

THE DIVING SEAGULL, INC.
(A COMPONENT UNIT OF THE STATE OF YAP)

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT**

YEARS ENDED SEPTEMBER 30, 2007 AND 2006

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
The Diving Seagull, Inc.:

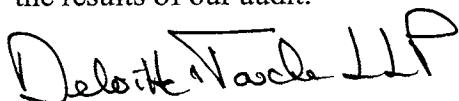
We have audited the accompanying statements of net assets of The Diving Seagull, Inc. (the Company), a component unit of the State of Yap, as of September 30, 2007 and 2006, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Company'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 for 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 Diving Seagull, Inc. as of September 30, 2007 and 2006 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 2 - 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 Company's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated June 27, 2008, on our consideration of The Diving Seagull, Inc.'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.



June 27, 2008

THE DIVING SEAGULL, INC.

Management Discussion and Analysis Year Ended September 30, 2007

The Yap State Government was required to adopt the provisions of the Government Accounting Standards Board (GASB). The Diving Seagull, Inc. is accounted for and is reported as component unit of the State of Yap.

In 2007, the Company's total current assets increased to \$4,091,711. Depreciation expenses for all assets; leased fishing vessel and purse net, leasehold improvements, computers, office furniture and vehicle also increased to \$888,779 during the fiscal year ended September 30, 2007, as a consequence of the Bareboat Charter Agreement, which has been extended for another 20 years, with which this year would be in its 6th year, upon inception in July 2002.

In 2005, the Company reported bad debts expense from an impairment loss on Palau Micronesian Airlines, \$300,000 of which is for bad debts and \$250,000 was for an impairment loss on an investment. Palau Micronesian Air suspended operations on December 23, 2004 to recognize and restore its business strategy. The note receivable went into effect in June 2005; however, to this date, there has been no payment or communication with The Diving Seagull, Inc. Management is attempting through our legal counsel to collect from PMAir. It is considered a first priority of The Diving Seagull, Inc.

Operating revenues generated from fish sales of \$5,491,876 increased by 4% due to fish price increases, due to an increase in fish volume, and due to a minimal rejection rate. These factors contributed to the 4% increase in fish sales revenues.

Income from operations in the fiscal year ended September 30, 2007 was \$460,044 and in 2006, income from operations was \$35,215. There is an increase shown this year due to an increase in revenues and a decrease in cost of sales.

The Company's operating cash flows totaled \$902,676 in 2007 and \$434,136 in 2006. During the year ended September 30, 2007, total cash and equivalents increased \$19,796 to \$1,539,705. The increase in cash and equivalents is due to a fish price increase to 1,300 per metric ton during the 2007 fiscal year.

In 2006, the FSM Development Bank disbursed \$1.3 million to pay dry-docking costs in Cairns, Australia. The Board decided to obtain another loan from the same bank for an additional \$1.37 million, both of which, were to be paid off within the next 5 years. The purpose of these loans was for dry-docking the FV Mathawmarfach at Tropical Reef Shipyard, in Cairns, Australia.

The following table summarizes the financial condition and results of operation of the Company for the fiscal years ended 2007, 2006 and 2005.

Assets:	<u>2007</u>	<u>2006</u>	<u>2005</u>
Property and equipment, net	\$ 2,355,297	\$ 911,388	\$ 1,051,206
Current assets	4,091,711	3,571,564	3,210,927
Other assets	<u>51,720</u>	<u>51,030</u>	<u>50,556</u>
Total assets	\$ <u>6,498,728</u>	\$ <u>4,533,982</u>	\$ <u>4,312,689</u>
Liabilities and Net Assets:			
Long-term debt	\$ 1,946,445	\$ 633,515	\$ 772,838
Current portion of long-term debt	415,084	159,859	100,942
Other current liabilities	<u>720,079</u>	<u>665,185</u>	<u>415,980</u>
Total liabilities	\$ <u>3,081,608</u>	\$ <u>1,458,559</u>	\$ <u>1,289,760</u>

THE DIVING SEAGULL, INC.

