NATIONAL FISHERIES CORPORATION

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

SEPTEMBER 30, 2009 AND 2008

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
National Fisheries Corporation:

We have audited the accompanying statements of net assets of the National Fisheries Corporation (NFC), a component unit of the FSM National Government, as of September 30, 2009 and 2008 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 NFC'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 NFC'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 report dated September 16, 2009, we expressed a modified opinion on the September 30, 2008 statement of net assets and the related statements of revenues, expenses and changes in net assets and of cash flows for the year then ended because of an inability to consolidate certain joint venture financial statements. As further described in note 2, NFC has changed its method of accounting for these items and this matter does not require restatement of the 2008 financial statements. Accordingly, our present opinion on the 2008 financial statement as presented herein is different from that expressed in our previous report.

In our opinion, the financial statements referred to in the first paragraph presents fairly, in all material respects, the financial position of NFC as of September 30, 2009 and 2008, 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.

The accompanying financial statements have been prepared assuming that NFC will continue as a going concern. As discussed in note 8 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's 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 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 measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 2010, on our consideration of NFC's internal control over financial reporting and on 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.

Deloitte + Touche LLP

June 15, 2010

NATIONAL FISHERIES CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Management Discussion and Analysis
September 30, 2009 and 2008

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, 2009. MD & A is supplementary information required by the 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 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 fishing 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 actual operation of longline fishing vessels, trading of fishing supplies and the airfreight business.

Due to drastic economic conditions, NFC's subsidiaries namely CFTI, YFTI, KSVI and MLFC failed to submit audited financial statements. The latest financial statement received from CFTI was dated September 1998. In FY2006, the MLFC board of directors declared the company (MLFC) to be bankrupt. NFC started the non-inclusion of MLFC's financial data in NFC's consolidated financial statement in fiscal year 2004. That company is now in trust or receivership and a new trustee has been appointed by the FSM Supreme court and NFC has no further responsibility for that company.

Because of the unavailability of financial data from NFC subsidiaries, balances from these investee's were excluded from NFC's financial statement. NFC started the non-inclusion of MLFC's financial data in NFC's financial statement in fiscal year 2004. Investment balance from CFTI amounting to $486k was also written –off in 2007.

The financial statements of NFC are presented as combined balances including the balances of corporate, fishing operations, airfreight operations, transshipment operations and baitfish services from previous years until FY 2006.

Overview of Fiscal Year 2009

The accounts of NFC are organized as a proprietary fund. Proprietary funds are used by the governmental units that are operated in a manner similar to private business enterprises.

For the current year, NFC corporate office activities includes combined activities from licensing of foreign boats, leasing of two fishing vessels, fish grading and regular corporate and administrative functions.

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 submit 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 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.

   Comparative Statements of Net Assets at September 30, 2009, 2008 and 2007 are summarized below:

	FY 2009	FY2008	FY2007
Assets:			
Current assets	$ 96,637	$ 131,183	$ 129,425
Noncurrent assets	113,477	160,377	111,704
	$ 210,114	$ 291,560	$ 241,129
Liabilities:			
Current liabilities	$ 3,857,379	$ 3,852,285	$ 3,862,942
Noncurrent liabilities	-	-	-
Total liabilities	3,857,379	3,852,285	3,862,942
Net deficiency:			
Invested in capital assets, net of related debt	113,477	160,377	(111,704)
Unrestricted	(3,760,742)	(3,721,102)	(3,733,517)
Total net deficiency	(3,647,265)	(3,560,725)	(3,621,813)
	$ 210,114	$ 291,560	$ 241,129

   Assets: Company total assets of $210 thousand dollars comprise $96.6 thousand or 46% of current assets and $113 thousand or 54% capital assets.

   Current assets: The major portion of the $96.6k current assets is inventory, which accounts for 66% or $64.7k. Cash represents $18k or 18% of current assets and the remaining is accounts receivable of $13 thousand.

