

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

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2013 AND 2012**

## INDEPENDENT AUDITORS' REPORT

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of The Diving Seagull, Inc. (the Company), a component unit of the Yap State Government, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Diving Seagull, Inc. as of September 30, 2013 and 2012, and the changes in its financial position and its cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America.

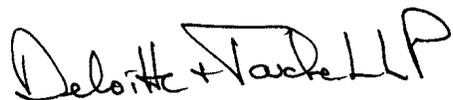
## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 5 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated June 17, 2014 on our consideration of The Diving Seagull, Inc., 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering The Diving Seagull, Inc., Inc.'s internal control over financial reporting and compliance.

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

June 17, 2014

## THE DIVING SEAGULL, INC.

### Management Discussion and Analysis Years Ended September 30, 2013 and 2012

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 a component unit of the State of Yap.

Total assets of \$17,270,891 at the end of fiscal year 2013 represents a 5.8% increase over 2012. In 2012, due to peak fish prices, the Company's total assets increased 41% from \$11,532,243 to \$16,311,013. Fiscal year 2013 is the 3<sup>rd</sup> full year of operation for the F/V Yap Seagull which began fishing in fiscal year 2010. Compared to 2012 when the new vessel's contribution to the 35% increase in operating revenue led to an 116% increase in current assets, in 2013, operating revenues declined by over 20%. However, despite the decline in operating revenues, total current assets still showed a modest 7% increase, primarily in cash and cash equivalents. The Company had for the past three years been making all efforts to improve its cash position in order to finance the dry dock of its two fishing vessels in late summer 2013.

Operating revenues generated from fish sales of \$13,185,070 represents a decline of 20% over 2012. While, the average price per metric ton remained consistent in fiscal year 2013 as compared to 2012, the tonnage of fish caught declined 25% in FY13. A higher rejection rate in 2013 and mechanical problems faced by two vessels contributed to the decreased volume of fish sold. Moreover from June to July of 2013, the F/V Yap Seagull suspended fishing operations as it underwent its scheduled dry dock in General Santos, Philippines. Cost of sales increased by \$385,466 or 3.7% indicating that the same number of fishing trips occurred during fiscal year 2013 as in 2012.

Net income from operations in the fiscal year ended September 30, 2013 decreased by 63% to \$2,185,254. In comparison, income from operations in 2012 was \$5,938,913. As explained above, the diminished profitability in 2013 is attributable to a lower volume of fish sold as compared to 2012.

The Company's cash flows from operating activities totaled \$3,891,293 in 2013 and \$5,119,847 in 2012. But for the year ended September 30, 2013, cash and cash equivalents increased from \$5,255,523 to \$7,474,114. The increase in cash and equivalents is due to proceeds of 2012 fish sales received in 2013.

The following table summarizes the financial condition and results of operations of the Company for 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
<u>Assets</u>			
Property and equipment, net	\$ 4,754,646	\$ 4,768,210	\$ 5,146,481
Current assets	9,981,504	9,312,612	4,309,353
Other assets	<u>2,534,741</u>	<u>2,230,191</u>	<u>2,076,409</u>
Total Assets	\$ <u>17,270,891</u>	\$ <u>16,311,013</u>	\$ <u>11,532,243</u>
<u>Liabilities and Net Position</u>			
Liabilities:			
Long-term debt, net of current portion	\$ 2,007,169	\$ 2,688,302	\$ 3,368,421
Current portion of long-term debt	667,515	655,562	884,141
Other current liabilities	<u>1,706,759</u>	<u>2,134,620</u>	<u>2,238,287</u>
Total Liabilities	<u>4,381,443</u>	<u>5,478,484</u>	<u>6,490,849</u>

## THE DIVING SEAGULL, INC.

### Management Discussion and Analysis Years Ended September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net position:			
Invested in capital assets, net of related debt	\$ 2,079,962	\$ 1,424,346	\$ 976,771
Restricted-expendable	2,230,707	2,230,191	2,076,289
Unrestricted	<u>8,578,779</u>	<u>7,177,992</u>	<u>1,988,334</u>
Total Net position	<u>12,889,448</u>	<u>10,832,529</u>	<u>5,041,394</u>
Total Liabilities and Net position	\$ <u>17,270,891</u>	\$ <u>16,311,013</u>	\$ <u>11,532,243</u>
<u>Revenues, Expenses, and Changes in Net position</u>			
Operating revenues	\$ 13,185,070	\$ 16,527,562	\$ 12,266,007
Cost of sales	(10,764,100)	(10,378,634)	(9,931,861)
Operating expenses	<u>(235,716)</u>	<u>(210,015)</u>	<u>(292,071)</u>
Net operating revenues	2,185,254	5,938,913	(2,042,075)
Nonoperating expenses	<u>(128,335)</u>	<u>(147,778)</u>	<u>(281,172)</u>
Change in net position	\$ <u>2,056,919</u>	\$ <u>5,791,135</u>	\$ <u>(1,760,903)</u>