Management Discussion and Analysis Year Ended September 30, 2007

Net assets:	<u>2007</u>	<u>2006</u>	<u>2005</u>
Invested in capital assets	\$ 2,355,297	\$ 911,388	\$ 1,051,206
Unrestricted	<u>1,061,823</u>	<u>2,164,035</u>	<u>1,971,723</u>
Total net assets	\$ <u>3,417,120</u>	\$ <u>3,075,423</u>	\$ <u>3,022,929</u>
Revenues, Expenses, and Changes in Net Assets:			
Operating revenues	\$ 5,501,572	\$ 5,299,294	\$ 5,113,127
Cost of sales	(4,687,935)	(5,010,798)	(3,844,084)
Operating expenses	<u>(353,593)</u>	<u>(253,281)</u>	<u>(736,203)</u>
Net operating revenues	<u>460,044</u>	<u>35,215</u>	<u>532,840</u>
Interest income	84,444	80,285	85,775
Interest expense	<u>(202,791)</u>	<u>(63,006)</u>	<u>(83,822)</u>
Net interest income (expense)	<u>(118,347)</u>	<u>17,279</u>	<u>1,953</u>
Change in net assets	\$ <u>341,697</u>	\$ <u>52,494</u>	\$ <u>534,793</u>

Capital Assets and Debt

As stated above, in fiscal year 2007, the Company made significant investment in capital assets for improvement to its chartered ship. Please see additional information concerning capital assets at note 5 to the financial statements.

To finance these improvements, the Company engaged in significant borrowings. Please see note 6 to the financial statements for additional information concerning Company debt.

Management's Discussion and Analysis for the year ended September 30, 2006 is set forth in the Company's report on the audit of financial statements, which is dated February 7, 2007. That Discussion and Analysis explains the major factors impacting the 2006 financial statements and can be viewed at the FSM Office of the Public Auditor's website at www.fsmpublicauditor.fm.

Plan of Action for 2008 – Economic Outlook

- 1. Renewal of Vessel Management Agreement/Captain Contract**
- 2. Aggressive collection on aging receivables**
- 3. Minimize fuel usage per trip**
- 4. Line of Credit assistance**
- 5. Revised business plan**
- 6. Diversification**
- 7. Research land purchases**
- 8. 2nd vessel strategy**
- 9. Training of staff**
- 10. Work policies and regulations**

THE DIVING SEAGULL, INC.

Statements of Net Assets
September 30, 2007 and 2006

<u>ASSETS</u>	<u>2007</u>	<u>2006</u>
Current assets:		
Cash and cash equivalents	\$ 1,487,985	\$ 1,468,879
Short-term investments	1,566,000	1,566,000
Net receivable from broker	806,485	-
Employee and director receivables	68,545	15,744
Other receivables	25,146	24,667
Deferred charges	123,065	481,789
Prepaid expenses	14,485	14,485
Total current assets	4,091,711	3,571,564
Restricted cash and cash equivalents	51,720	51,030
Property and equipment, net	2,355,297	911,388
	\$ 6,498,728	\$ 4,533,982
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current portion of long-term debt	\$ 415,084	\$ 159,859
Accounts payable	380,842	342,402
SA accounts payable	26,492	26,492
Net payable to broker	-	157,104
Accrued expenses	312,745	139,187
Total current liabilities	1,135,163	825,044
Long-term debt, net of current portion	1,946,445	633,515
Total liabilities	3,081,608	1,458,559
Contingencies and commitments		
Net assets:		
Invested in capital assets	2,355,297	911,388
Unrestricted	1,061,823	2,164,035
Total net assets	3,417,120	3,075,423
	\$ 6,498,728	\$ 4,533,982

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Operating revenues:		
Fish sales	\$ 5,491,876	\$ 5,298,811
Other revenues	9,696	483
Total operating revenues	<u>5,501,572</u>	<u>5,299,294</u>
Cost of sales	<u>4,687,935</u>	<u>5,010,798</u>
Gross margin	<u>813,637</u>	<u>288,496</u>
Selling, general and administrative expenses:		
Travel	100,861	29,499
Payroll, taxes and benefits	74,977	102,831
Survey	41,695	5,513
Communications and utilities	19,107	14,995
Office expense	12,159	32,895
Depreciation	11,588	9,211
Rent	6,192	8,405
SA expenses	-	5,290
Miscellaneous	87,014	44,642
Total selling, general and administrative expenses	<u>353,593</u>	<u>253,281</u>
Income from operations	<u>460,044</u>	<u>35,215</u>
Nonoperating revenues (expenses):		
Interest expense	(202,791)	(63,006)
Interest income	84,444	80,285
Total nonoperating revenues (expenses), net	<u>(118,347)</u>	<u>17,279</u>
Change in net assets	341,697	52,494
Net assets at beginning of year	<u>3,075,423</u>	<u>3,022,929</u>
Net assets at end of year	<u>\$ 3,417,120</u>	<u>\$ 3,075,423</u>

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.

