,508 of recorded advances was available for inspection.

<u>Acct. #</u>	<u>Description</u>	
1004	Advances	\$ 45,740
1022	Interco receivable	<u>28,768</u>
	Total	\$ <u>74,508</u>

Cause: The root cause of the weakness is that a subsidiary ledger was not maintained.

Effect: As a result of this condition, advances of \$ 74,508 are deemed uncollectible due to the absence of a subsidiary ledger. Also, there is a potential material misstatement of the financial statements.

Recommendation: We recommend that NFC maintain subsidiary ledgers to support all significant amounts reported in the financial statements.

Auditee Response: We concur with this finding and already included this finding with other problems that were reported to NFC Board of Directors. The management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs Year Ended September 30, 2006

Receivables, Continued

Finding No. 2006-3

Criteria: Amounts reported in the financial statements should agree with subsidiary records.

Condition: The total of trade receivables per the general ledger does not agree with the provided aging schedule.

<u>Per books</u>	<u>Per aging</u>	<u>Variance</u>
\$1,272,786	\$ 1,256,514	\$ 16,272

Cause: The root cause of the weakness is that subsidiary records, i.e. aging schedules, are not reconciled with the general ledger.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Recommendation: We recommend that NFC ensure that subsidiary records reconcile with the general ledger and that the reconciliation occurs periodically throughout the year.

Auditee Response: NFC is in the process of performing reconciliations of general ledger with subsidiary ledger and will continue it as part of the current accounting procedures and practices to ensure reporting of correct and accurate accounts in the financial statements. Management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Receivables, Continued

Finding No. 2006-4

Criteria: Amounts reported in the financial statements should be both reasonable and valid.

Condition: NFC recorded an expense of \$103,320 for potential uncollectable advances. However, there was no movement in the related allowance account during the year.

Cause: The root cause of the weakness is that inadequate reconciliation efforts have been applied to the financial statements.

Effect: The effect of this condition is a material misstatement of the financial statements.

Recommendation: We recommend that NFC ensure that the allowance for doubtful accounts is substantiated and correctly calculated.

Auditee Response: The bad debts expense recorded in the books amounting to \$103,320 came from closing its cash accounts of \$10K and accounts payable with debit balances in FY05. The book shows cash balance of 10K but per bank shows zero balance. These accounts were closed by debiting bad debts expense and crediting cash in bank and accounts payable. The comptroller, Mr. Abiner Robert has been instructed to have all expenses recorded be supported by proper documentation and ensure that expenses recorded are properly substantiated. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs Year Ended September 30, 2006

Receivables, Continued

Finding No. 2006-5

Criteria: Adequate source documentation should be available to support amounts and items reported in the financial statements.

Condition: For 18 of 18 (100%) trade receivable samples and 11 of 11 (100%) receivable from affiliates samples tested, we were not able to trace collections to underlying documentation such as cash receipts, bank validated deposit slips and/or bank statements, and sales invoices. As such, we could not ensure the completeness and validity of the recorded amounts.

Cause: The root cause of the weakness is that these receivables were recorded in previous fiscal years and were then carried forward without underlying historical data.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Recommendation: We recommend that NFC ensure that source documentation is kept to support amounts recorded in the financial statements.

Auditee Response: 95% of the trade receivables balances were aged more than 1 year and most of the records supporting these receivables were either lost or have been misplaced. The previous accounting system was adequate and former staffs were capable however the records were not properly maintained and there was no proper turn over of records and files to new staffs. The management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details and documents. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs Year Ended September 30, 2006

Fixed Assets

Finding No. 2006-6

Criteria: Adequate documentation, including subsidiary records, should be available to support amounts and items reported in the financial statements.

Condition: Subsidiary records, i.e. the fixed asset register, supporting \$492,377 of net fixed assets were not available for inspection.

Cause: The root cause of the condition is that subsidiary records are not maintained in a correct manner.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Recommendation: We recommend that NFC ensure that subsidiary records are properly maintained.

Auditee Response: 99% of the fixed assets were aged more than 1 year and most of the records supporting these fixed assets were either lost or have been misplaced. The previous accounting system was adequate and former staffs were capable however the records were not properly maintained and there was no proper turn over of records and files to new staffs. Management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details and documents and subsidiary records are maintained. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs Year Ended September 30, 2006

Depreciation Expense

Finding No. 2006-7

Criteria: Depreciation expense should be accurately calculated and recorded.

Condition: Depreciation expense recorded in the general ledger was lower than the actual calculation by \$13,883.