#### Capital Assets and Debt

The Company did not acquire significant capital assets in the year ended September 30, 2013. For additional information concerning capital assets, please refer to note 6 to the financial statements.

Additionally, no additional debt was obtained in fiscal year 2013. For more information concerning debt, please refer to note 7 to the financial statements.

The Management Discussion and Analysis for the year ended September 30, 2012 is set forth in the Company's report on the audit of financial statements, which is dated June 21, 2013. That Discussion and Analysis explains the major factors impacting the 2012 financial statements and can be viewed at the FSM Office of the Public Auditor's website.

#### **Plan of Action for 2014 – Economic Outlook**

In 2010, the Parties to the Nauru Agreement (of which the FSM is a member) adopted a FAD fishing closure policy to extend from July to September of each year as a conservation measure for the tuna species and other species that have economic value. Another conservation measure adopted by the Parties to the Nauru Agreement was the establishment of quotas on the number of days vessels are allowed to fish in the territorial waters for each PNA member country. These measures had negatively impacted the Company's fishing operations in the Western Pacific region for the past two years and will continue to affect operations in the years to come.

The scheduling of the dry dock for the vessels was intended to coincide with the FAD (floating aggregating device) closure season. The F/V Yap Seagull completed its dry dock repairs from June to July of 2013, as planned. The F/V Mathawmarfach, on the other hand, left for dry dock in late September 2013 but because of issues with its main engine was not able to resume fishing until April 2014.

## **THE DIVING SEAGULL, INC.**

Management Discussion and Analysis  
Years Ended September 30, 2013 and 2012

Below are some of the issues and challenges that will be facing the Company in 2014:

1. Challenges with FSM/PNA fishing regulations
2. Improving profit margin of fishing vessels
3. Diversification

### **Financial Management Contact**

This financial report is designed to provide all interested users with a general overview of the Company's finances. Inquiries concerning this report, if any, may be directed to the Diving Seagull, Inc. P.O. Box 1036, Colonia Yap, FM96943

**THE DIVING SEAGULL, INC.**

Statements of Net Position  
September 30, 2013 and 2012

	2013	2012
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 7,474,114	\$ 5,255,523
Time certificates of deposit	1,566,000	1,566,000
Investments	556,426	498,401
Net receivable from broker	-	1,496,575
Employee and director receivables, net	50,623	42,850
Other receivables, net	1,580	-
Prepaid expenses	18,744	103,263
Current portion of drydocking costs	152,017	-
Fuel inventory	162,000	350,000
Total current assets	9,981,504	9,312,612
Restricted cash and cash equivalents	2,230,707	2,230,191
Long-term drydocking costs, net of current position	304,034	-
Property and equipment, net	4,754,646	4,768,210
	\$ 17,270,891	\$ 16,311,013
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Current portion of long-term debt	\$ 667,515	\$ 655,562
Accounts payable	906,772	1,601,296
Net payable to broker	635,790	-
Accrued expenses	164,197	533,324
Total current liabilities	2,374,274	2,790,182
Long-term debt, net of current portion	2,007,169	2,688,302
Total liabilities	4,381,443	5,478,484
Contingencies and commitments		
Net position:		
Invested in capital assets, net of related debt	2,079,962	1,424,346
Restricted, expendable	2,230,707	2,230,191
Unrestricted	8,578,779	7,177,992
Total net position	12,889,448	10,832,529
	\$ 17,270,891	\$ 16,311,013

See accompanying notes to financial statements.

