

**POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2007 AND 2006

INDEPENDENT AUDITORS' REPORT

Board of Directors
Pohnpei Fisheries Corporation:

We have audited the accompanying statements of net assets of the Pohnpei Fisheries Corporation, a component unit of Pohnpei State Government, as of September 30, 2007 and 2006, and the related statements of revenues, expenses and changes in net deficiency and of cash flows for the years 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 audits.

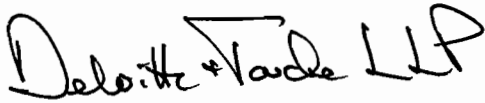
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Pohnpei Fisheries Corporation as of September 30, 2007 and 2006, and the changes in its net deficiency and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Corporation will continue as a going concern. As discussed in note 10 to the financial statements, the Corporation has incurred losses from operations and has accumulated a net deficiency of in excess of \$2.3 million. 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 10. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Management Discussion and Analysis on pages 3 and 4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Corporation'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 May 22, 2008, on our consideration of the Pohnpei Fisheries Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

May 22, 2008

POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Management's Discussion and Analysis
Years Ended September 30, 2007 and 2006

Our discussion and analysis of the Pohnpei Fisheries Corporation provides an overview of the Corporation's financial activities for the fiscal year ended September 30, 2007. Please read it in conjunction with the Corporation's financial statements, which follows this section.

Financial Highlights

- The Corporation's net deficiency as of September 30, 2007 decreased to \$2,386,951 compared to \$3,143,206 in fiscal year 2006.
- A total of \$918,074 gain on settlement of debt was recorded during fiscal year 2007.

Overview of the Financial Statements

The financial statements presented herein include all of the activities of the Pohnpei Fisheries Corporation. Included in this report are the statement of net assets, the statement of revenues, expenses, and changes in net assets, and the statement of cash flows. These statements include all assets and liabilities using accrual basis of accounting.

The accounts of the Corporation are organized as a proprietary fund. The Corporation operates like a private business enterprise as it charges its customers for services it provides.

Financial Analysis of the Corporation as a Whole

Net Assets

The statement of net assets presents the financial position or condition of the Corporation and it shows the information on all of the Corporation's assets and liabilities, with the difference between the two reported as net assets or net liabilities. The passage of time and/or increases or decreases in net assets may serve as a usual indicator whether the financial position of the Corporation is improving or deteriorating.

The following table is a comparative change in net assets as of fiscal years ended September 30, 2005 to 2007. The Corporation's net liabilities decreased by \$1,406,995 or 37% from 2005 to 2007.

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------|-----------------------|-----------------------|-----------------------|
| Current assets | \$ 53,098 | \$ 234,631 | \$ 91,971 |
| Capital and other assets | <u>274,330</u> | <u>548,339</u> | <u>873,142</u> |
| Total assets | <u>327,428</u> | <u>782,970</u> | <u>965,113</u> |
| Current liabilities | 209,379 | 1,420,996 | 1,207,396 |
| Non-current liabilities | <u>2,505,000</u> | <u>2,505,000</u> | <u>3,551,663</u> |
| Total liabilities | <u>2,714,379</u> | <u>3,925,996</u> | <u>4,759,059</u> |
| Net deficiency | \$ <u>(2,386,951)</u> | \$ <u>(3,143,026)</u> | \$ <u>(3,793,946)</u> |

POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Management's Discussion and Analysis
Years Ended September 30, 2007 and 2006

Changes in Net Assets

The statement of revenues, expenses, and changes in net assets shows the results of operations of the Corporation. It reports the revenues earned and expenses incurred and it indicates the effect on the net assets of the Corporation.

For the year ended September 30, 2007, net assets of the Corporation changed as follows with comparisons for FY06 and FY05.