   Noncurrent assets: The total noncurrent assets of $113k is comprised of the Company's property and equipment, net of accumulated depreciation.

   Liabilities: NFC's liabilities of $3.857 million are all current consisting of a $3.6 million loan from the National Government, which comprises 94% of total NFC liabilities, and other accounts payable and accrued liabilities of $257k.

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

The SRECNA provides information on the financial performance of the current 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, 2009, 2008 and 2007:

	FY 2009	FY 2008	FY 2007
Sales	$ 181,945	$ 138,537	$ 98,415
Cost of sales and bad debts	(6,983)	(31,881)	(491,235)
Gross profit	174,962	106,656	(392,820)
Operating expenses	213,864	221,259	396,350
Loss from operations	(38,902)	(114,603)	(789,170)
Other income (expense)	(47,638)	175,691	1,141,054
Increase (decrease) in net assets	(86,540)	61,088	351,884
Beginning net assets	(3,560,725)	(3,621,813)	(3,973,697)
Ending net assets	$ (3,647,265)	$ (3,560,725)	$ (3,621,813)

Significant 2009 comparatives of revenues are management fees of $61k versus $72k in 2008, fish grading in 2009 of $27k versus $20.5k in 2008, and vessel lease of $26k in 2009 versus $25k in 2008.

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 the activities into cash flows arising from operating activities, non capital financing and capital and related financing.

Below is the summary statement of cash flows:

	FY 2009	FY 2008	FY 2007
From operating activities	$ (51,257)	$ (104,381)	$ (94,170)
Provided by non capital financing activities	25,000	135,000	100,000
From capital and related financing activities	-	(11,000)	(979)
Net change in cash	(26,257)	19,619	4,851
Cash at beginning of year	44,293	24,674	19,823
Cash at year end	$ 18,036	$ 44,293	$ 24,674

4. Debt and Capital Asset Activities

No significant debt or capital asset activities occurred during the years ended September 30, 2009 and 2008. For additional information on fixed assets, please refer to Note 4 to the financial statements and for additional information on debt, please refer to note 5 to the financial statements.

Management's Discussion and Analysis for the year ended September 30, 2008 is set forth in NFC's report on the audit of financial statements, which is dated September 16, 2009. That Discussion and Analysis explains the major factors impacting the 2008 financial statements and can be obtained from the FSM Office of the National Public Auditor's website at www.fsmpublicauditor.fm.

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 reconstruct its debt to FSM National Government. NFC management is in process of establishing joint ventures with other foreign fishing companies and anticipates commencing new joint venture operations. The joint venture operation is expected to generate sufficient added income to render NFC to be a self supporting company in FY 2010 and thereafter.

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Statements of Net Assets
September 30, 2009 and 2008

	2009	2008
ASSETS		
Current assets:		
Cash	$ 18,036	$ 44,293
Receivables, net of allowance for uncollectible accounts of $1,012,817 and $1,006,681 in 2009 and 2008, respectively	13,909	3,426
Inventory	64,692	83,464
Total current assets	96,637	131,183
Property and equipment, net	113,477	160,377
	$ 210,114	$ 291,560
LIABILITIES AND NET DEFICIENCY		
Current liabilities:		
Notes payable	$ 3,600,000	$ 3,600,000
Accounts payable	237,242	241,304
Accrued liabilities	20,137	10,981
Total current liabilities	3,857,379	3,852,285
Commitment and contingencies		
Net deficiency:		
Invested in capital assets	113,477	160,377
Unrestricted deficit	(3,760,742)	(3,721,102)
Total net deficiency	(3,647,265)	(3,560,725)
	$ 210,114	$ 291,560

See accompanying notes to financial statements.