Statements of Cash Flows
Years Ended September 30, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Cash received from customers	\$ 4,537,504	\$ 5,282,127
Cash payments to suppliers for goods and services	(2,576,978)	(3,235,693)
Cash payments to boat crew and employees for services	(1,057,850)	(1,612,298)
Net cash provided by operating activities	902,676	434,136
Cash flows from investing activities:		
Interest received from short-term investments	84,444	80,285
Net cash provided by investing activities	84,444	80,285
Cash flows from capital and related financing activities:		
Principal repayments of long-term debt	(308,471)	(873,780)
Interest paid on long-term debt	(202,791)	(63,006)
Proceeds from issuance of long-term debt	1,876,626	793,374
Acquisition of property and equipment	(2,332,688)	(17,185)
Proceeds from sale of fixed assets	-	25,500
Net cash used in capital and related financing activities	(967,324)	(135,097)
Net change in cash	19,796	379,324
Cash and equivalents at beginning of year	1,519,909	1,140,585
Cash and equivalents at end of year	\$ 1,539,705	\$ 1,519,909
Reconciliation of income from operations to net cash provided by operating activities:		
Operating income	\$ 460,044	\$ 35,215
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	888,779	131,503
Changes in assets and liabilities:		
Employee and director receivables	(52,801)	(15,288)
Other receivables	(479)	(17,382)
Net receivable from Broker	(806,485)	-
Deferred charges	358,724	(10,553)
Prepaid expense	-	61,436
Net payable to broker	(157,104)	215
Accounts payable-SA	-	(1,112)
Accounts payable - other	38,440	253,185
Accrued expenses	173,558	(3,083)
Net cash provided by operating activities	\$ 902,676	\$ 434,136

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies

Reporting Entity

The Diving Seagull, Inc. (the "Company"), a component unit of the State of Yap, was incorporated in Yap in the Federated States of Micronesia on March 17, 1997. The Company is organized primarily to pursue fishing and other fishing related activities by operating fishing vessels, marketing and selling fish, and developing cold storage and/or transshipment facilities. A seven member Board of Directors is responsible for managing the business affairs and directing the daily operations of the corporation.

The Articles of Incorporation authorized the issuance of 6,500,000 shares of common stock at \$1 par value per share. All such shares were issued to the Yap Investment Trust fund, a fund of the State of Yap, under the terms of a twenty-five year lease agreement for use of the fishing vessel, Mathawmarfach, and purse seine fishing net. This Bareboat Charter Agreement expires in March 2022.

Basis of Accounting

The financial statements of the Company have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. Governmental Accounting Standards Board (GASB) Statement No. 20, "*Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Company has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The Company adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34 (Basic Financial Statements – Management's Discussion and Analysis for State and Local Governments). GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into four net asset categories:

- (a) *Invested in capital assets, net of related debt* – Capital assets, net of accumulated depreciation, and outstanding principle balances of debt attributable to the acquisition, construction, or improvement of those assets.
- (b) *Restricted Nonexpendable* – Net assets subject to externally imposed stipulations that require the Company to maintain them permanently.
- (c) *Restricted Expendable* – Net assets whose use by the Company is subject to externally imposed stipulations that can be fulfilled by actions of the Company pursuant to those stipulations or that expire by the passage of time.
- (d) *Restricted 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.

The Company's 6,500,000 shares of authorized, issued and outstanding common stock with par value of \$1 per share represent capital net assets. However, since all shares are held by the State and since the Company is a component unit of the State, these shares are not presented in the accompanying balance sheets.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

Operating and Non-Operating Revenue and Expenses

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

New Accounting Standards

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*, which establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

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 Company.

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 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 Company.

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 Company.

In May 2007, GASB issued Statement No. 50, *Pension Disclosures-an Amendment of GASB Statements No. 25 and 27*, which amends applicable note disclosure and RSI requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27 *Accounting for Pensions by State and Local Governmental Employers*, to conform with requirements of Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* and Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions*. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe the implementation of this statement will have a material effect on the financial statements of the Company.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

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 Company.

Cash and Equivalents

Cash includes cash on hand as well as cash in various bank accounts and time certificates of deposits with an initial maturity date of three months or less. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified as short-term investments.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. Routine maintenance and repairs are expensed as incurred. Depreciation is recorded in the financial statements under the straight-line method based on the estimated useful lives of the assets as follows:

Computer and office furniture and equipment	3-5 years
Leased equipment	5-20 years
Leasehold improvements	3-10 years
Vehicles	5 years

Leased assets and leasehold improvements are capitalized over the lesser of the useful life or the lease term. Capitalization thresholds are \$1,000 for leasehold improvements and \$500 for all other assets.