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--|--------------------------|--------------------------|----------------------------|
| Operating revenues: | | | |
| Charges for goods and services | \$ 32,807 | \$ 436,567 | \$ 287,359 |
| Cost of sales | <u>2,600</u> | <u>678,787</u> | <u>549,671</u> |
| Gross profit (loss) | <u>30,147</u> | <u>(242,220)</u> | <u>(262,312)</u> |
| Rental income | <u>100,000</u> | <u>36,333</u> | <u>18,250</u> |
| General and administrative expenses | <u>275,505</u> | <u>74,829</u> | <u>115,572</u> |
| Loss from operations | (145,358) | (280,716) | (359,634) |
| Non-operating revenues (expenses), net | <u>901,433</u> | <u>931,636</u> | <u>-</u> |
| Change in net assets (liabilities) | \$ <u><u>756,075</u></u> | \$ <u><u>650,920</u></u> | \$ <u><u>(359,634)</u></u> |

Capital Assets and Debt Administration

The Corporation did not acquire any significant capital assets during the fiscal year. Please refer to Note 3 to the accompanying financial statements for additional information concerning capital assets. The long term debt of the Corporation consists principally of a note payable to Pohnpei State Government and other notes payable to government agencies of the Federated States of Micronesia. For additional information concerning debt, please refer to Notes 4 and 5 to the accompanying financial statements.

There were two (2) debt settlements made during the year. One was between the Corporation and the Pohnpei Economic Development Authority and the other was between the Corporation and the Pohnpei Utilities Corporation. Both are component units of Pohnpei State Government.

The Management's Discussion and Analysis for the year ended September 30, 2006 is set forth in the Corporation's report on the audit of financial statements, which is dated August 20, 2007. That Discussion and Analysis explains the major factors impacting the 2006 financial statements and can be viewed on the Office of the Public Auditor's website at www.fsmpublicauditor.fm.

Contacting the Corporation's Financial Management

This Management's Discussion and Analysis is designed to provide the customers, creditors, investors, and other interested parties, with a general overview of the Corporation's financial activities. Questions concerning any of the information provided in this discussion and analysis or requests for additional information should be addressed to the Director of Treasury and Administration, officer in-charge at P.O. Box 448, Pohnpei, FM 96941.

POHNPEI FISHERIES CORPORATION

Statements of Net Assets
September 30, 2007 and 2006

| <u>ASSETS</u> | <u>2007.</u> | <u>2006</u> |
|---|--------------------|--------------------|
| Current assets: | | |
| Cash | \$ 53,098 | \$ 234,631 |
| Accounts receivable, net | - | - |
| Total current assets | <u>53,098</u> | <u>234,631</u> |
| Property and equipment, net | <u>274,330</u> | <u>548,339</u> |
| | <u>\$ 327,428</u> | <u>\$ 782,970</u> |
| <u>LIABILITIES AND NET DEFICIENCY</u> | | |
| Current liabilities: | | |
| Current installments of long-term debt | \$ 85,299 | \$ 124,982 |
| Accounts payable | 57,413 | 1,129,347 |
| Unearned income | <u>66,667</u> | <u>166,667</u> |
| Total current liabilities | 209,379 | 1,420,996 |
| Long-term debt, excluding current installments | 55,000 | 55,000 |
| Due to Primary Government | <u>2,450,000</u> | <u>2,450,000</u> |
| Total liabilities | <u>2,714,379</u> | <u>3,925,996</u> |
| Contingencies and commitments | | |
| Net deficiency: | | |
| Invested in capital assets, net of related debt | (2,175,670) | (1,901,661) |
| Unrestricted | <u>(211,281)</u> | <u>(1,241,365)</u> |
| Total net deficiency | <u>(2,386,951)</u> | <u>(3,143,026)</u> |
| | <u>\$ 327,428</u> | <u>\$ 782,970</u> |

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION
Statements of Revenues, Expenses, and Changes in Net Deficiency
Years Ended September 30, 2007 and 2006

| | <u>2007</u> | <u>2006</u> |
|---|-----------------------|-----------------------|
| Revenues: | | |
| Charges for goods and services | \$ 32,807 | \$ 436,567 |
| Cost of sales | <u>2,660</u> | <u>678,787</u> |
| Gross profit (loss) | <u>30,147</u> | <u>(242,220)</u> |
| Rental income | <u>100,000</u> | <u>36,333</u> |
| General and administrative expenses: | | |
| Depreciation | 274,307 | - |
| Salaries, wages and benefits | - | 17,495 |
| Utilities | - | 8,355 |
| Other | <u>1,198</u> | <u>48,979</u> |
| Total general and administrative expenses | <u>275,505</u> | <u>74,829</u> |
| Loss from operations | <u>(145,358)</u> | <u>(280,716)</u> |
| Nonoperating revenues (expenses): | | |
| Gain on forgiveness of debt | 918,074 | 975,739 |
| Interest expense | (16,641) | - |
| Other expense | <u>-</u> | <u>(44,103)</u> |
| Total nonoperating revenues (expenses), net | <u>901,433</u> | <u>931,636</u> |
| Net earnings | 756,075 | 650,920 |
| Net deficiency at beginning of year | <u>(3,143,026)</u> | <u>(3,793,946)</u> |
| Net deficiency at end of year | <u>\$ (2,386,951)</u> | <u>\$ (3,143,026)</u> |