Cause: The root cause of the weakness is an incorrect calculation of depreciation expense.

Effect: The effect of this condition is a \$13,883 misstatement of depreciation expense.

Recommendation: We recommend that NFC ensure that accurate calculations of depreciation expense are performed.

Prior year status: This same matter was reported in the 2005 schedule of findings and questioned costs.

Auditee Response: We do not agree with this finding. The \$13,883.00 difference was due to failure of the auditor to consider the salvage value of the fixed assets in fishing Vessel. In previous years, the Salvage Value of the three Fishing Vessel amounting to \$204,371 had been properly considered and calculated in the getting the depreciation expense. This was evidenced by NFC's fixed assets report and printout from its old accounting system. Depreciation expense has not been an issue in previous years until FY04 up to FY06 because of inconsistency in calculating the depreciation expense. We maintain that salvage value be considered in calculating the depreciation expense as has been previously considered when the fixed assets were first acquired.

Auditor Response: This is a matter that also occurred in the prior year. We can find no evidence of any prior year consideration of salvage values and no mention of this matter occurred in the 2005 response from management.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Liabilities

Finding No. 2006-8

Criteria: Amounts reported in the financial statements should agree with subsidiary records.

Condition: There were no details of the following payable balances.

<u>Account</u>	<u>G/L</u>
2002	(85,472)
2005	2,000
2006	13,563

Cause: The root cause of the weakness is that subsidiary records, i.e. aging schedules, are not periodically reconciled with the general ledger.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Recommendation: We recommend that NFC periodically ensure that subsidiary records reconcile with the general ledger.

Auditee Response: 100% of the payables under accounts 2002, 2005, 2006 are aged 1 or more years and most of the records supporting these payables were either lost or have been misplaced. The previous accounting system was adequate and former staffs were capable however the records were not properly maintained and there was no proper turn over of records and files to new staffs. The management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details and documents and subsidiary records are maintained. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Other Income

Finding No. 2006-9

Criteria: Adequate documentation, including subsidiary records, should be available to support amounts and items reported in the financial statements.

Condition: Detailed records supporting \$ 97,597 of other income were not available for inspection.

<u>Account</u>	<u>Amount</u>
4025	\$ 26,600
4060	60,042
4999	<u>10,955</u>
Total	\$ <u>97,597</u>

Cause: The root cause of the weakness is that subsidiary records are not correctly maintained.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Recommendation: We recommend that NFC ensure appropriate maintenance of all subsidiary ledgers to support amounts reported in the financial statements.

Auditee Response: We agree with this finding. The management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details and documents and subsidiary records are maintained. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs Year Ended September 30, 2006

Management Fees

Finding No. 2006-10

Criteria: Amounts reported in the financial statements should be valid.

Condition: The management contracts for Kosrae Sea Venture, Inc. and Ettal Municipal Government terminated on April 22, 1998 and January, 20, 1999, respectively. The termination of the contract with Ettal Municipal Government was acknowledged by NFC's lawyer in a memo to Ettal Investment Corporation dated October 5, 2000. However, management fees for these contracts continue to be recorded throughout fiscal year 2006.

Cause: The root cause of this condition is an inadequate review of underlying source documentation.

Effect: Revenue of some \$60,042 was recorded in error.

Recommendation: We recommend that NFC ensure that all amounts reported in the financial statements are valid.

Auditee Response: The management contract was extended again but was not formalized into a written agreement. NFC continued to manage the vessels until early part of fiscal year 2006 when Ettal finally took their vessel. KSVI is in the process of terminating the contract and in taking possession of their vessel.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Cash

Finding No. 2006-11

Criteria: Adequate documentation, including subsidiary records such as bank reconciliations, should be available to support amounts and items reported in the financial statements.

Condition: General journal adjustments to cash totaling \$72,851 lacked documentary evidence substantiating the propriety of the transaction; 2) \$9,507 of cash collections was never banked and also we were not able to locate the recording of expenditures in the general ledger relating to the use of such cash collections; 3) we were not able to locate the recordation of petty cash disbursements totaling \$2,034 in the general ledger and 4) no evidence of bank reconciliations was located for the following cash accounts.

<u>Account No.</u>	<u>G/L</u>
1002	\$ 192
1007B	450
1009	325
1010A	1,608
1011A	<u>71</u>
Total	\$ <u>2,646</u>

Cause: The root cause of the condition is that subsidiary records, i.e. bank reconciliations, are not reconciled with the general ledger on a timely basis. The basis of recording general journal entries was not adequately explained and documented.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Recommendation: We recommend that subsidiary records be timely reconciled with the general ledger and that variances be investigated and disposed of in a timely manner. All general journal entries should be adequately supported and the basis for the adjustment documented.