**THE DIVING SEAGULL, INC.**

Statements of Revenues, Expenses and Changes in Net Position  
Years Ended September 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating revenues:		
Fish sales	\$ 13,166,650	\$ 16,488,389
Other revenues	18,420	73,198
Bad debts	-	(34,025)
Total operating revenues	<u>13,185,070</u>	<u>16,527,562</u>
Cost of sales	<u>10,764,100</u>	<u>10,378,634</u>
Gross margin	<u>2,420,970</u>	<u>6,148,928</u>
Operating expenses:		
Payroll, taxes and benefits	88,164	86,909
Professional fees	42,248	32,492
Travel	25,145	37,744
Rent	12,384	12,384
Communications and utilities	11,305	12,189
Board fees and expenses	10,323	10,227
Office expense	9,605	5,466
Bank loan fees	7,527	8,886
Depreciation	966	528
Insurance	493	546
Miscellaneous	27,556	2,644
Total operating expenses	<u>235,716</u>	<u>210,015</u>
Income from operations	<u>2,185,254</u>	<u>5,938,913</u>
Nonoperating revenues (expenses):		
Interest expense	(229,628)	(284,977)
Investment income	43,268	88,732
Gain on investments	58,025	48,467
Total nonoperating revenues (expenses), net	<u>(128,335)</u>	<u>(147,778)</u>
Change in net position	2,056,919	5,791,135
Net position at beginning of year	<u>10,832,529</u>	<u>5,041,394</u>
Net position at end of year	<u>\$ 12,889,448</u>	<u>\$ 10,832,529</u>

See accompanying notes to financial statements.

## THE DIVING SEAGULL, INC.

### Statements of Cash Flows Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	\$ 15,317,435	\$ 15,062,161
Cash payments to suppliers for goods and services	(9,764,103)	(8,082,732)
Cash payments to boat crew and employees for services	(1,662,039)	(1,859,582)
Net cash provided by operating activities	3,891,293	5,119,847
Cash flows from investing activities:		
Increase in short-term investments and time certificate of deposit	42,752	(65,170)
Net cash provided by (used in) investing activities	42,752	(65,170)
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(816,645)	(354,567)
Principal repayments of long-term debt	(669,180)	(908,698)
Interest paid on long-term debt	(229,629)	(284,977)
Net cash used in capital and related financing activities	(1,715,454)	(1,548,242)
Net change in cash	2,218,591	3,506,435
Cash and cash equivalents at beginning of year	5,255,523	1,749,088
Cash and cash equivalents at end of year	\$ 7,474,114	\$ 5,255,523
Reconciliation of income from operations to net cash provided by operating activities:		
Operating income	\$ 2,185,254	\$ 5,938,913
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	830,209	732,838
Bad debt expense	-	34,025
Changes in assets and liabilities:		
Net receivable from broker	1,496,575	(1,496,575)
Employee and director receivables	(7,773)	(2,913)
Other receivables	(1,580)	-
Prepaid expenses	84,520	(7,894)
Current portion of drydocking costs	(152,017)	-
Fuel inventory	188,000	25,000
Other assets	-	120
Long-term drydocking costs, net of current portion	(304,034)	-
Accounts payable	(694,524)	77,000
Net payable to broker	635,790	(2,851)
Accrued expenses	(369,127)	(177,816)
Net cash provided by operating activities	\$ 3,891,293	\$ 5,119,847

See accompanying notes to financial statements.

## THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2013 and 2012

### (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 five 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 a purse seine fishing net. This Bareboat Charter Agreement expires in March 2022. The Company also purchased another fishing vessel, the Yap Seagull, in February 2010.

#### Basis of Accounting

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 position 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 position subject to externally imposed stipulations that require the Company to maintain them permanently.
- (c) *Restricted Expendable* – Net position 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) *Unrestricted* – Net position that are not subject to externally imposed stipulations. Unrestricted net position 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 position. 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 statement of net position.

## THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2013 and 2012

### (1) Summary of Significant Accounting Policies, Continued

#### Operating and Non-Operating Revenues 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

During the year ended September 30, 2013, the Company implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which improved financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which enhanced the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement no. 62 superceded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.

## THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2013 and 2012

### (1) Summary of Significant Accounting Policies, Continued

#### New Accounting Standards, Continued

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Company.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of the Company.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of the Company.

# THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2013 and 2012

## (1) Summary of Significant Accounting Policies, Continued

### New Accounting Standards, Continued

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 70 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of the Company.

### Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand as well as cash in various bank accounts and time certificates of deposit with initial maturity dates of three months or less but excludes restricted cash and cash equivalents. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified.