NATIONAL FISHERIES CORPORATION
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Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2009 and 2008

	2009	2008
Sales	$ 181,945	$ 138,537
Bad debts	(6,135)	-
Net revenue	175,810	138,537
Cost of sales	(848)	(31,881)
Gross profit	174,962	106,656
Operating expenses:		
Salaries and wages	130,309	130,401
Rent	36,731	23,702
Office expense	18,447	25,552
Telephone and communication	9,504	8,912
Utilities	8,770	12,244
Travel and entertainment	5,559	11,645
Repairs and maintenance	1,807	1,254
Representation	1,263	1,479
Depreciation and amortization	1,100	3,018
Contractual services	285	2,410
Miscellaneous	89	642
Total operating expenses	213,864	221,259
Loss from operations	(38,902)	(114,603)
Other income (expense):		
FSM National Government operating subsidy	-	135,000
Operating subsidy from Luen Thai	25,000	-
Other expense, net	(72,638)	-
Gain on disposal of fixed assets	-	40,691
Total other income (expense), net	(47,638)	175,691
Change in net assets	(86,540)	61,088
Net assets at beginning of year	(3,560,725)	(3,621,813)
Net assets at end of year	$ (3,647,265)	$ (3,560,725)

See accompanying notes to financial statements.

NATIONAL FISHERIES CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Cash received from customers	$ 171,462	$ 151,009
Cash paid to suppliers for goods and services	(101,566)	(121,753)
Cash paid to employees for services	(121,153)	(133,637)
Net cash used in operating activities	(51,257)	(104,381)
Cash flows from noncapital financing activities:		
Luen Thai operating subsidies	25,000	-
FSM National Government operating subsidies	-	135,000
Net cash provided by noncapital financing activities	25,000	135,000
Cash flows from capital and related financing activities:		
Acquisition of capital assets/disposal of fixed assets	-	(11,000)
Net cash used for capital and related financing activities	-	(11,000)
Net change in cash	(26,257)	19,619
Cash at beginning of year	44,293	24,674
Cash at end of year	$ 18,036	$ 44,293
Reconciliation of loss from operations to net cash flows used in operating activities:		
Loss from operations	$ (38,902)	$ (114,603)
Adjustments to reconcile loss from operations to net cash used in operating activities:		
Depreciation and amortization	1,100	3,018
Bad debts	6,135	-
Other income/expense	(26,838)	-
(Increase) decrease in assets:		
Accounts receivable	(16,618)	12,472
Inventory	18,772	5,389
Increase (decrease) in liabilities:		
Accounts payable	(4,062)	(7,421)
Accrued liabilities	9,156	(3,236)
Net cash used in operating activities	$ (51,257)	$ (104,381)

Supplementary cash flow information:
During the year ended September 30, 2009, an impairment loss of $45,800 was recorded relative to the sale of a vessel as per note 11.

See accompanying notes to financial statements.

(1) 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 NFC 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.

NFC is a discretely presented component unit of the FSM National Government. The financial statements of NFC are incorporated into those of the FSM National Government. Debts and obligations of 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.

(2) Summary of Significant Accounting Policies

The accounting policies of NFC 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. NFC 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 modify certain other financial statement disclosure requirements.

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

- Investment in capital assets; capital assets, net of accumulated depreciation, 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.

(2) 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 total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. Expenses not meeting this definition are reported as nonoperating expenses.

Cash

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 or held by the pledging financial institution but not in the depositor-government's name. NFC does not have a deposit policy for custodial credit risk.

As of September 30, 2009 and 2008, the carrying amount of NFC's total cash and cash equivalents and time certificates of deposit were $18,036 and $44,293, respectively, and the corresponding bank balances were $18,699 and $44,463, respectively, all of which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2009 and 2008, 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.

Investments 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.

(2) Summary of Significant Accounting Policies, Continued

Investments and Business Development, Continued

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 Micronesia Longline Fishing Company (MLFC), Yap Fishing Corporation (YFC), Yap Fresh Tuna, Inc. (YFTI), Chuuk Fresh Tuna, Inc. (CFTI), and Kosrae Sea Venture Inc. (KSVI) are accounted for using the equity method and, accordingly, the carrying values of these investments have been reduced to $0. In 2009 and 2008, financial statements for these joint ventures were not available. Management has asserted that it is unable to control these joint ventures and does not believe that it is liable for any additional losses of these entities that may occur. As a result, the equity method of accounting has been adopted for investments in these entities for both the years ended September 30, 2009 and 2008.