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION

Statements of Cash Flows

Years Ended September 30, 2007 and 2006

| | <u>2007</u> | <u>2006</u> |
|---|---------------------|-------------------|
| Cash flows from operating activities: | | |
| Cash received from customers | \$ 32,807 | \$ 686,115 |
| Cash paid to employees for services | - | (17,495) |
| Cash paid to suppliers for goods and services | <u>(157,718)</u> | <u>(384,169)</u> |
| Net cash (used in) provided by operating activities | <u>(124,911)</u> | <u>284,451</u> |
| Cash flows from capital and related financing activities: | | |
| Acquisition of fixed assets | <u>(298)</u> | <u>(800)</u> |
| Cash flows from noncapital financing activities: | | |
| Principal repayment of long-term debt | (39,683) | (48,831) |
| Interest paid on long-term debt | <u>(16,641)</u> | <u>-</u> |
| Net cash used in by noncapital financing activities | <u>(56,324)</u> | <u>(48,831)</u> |
| Net change in cash | (181,533) | 234,820 |
| Cash at beginning of year | <u>234,631</u> | <u>(189)</u> |
| Cash at end of year | <u>\$ 53,098</u> | <u>\$ 234,631</u> |
| <u>Reconciliation of loss from operations to net cash (used in) provided by operating activities:</u> | | |
| Loss from operations | \$ (145,358) | \$ (280,716) |
| Adjustment to reconcile loss from operations to net cash (used in) provided by operating activities: | | |
| Depreciation | 274,307 | 281,500 |
| Bad debts | - | 46,548 |
| Changes in assets and liabilities: | | |
| Decrease in inventory | - | 45,612 |
| (Decrease) increase in accounts payable | (153,860) | 24,840 |
| (Decrease) increase in unearned income | <u>(100,000)</u> | <u>166,667</u> |
| Net cash provided by (used in) operating activities | <u>\$ (124,911)</u> | <u>\$ 284,451</u> |
| Summary disclosure of non-cash activities: | | |
| Decrease in accounts payable | \$ 918,074 | \$ - |
| Decrease in due to Primary Government | - | 975,739 |
| Gain on forgiveness of debt | <u>(918,074)</u> | <u>(975,739)</u> |
| | <u>\$ -</u> | <u>\$ -</u> |

See accompanying notes to financial statements.

POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2007 and 2006

(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 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.

To conform to the requirements of GASB Statement 34, retained earnings are presented in the following net asset categories:

- Invested in capital assets; capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting

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 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. The Corporation considers revenues and costs that are directly related to the operation and maintenance of the managed fish processing plant and cold storage facility to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

Cash

Custodial credit risk is the risk that in the event of a bank failure, the Corporation'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 or held by the pledging financial institution but not in the depositor-government's name. The Corporation does not have a deposit policy for custodial credit risk.

For the purposes of the statements of net assets and cash flows, cash is defined as cash in checking accounts, savings accounts and cash on hand. As of September 30, 2007 and 2006, cash was \$53,098 and \$234,631, respectively, and the corresponding bank balances were \$65,984 and \$235,172, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007 and 2006, bank deposits in the amount of \$65,984 and \$100,000, respectively, were FDIC insured. Accordingly, these deposits are exposed to custodial credit risk. The Corporation does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized.

Receivables

All receivables are due from businesses and individuals located in the United States of America and within Pohnpei, Federated States of Micronesia, and are interest free and uncollateralized. 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 bad debts charged to expense.

POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

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. All capital assets are capitalized where it is determined that such assets have a useful life that exceeds 1 year. 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 |

New Accounting Standards

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, 2006. 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*. GASB Statement 45 establishes standards for the measurement, recognition, and display of other post employment 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, 2007. 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.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. 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.

POHNPEI FISHERIES CORPORATION
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Notes to Financial Statements
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In May 2007, GASB issued Statement No. 50, *Pension Disclosures an Amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits. The provisions of this statement are effective for periods beginning after June 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 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Corporation.