Auditee Response: We agree with this finding. The management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details and documents and subsidiary records are maintained. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Inventory

Finding No. 2006-12

Criteria: Inventories should be supported by invoices.

Condition: For 9 of 9 (100%) invoices tested, no support was located for the inventory carrying cost.

Cause: The root cause of the weakness is inventory items carried forward from prior years without historical records.

Effect: The effect of this condition is a potential misstatement of inventory.

Recommendation: We recommend that NFC exercise more stringent adherence to existing document policies to prevent the disappearance of necessary supporting documentation.

Auditee Response: We agree with this finding. 100% of the inventory are aged 1 or more years and most of the records supporting these inventories were either lost or have been misplaced. The previous accounting system was adequate and former staffs were capable however the records were not properly maintained and there was no proper turn over of records and files to new staffs. The management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details and documents and subsidiary records are maintained. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Inventory

Finding No. 2006-13

Criteria: Amounts reported in the financial statements should agree with subsidiary records.

Condition: Inventory per the general ledger (G/L) does not agree with the provided subsidiary records, i.e. inventory valuation report.

<u>Per G/L</u>	<u>Per detailed schedule</u>	<u>Variance</u>
\$ 30,747	\$ 62,756	\$ 32,008

Cause: The root cause of the weakness is that subsidiary records, i.e. the inventory valuation report, are not reconciled with the general ledger.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Recommendation: We recommend that NFC ensure that subsidiary records reconcile with the general ledger and that the reconciliation occurs periodically throughout the year.

Auditee Response: We agree with this finding. The management has recently contracted a Certified Public Accountant to assist the Comptroller in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details and documents and subsidiary records are maintained. This finding will be corrected in FY08.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs Year Ended September 30, 2006

Unsupported Revenue

Finding No. 2006-14

Criteria: Adequate source documentation should be available to support amounts and items reported in the financial statements.

Condition: For 25 of 42 (60%) samples tested, NFC could not provide sales invoices or the basis for the general journal entries to revenue for \$920,543 and \$640,169 of debits and credits, respectively. As such, we could not ensure the completeness and validity of the recorded revenue.

Cause: The root cause of the weakness is a lack of control over recordkeeping.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Recommendation: We recommend that more stringent documentation policies be considered and the basis for all general journal entries be properly explained and adequately supported.

Auditee Response: We agree with the finding and recommendation. Starting fiscal year 2008, all transaction relating to revenue are duly supported by documents and available for inspection. The management has recently contracted a Certified Public Accountant to assist the Comptroller, Mr. Abiner Robert in cleaning up the Financial Statements of NFC and to ensure that all balances reflected in the trial balance are properly supported with details and documents and subsidiary records are maintained.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs Year Ended September 30, 2006

Unsupported Expenditures

Finding No. 2006-15

Criteria: Adequate source documentation should be available to support amounts and items reported.

Condition: For 19 of 40 (48%) samples tested, NFC was not able to provide the underlying documentation, i.e. vendor invoice, contract, or any related documentation or the basis for the general journal entries for expenditures of \$125,826 and \$70,707 of debits and credits, respectively.

Cause: The root cause of the weakness is lack of control over recordkeeping.

Effect: The effect of this condition is a material misstatement of the financial statements.

Recommendation: We recommend that more stringent documentation policies be considered and the basis or justification for all of general journal entries to the general ledger should be properly explained and adequately supported.

Auditee Response: We agree with the finding and recommendation. A policy will be issued by the management, starting fiscal year 2008, to have all entries in the accounting system be properly supported and justified. The comptroller, Mr. Abiner Robert and newly contracted CPA will ensure that the policy will be enforced and applied.

NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Schedule of Findings and Questioned Costs Year Ended September 30, 2006

Leases Payable

Finding No. 2006-16

Criteria: Items and amounts reported in the financial statements should be valid.

Condition: We were unable to verify the validity of the \$992,228 lease payable as of September 30, 2006.

Cause: The root cause of the condition is that relevant information such as account history was not available.

Effect: It is possible that this liability is no longer valid as we have not been made aware of any collections attempt by the vendor and we did not note anything related to this matter in the letter from legal counsel.

Recommendation: We recommend that NFC management investigate this matter and determine if the recorded amount is still valid.

Auditee Response: The recorded amount is valid and a written note from APA management is forthcoming. Management is in the process of negotiating with APA on the resolution of this account by fiscal year 2008.