Revenue Recognition

The Company's primary source of revenue is derived from the sale of fish. Sales of fish are only considered earned upon offloading the catch to a designated third party. The sales are estimated, less a provision for rejected fish, based on broker commitments per ton and are adjusted upon receipt of a final settlement from the broker.

Other revenue is recorded when earned and measurable.

Translation of Foreign Currencies

Gains and losses that arise from exchange rate changes on transactions denominated in a currency other than U.S. dollars are included in the statement of income as incurred.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2007 and 2006

(1) Summary of Significant Accounting Policies, Continued

Deferred Charges

Direct costs incurred for ongoing fishing trips are recognized as deferred charges. Deferred charges primarily comprise fuel inventory on hand, crew salaries, license fees, port fees and other direct expenses related to the trip, but exclude depreciation.

Allowance for Doubtful Accounts

The Company establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information.

(2) Deposits

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.

The deposit and investment policies of the Company are governed by its enabling legislation. The Board of Directors is required to engage one or more fund custodians to assume responsibility for the physical possession of the Company's investments.

A. Deposits:

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

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2007 and 2006

(2) Deposits, Continued

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, the Company'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 Company does not have a deposit policy for custodial credit risk.

As of September 30, 2007 and 2006, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit was \$3,105,705 and \$3,085,909, respectively, and the corresponding bank balances were \$3,168,247 and \$3,067,773, respectively. Of the bank balances, \$1,476,134 and \$1,326,096, respectively, 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 \$141,955 and \$148,199, respectively, were FDIC insured. The Company 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. The Company has not experienced any losses on such accounts and management believes it is not exposed to any significant credit risk on its deposits.

(3) Net Receivable from/Payable to Broker

Approximately 100% of fish sales in the years ended September 30, 2007 and 2006 were conducted with a single broker based in Taiwan. Upon offloading the fish catch from the vessel to a designated third party, the broker pays 95% of the estimated settlement. When the final settlement is determined, the Company may either be entitled to an additional amount due from the broker or be liable for an amount due to the broker. The net broker account is a receivable of \$806,485 at September 30, 2007 and a payable of \$157,104 at September 30, 2006.

(4) Notes and Other Receivables

Outstanding balances from notes and other receivables due the Company from various parties are detailed below:

	<u>2007</u>	<u>2006</u>
Palau Micronesia Air (PMAir)	\$ 550,000	\$ 550,000
Fishing companies	55,234	55,234
Micronesian Petroleum Company (MPC) Yap	40,631	40,631
National Fisheries Corporation (NFC)	<u>3,477</u>	<u>3,477</u>
	649,342	649,342
Less: allowance for doubtful accounts	<u>(649,342)</u>	<u>(649,342)</u>
	\$ <u>-</u>	\$ <u>-</u>

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2007 and 2006

(5) Property and Equipment

Property and equipment consist of the following at September 30, 2007 and 2006:

	Beginning Balance Oct. 1, 2006	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2007
Leased fishing vessel and purse seine net	\$ 6,320,962	\$ -	\$ -	\$ 6,320,962
Leasehold improvements	1,552,372	2,299,636	-	3,852,008
Computer and office furniture and equipment	38,789	6,484	(17,175)	28,098
Vehicle	<u>34,304</u>	<u>26,568</u>	<u>(34,304)</u>	<u>26,568</u>
Total cost	7,946,427	2,332,688	(51,479)	10,227,636
Less accumulated depreciation	<u>(7,035,039)</u>	<u>(888,779)</u>	<u>51,479</u>	<u>(7,872,339)</u>
	\$ <u>911,388</u>	\$ <u>1,443,909</u>	\$ <u>-</u>	\$ <u>2,355,297</u>
	Beginning Balance Oct. 1, 2005	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2006
Leased fishing vessel and purse seine net	\$ 6,345,962	\$ -	\$ (25,000)	\$ 6,320,962
Leasehold improvements	1,552,372	-	-	1,552,372
Computer and office furniture and equipment	21,604	17,185	-	38,789
Vehicle	<u>34,804</u>	<u>-</u>	<u>(500)</u>	<u>34,304</u>
Total cost	7,954,742	17,185	(25,500)	7,946,427
Less accumulated depreciation	<u>(6,903,536)</u>	<u>(131,503)</u>	<u>-</u>	<u>(7,035,039)</u>
	\$ <u>1,051,206</u>	\$ <u>(114,318)</u>	\$ <u>(25,500)</u>	\$ <u>911,388</u>