Receivables

Receivables from fishing and ancillary activities are based on contracted prices, which are both interest free and uncollateralized and are primarily due from government agencies, businesses and individuals located within the FSM. 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 collectability 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.

Inventory

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

Property and Equipment

Property and equipment are stated at cost or estimated historical cost, less accumulated depreciation. One vessel is carried at its value as of the date of sale and an impairment loss was recorded to bring the carrying value of the asset to the sales value. 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 10 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. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits.

(2) 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.

Revenue Recognition

NFC's primary source of revenue is derived from the provision of services, which are recorded at the time the buyer accepts that the services have been performed.

Other revenue is recorded when earned and measurable.

New Accounting Standards

During fiscal year 2009, NFC implemented the following pronouncements:

- GASB 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.

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

- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.

- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.

- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which 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 NFC.

In June 2008, GASB issued statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. 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 NFC.

In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment. 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 NFC.

In March 2009, GASB issued statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement will have a material effect on the financial statements of NFC.

(3) Related Party Transactions

NFC 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.

NFC and Kasar Fishing Corporation (KFC) entered into a management agreement in August 2009 wherein NFC would receive $14,000 per month for two years. NFC received $28,000 in fiscal year 2009 for management of KFC operations.

(4) Property and Equipment

Capital asset activity for the years ended September 30, 2009 and 2008 follows:

	October 1, 2008	Additions	Deletions	September 30, 2009
Machinery and equipment	$ 24,750	$ -	$ -	$ 24,750
Fishing vessels – donated	1,497,618	-	-	1,497,618
Office furniture and equipment	27,061	-	-	27,061
	1,549,429	-	-	1,549,429
Less accumulated depreciation	(1,389,052)	(1,100)	(45,800)	(1,435,952)
	$ 160,377	$ (1,100)	$ (45,800)	$ 113,477

	October 1, 2007	Additions	Deletions	September 30, 2008
Machinery and equipment	$ 13,750	$ 11,000	$ -	$ 24,750
Fishing vessels – donated	1,497,618	-	-	1,497,618
Office furniture and equipment	32,315	-	(5,254)	27,061
	1,543,683	11,000	(5,254)	1,549,429
Less accumulated depreciation	(1,431,979)	(3,018)	45,945	(1,389,052)
	$ 111,704	$ 7,982	$ 40,691	$ 160,377

(5) Notes Payable

Notes payable consist of the following at September 30, 2009 and 2008:

	2009	2008
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

(5) Notes Payable, Continued

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
	$ 3,600,000	$ 3,600,000

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

Changes in debt during the years ended September 30, 2009 and 2008 are as follows:

Balance at Beginning of Year 2009	Additions	Deletions	Balance at End of Year 2009
$ 3,600,000	$ -	$ -	$ 3,600,000

Balance at Beginning of Year 2008	Additions	Deletions	Balance at End of Year 2008
$ 3,600,000	$ -	$ -	$ 3,600,000

(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.

NFC is ultimately liable for Micronesia Longline Fishing Company's (MLFC) loans payable to the Asian Development Bank. MLFC has defaulted on this loan; however, the FSM National Government has been making required debt service payments on behalf of NFC and it is not possible to predict the ultimate outcome of this matter. No provision for this matter has been made in the accompanying financial statements. The MLFC debt is, instead, recorded in the financial statements of the FSM National Government.

(7) Future Lease Revenues

The approximate future minimum annual lease revenue receivable by NFC for vessel and space lease contracts currently held with certain private customers is as follows:

Year Ending September 30,	Total
2010	$25,501
2011	$14,301
2012	$10,301
2013	$10,301
2014	$10,301
2015 – 2016	$16,310

(8) 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. The FSM National Government has introduced legislation to dissolve NFC and the ultimate impact of this matter on the accompanying financial statements is uncertain. Additionally, the same measure seeks to transfer NFC's holdings in joint ventures to the applicable State governments.