(2) Receivables

A summary of accounts receivable at September 30, 2007 and 2006 is presented below:

| | <u>2007</u> | <u>2006</u> |
|---------------------------------|------------------|------------------|
| Accounts receivable - trade | \$ 182,628 | \$ 182,628 |
| Advances to employees | 4,161 | 4,161 |
| Others | <u>622</u> | <u>622</u> |
| | 187,411 | 187,411 |
| Allowance for doubtful accounts | <u>(187,411)</u> | <u>(187,411)</u> |
| Accounts receivable, net | \$ <u>-</u> | \$ <u>-</u> |

(3) Property and Equipment

Capital asset activity for the years ended September 30, 2007 and 2006, was as follows:

| | <u>2007</u> | | | |
|--------------------------|--|-------------------------------|-------------------------------|--|
| | Beginning Balance October 1, 2006 | Transfers and Additions | Transfers and Deletions | Ending Balance September 30, 2007 |
| Contributed assets | \$ 10,498,893 | \$ - | \$ - | \$ 10,498,893 |
| Machinery and equipment | 1,855,494 | - | - | 1,855,494 |
| Buildings | 282,463 | - | - | 282,463 |
| Vehicles | 86,405 | - | - | 86,405 |
| Furnitures and fixtures | <u>46,510</u> | <u>298</u> | <u>-</u> | <u>46,808</u> |
| | 12,769,765 | 298 | - | 12,770,063 |
| Accumulated depreciation | <u>(12,221,426)</u> | <u>(274,307)</u> | <u>-</u> | <u>(12,495,733)</u> |
| | \$ <u>548,339</u> | \$ <u>(274,009)</u> | \$ <u>-</u> | \$ <u>274,330</u> |

POHNPEI FISHERIES CORPORATION
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Notes to Financial Statements
September 30, 2007 and 2006

(3) Property and Equipment, Continued

| | 2006 | | | |
|--------------------------|--|-------------------------------|-------------------------------|--|
| | Beginning Balance October 1, 2005 | Transfers and Additions | Transfers and Deletions | Ending Balance September 30, 2006 |
| Contributed assets | \$ 10,498,893 | \$ - | \$ - | \$ 10,498,893 |
| Machinery and equipment | 1,855,494 | - | - | 1,855,494 |
| Buildings | 282,463 | - | - | 282,463 |
| Vehicles | 86,405 | - | - | 86,405 |
| Furnitures and fixtures | <u>45,710</u> | <u>800</u> | <u>-</u> | <u>46,510</u> |
| | 12,768,965 | 800 | - | 12,769,765 |
| Accumulated depreciation | <u>(11,939,926)</u> | <u>(281,500)</u> | <u>-</u> | <u>(12,221,426)</u> |
| | <u>\$ 829,039</u> | <u>\$ (280,700)</u> | <u>\$ -</u> | <u>\$ 548,339</u> |

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

(4) Due to Primary Government

As of September 30, 2007 and 2006, 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. Since net assets are not expected to reach this level in the near term, the note has been classified as long-term.

During the year ended September 30, 2006, the Corporation recognized a gain on forgiveness of debt relating to a note payable to Caroline Fisheries Corporation, an investee of a Pohnpei State Government component unit, in the amount of \$975,739.

(5) Long-Term Debt

A summary of long-term debt as of September 30, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|---|------------------|------------------|
| Note payable to Pohnpei Economic Development Authority, uncollateralized and without interest, due in equal monthly installments beginning April 30, 1998 of \$20,000. | \$ 40,000 | \$ 40,000 |
| Note 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 2004, ending May 2007. | 85,299 | 124,982 |
| Note 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> | <u>15,000</u> |
| | 140,299 | 179,982 |
| Less current installments | <u>(85,299)</u> | <u>(124,982)</u> |
| | <u>\$ 55,000</u> | <u>\$ 55,000</u> |

POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2007 and 2006

(5) Long-Term Debt, Continued

Future maturities on notes payable are as follows:

| <u>Year ending September 30,</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|----------------------------------|------------------|-----------------|------------------|
| 2007 | \$ <u>85,299</u> | \$ <u>7,111</u> | \$ <u>92,410</u> |

There are no maturities associated with the remaining notes of \$55,000 and no interest on these notes has been either assessed to date or paid.