(6) Long-Term Debt

On July 28, 2006, the Company signed a five-year loan agreement with the Federated States of Micronesia Development Bank (FSMDB) authorizing a maximum loan of \$1,300,000 to cover the dry-dock costs of the fishing vessel. The agreement stipulates a 1.5% loan fee and interest rate of 9%. Interest is due monthly during the six-month grace period. Interest and principal are payable in monthly installments of \$26,986 beginning January 30, 2007. Part of the loan agreement requires the Company to establish a joint account with FSMDB and to make deposits therein as required by that agreement. As of September 30, 2007 and 2006, the balance of this restricted account is \$51,720 and \$51,030, respectively.

On February 16, 2007, a new loan was granted by FSMDB amounting to \$1,370,000 to cover additional dry dock costs of the fishing vessel at an interest rate of 9%. Interest and principal are payable in monthly installments of \$28,606 beginning June 15, 2007.

Both notes are collateralized by a chattel mortgage on all property and equipment, including the fishing vessel Mathawmarfach.

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2007 and 2006

(6) Long-Term Debt, Continued

A summary of changes in long-term debt is provided below:

	<u>2007</u>	<u>2006</u>
Balance at beginning of year	\$ 793,374	\$ 873,780
Additions	1,876,626	793,374
Payments	<u>(308,471)</u>	<u>(873,780)</u>
Balance at end of year	2,361,529	793,374
Less current portion	<u>(415,084)</u>	<u>(159,859)</u>
Long-term debt	\$ <u>1,946,445</u>	\$ <u>633,515</u>

Future debt service on the above debt is as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 415,084	\$ 185,166	\$ 600,250
2009	512,737	154,372	667,109
2010	560,835	106,274	667,109
2011	613,445	53,664	667,109
2012	<u>259,428</u>	<u>5,558</u>	<u>264,986</u>
	\$ <u>2,361,529</u>	\$ <u>505,034</u>	\$ <u>2,866,563</u>

(7) Lease Commitments

The Company leases the fishing vessel and purse seine fishing net from Yap Investment Trust, a fund of the Yap State Government (the "State"), with a lease term through July 2022. Common stock was issued by the Company as total consideration for the agreement.

(8) Cost of Sales

The detail of cost of sales for the years ended September 30, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>
Fuel	\$ 1,420,951	\$ 1,572,502
Depreciation	877,191	122,292
Crew salaries and wages	874,738	1,184,121
Repair and maintenance	398,936	910,787
License, agent and port fees	398,195	326,475
Insurance	229,346	269,058
Management fee	193,342	249,054
Salt and provisioning	86,301	96,465
Supplies and freight	59,929	62,592
Crew travel	58,947	86,153
Communications	51,617	73,378
Stevedoring	35,550	57,921
Other vessel expenses	<u>2,892</u>	<u>-</u>
	\$ <u>4,687,935</u>	\$ <u>5,010,798</u>

THE DIVING SEAGULL, INC.

Notes to Financial Statements
September 30, 2007 and 2006

(9) Risk Management

The Company is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Company has elected to purchase commercial insurance for the risks of loss to which it is exposed. It claims expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. No losses as a result of these risks have occurred in any of the past three years.

(10) Related Parties

The Company has entered into significant transactions with the State, as discussed in Note 7. Several board members and officers of the Company hold management positions and other positions of influence with the State.

Certain officers of the Company represented on the Board of the Yap Investment Trust, the sole owner of the Company, also represent the State on the Board of Palau Micronesia Air.

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

To the Board of Directors of
The Diving Seagull, Inc.:

We have audited the financial statements of The Diving Seagull, Inc. (the Company), as of and for the year ended September 30, 2007, and have issued our report thereon dated June 27, 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 the Company'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 Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company'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 affects 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.

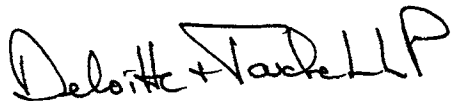
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies 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 Company'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 or other matters that are required to be reported under *Government Auditing Standards*.

We noted other matters that we reported to management of the Company in a separate letter dated June 27, 2008.

This report is intended for the information of the Board of Directors and management of The Diving Seagull, Inc, 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.

June 27, 2008