(9) Risk Management

NFC 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 during the past three years.

(10) Other Expense

During the year ended September 30, 2009, NFC recorded net non-operating expense of $747, which represents the write-off of two accounts payable, totaling $18,163, and the write-off of two accounts payable with negative balances, totaling $18,910.

(11) Subsequent Events

NFC sold Fishing Vessel NFC Chuuk for $29,200 in November 2009.

In October 2009, NFC entered into a fund accommodation agreement with a fishing company in Japan and borrowed $60,000 with a 3% interest per annum to purchase shares of Kasar Fishing Corporation. The payment schedule of the loan is as follows:

Payment date	Principal	Interest
October 1, 2015	$30,000	$10,800
October 1, 2016	$30,000	$ 900

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

The Board of Directors
National Fisheries Corporation:

We have audited the financial statements of the National Fisheries Corporation (NFC) as of September 30, 2009 and have issued our report thereon dated June 15, 2010, which was qualified with respect to equity investments. 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 NFC'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 NFC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of NFC'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 accounting principles generally accepted in the United States of America 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 a 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 the 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 the 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 NFC'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*.

NFC's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit NFC's responses and, accordingly, we express no opinion on them.

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.

Deloitte + Touche LLP

June 15, 2010

Income Tax Payment

Finding No. 2009-1

Criteria: Income taxes should be accurately calculated, withheld, and paid.

Condition: We noted a difference of $818 in recalculating income tax payments for the second quarter of calendar year 2009.

Gross Wage	Tax Paid	D&T Recal.	Difference
$ 6,730.78	$ 334.66	$ 554.62	$ (216.96)
6,192.34	280.78	500.77	(219.99)
4,230.40	205.78	304.58	(98.80)
4,307.66	212.27	312.30	(100.03)
5,384.61	240.00	420.00	(180.00)
2,961.55	177.72	177.69	0.03
$ 29,807.34	$ 1,451.21	$ 2,269.96	$ (818.75)

Cause: Income tax did not appear to be accurately calculated, withheld, and paid.

Effect: The condition may result in potential noncompliance with applicable FSM tax laws.

Recommendation: The Corporation should ensure that income tax is accurately calculated, withheld and paid.

Auditee Response: Ending second quarter of calendar year 2009 the income tax was accurately calculated and deducted from each of NFC employees. Deduction based on a formula for six percent up to $11,000 and over $11,000 for ten percent. Total of income tax deducted from each NFC Employees reported full amounts that deducted from them for calendar year 2009 from First Quarter to Fourth Quarter 2009. For calender 2010 income tax for each quarter will be accurately deducted and reported.

Journal Voucher Entries

Finding No. 2009-2

Criteria: Adjustments to the general ledger should be correct and valid.

Condition: Of five journal voucher entries tested, four were incorrect and appeared invalid or unsupported.

JV#	Amount	Transaction Description
09-60	$ 2,000	Write-off of accounts payable
09-61	$ 16,163	Write-off of accounts payable
09-62	$ 747	Write-off of accounts payable with negative balances
09-63	$ 18,162	Write-off of accounts payable with negative balances

Cause: The cause of this condition is that journal entry vouchers were prepared without adequate documentation in support of the adjustments.

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

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

Recommendation: We recommend that management scrutinize each journal entry voucher as to correctness and validity before it is entered into the accounting system.

Auditee Response: The reason NFC Finance Division recommended to NFC Boards for write-off account payable, because the New Management cannot locate any supporting documents for those vendors accounts. NFC Finance will try to correct all of them before enter to the system.

NATIONAL FISHERIES CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Unresolved Prior Year Findings
Year Ended September 30, 2009

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses section of this report (pages 18 through 21).