The Corporation has defaulted on its note payable to the FSM Development Bank as of September 30, 2007.

Changes in long-term debt for the year ended September 30, 2007 as follows:

| | <u>Outstanding</u> <u>October 1,</u> <u>2006</u> | <u>Increases</u> | <u>Decreases</u> | <u>Outstanding</u> <u>September</u> <u>30, 2007</u> | <u>Current</u> |
|--|--|------------------|------------------|---|------------------|
| Note payable to Pohnpei Economic Development Authority | \$ 40,000 | \$ - | \$ - | \$ 40,000 | \$ - |
| Payable to Primary Government | 2,450,000 | - | - | 2,450,000 | - |
| Note payable to FSMDB | 124,982 | - | 39,683 | 85,299 | 85,299 |
| Note payable to FSM National Government | 15,000 | - | - | 15,000 | - |
| | <u>\$ 2,629,982</u> | <u>\$ -</u> | <u>\$ 39,683</u> | <u>\$ 2,590,299</u> | <u>\$ 85,299</u> |

Changes in long-term debt for the year ended September 30, 2006 are as follows:

| | <u>Outstanding</u> <u>October 1,</u> <u>2005</u> | <u>Increases</u> | <u>Decreases</u> | <u>Outstanding</u> <u>September</u> <u>30, 2006</u> | <u>Current</u> |
|--|--|------------------|---------------------|---|-------------------|
| Note payable to Pohnpei Economic Development Authority | \$ 40,000 | \$ - | \$ - | \$ 40,000 | \$ - |
| Payable to Primary Government | 3,425,739 | - | 975,739 | 2,450,000 | - |
| Note payable to FSMDB | 173,813 | - | 48,831 | 124,982 | 124,982 |
| Note payable to FSM National Government | 15,000 | - | - | 15,000 | - |
| | <u>\$ 3,654,552</u> | <u>\$ -</u> | <u>\$ 1,024,570</u> | <u>\$ 2,629,982</u> | <u>\$ 124,982</u> |

POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2007 and 2006

(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

As of September 30, 2007 and 2006, the Corporation has recorded payables due to the following affiliates, which are component units of the Pohnpei State Government:

| | <u>2007</u> | <u>2006</u> |
|--|-------------|---------------------|
| Pohnpei Economic Development Authority | \$ - | \$ 777,522 |
| Pohnpei Utilities Corporation | <u>-</u> | <u>277,216</u> |
| | <u>\$ -</u> | <u>\$ 1,054,738</u> |

These amounts are reflected within accounts payable balances in the statements of net assets.

During the year ended September 30, 2007, the Corporation entered into settlement agreements with these affiliates and recognized a resulting gain on forgiveness of debt of \$918,074.

(8) Risk Management

The Corporation purchases commercial insurance to cover its potential risks from workmen's compensation liability. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. The Corporation is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

(9) Future Lease Revenue

The approximate future minimum annual rental revenue receivable by the Corporation for a 5 year lease on the fish processing plant currently held with a private corporation is as follows:

| <u>Year ending September 30,</u> | <u>Total</u> |
|----------------------------------|-------------------|
| 2009 | \$ 100,000 |
| 2010 | 100,000 |
| 2011 | <u>100,000</u> |
| | <u>\$ 300,000</u> |

Per the terms of the lease, \$200,000 was paid on signing the lease, which constitutes a pre-payment of the initial two years of the lease term. The unamortized amount of the prepayment is reflected as unearned income in the accompanying statements of net assets.

POHNPEI FISHERIES CORPORATION
(A COMPONENT UNIT OF THE STATE OF POHNPEI)

Notes to Financial Statements
September 30, 2007 and 2006

(10) Going Concern

As of September 30, 2007 and 2006, the Corporation has accumulated net liabilities of \$2,386,951 and \$3,143,026, respectively. Management will attempt to return the Corporation to profitability by reducing its cost of operations and by generating lease revenues and also is dependent support from Pohnpei State.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS 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, 2007, and have issued our report thereon dated May 22, 2008. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely effects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

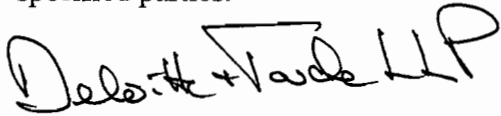
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters 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 management, and others within the entity, 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 + Touche LLP". The signature is written in a cursive, stylized font.

May 22, 2008