### Investments

Investments and related investment earnings and losses are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

### 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. Bad debts are written off against the allowance based on the specific identification method.

### Dry docking costs

Dry docking costs are amortized over three years. Amortization schedule is detailed below:

<u>Year ending September 30,</u>	<u>Amortization</u>
2014	\$ 152,017
2015	152,017
2016	<u>152,017</u>
	\$ <u>456,051</u>

### Fuel Inventory

Fuel inventory consists of fuel on two fishing vessels and is stated at purchased cost.

## THE DIVING SEAGULL, INC.

Notes to Financial Statements  
September 30, 2013 and 2012

### (1) Summary of Significant Accounting Policies, Continued

#### 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:

Mathawmarfach vessel	20 years
Yap Seagull vessel	25 years
Fishing net and other vessel parts	5 years
Leasehold improvements	3-10 years
Vessel improvements	3-5 years
Office furniture and equipment	3-5 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 revenues, expenses and changes in net position.

#### 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, 2013 and 2012

### (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.

GASB Statement No. 40 requires disclosures for 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, 2013 and 2012, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit was \$11,270,821 and \$9,051,714, respectively, and the corresponding bank balances were \$11,508,967 and \$9,055,585, respectively. Of the bank balances, \$9,672,848 and \$7,232,217, respectively, is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2013 and 2012, bank deposits in the amount of \$500,000 and \$5,458,316, 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) Investments

GASB Statement No. 40 requires disclosures addressing common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the Company will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Company's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the Company's name by the Company's custodial financial institutions. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the Company. As of September 30, 2013 and 2012, the Company did not hold an investment in any one issuer that represented more than 5% of the Company's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The Company does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

**THE DIVING SEAGULL, INC.**

Notes to Financial Statements  
September 30, 2013 and 2012

(3) Investments, Continued

As of September 30, 2013 and 2012, investments at fair value comprise the following:

	<u>2013</u>	<u>2012</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 63,856	\$ 79,176
U.S. Government agencies	28,027	34,479
Corporate notes	<u>87,224</u>	<u>78,874</u>
	<u>179,107</u>	<u>192,529</u>
Other Investments:		
Common equities	349,430	288,133
Money market funds	<u>27,889</u>	<u>17,739</u>
	<u>377,319</u>	<u>305,872</u>
	<u>\$ 556,426</u>	<u>\$ 498,401</u>

As of September 30, 2013, the Company's fixed income securities had the following maturities:

		<u>Fair Value</u>	<u>Less than 1 Year</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>
U.S. Treasury obligations	AAA	\$ 63,856	\$ 12,261	\$ 19,051	\$ 32,544
U.S. Government agencies obligations	AAA	28,027	-	28,027	-
Corporate Notes	A1	25,820	-	25,820	-
Corporate Notes	A2	35,590	-	30,678	4,912
Corporate Notes	A3	20,416	10,591	-	9,825
Corporate Notes	AA2	<u>5,398</u>	<u>-</u>	<u>5,398</u>	<u>-</u>
		<u>\$ 179,107</u>	<u>\$ 22,852</u>	<u>\$ 108,974</u>	<u>\$ 47,281</u>

As of September 30, 2012, the Company's fixed income securities had the following maturities:

		<u>Fair Value</u>	<u>Less than 1 Year</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>
U.S. Treasury obligations	AAA	\$ 78,904	\$ 29,438	\$ 35,685	\$ 13,781
U.S. Government agencies obligations	AAA	34,751	20,645	14,106	-
Corporate Notes	A1	28,436	-	15,977	12,459
Corporate Notes	A2	16,744	-	-	16,744
Corporate Notes	A3	<u>33,694</u>	<u>-</u>	<u>23,181</u>	<u>10,513</u>
		<u>\$ 192,529</u>	<u>\$ 50,083</u>	<u>\$ 88,949</u>	<u>\$ 53,497</u>

**THE DIVING SEAGULL, INC.**

Notes to Financial Statements  
September 30, 2013 and 2012

(4) Net Receivable from/Payable to Broker

Approximately 72% and 92%, respectively, of fish sales in the years ended September 30, 2013 and 2012 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 payable of \$635,790 at September 30, 2013 and a receivable of \$1,496,575 at September 30, 2012.

(5) Notes and Other Receivables

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

	<u>2013</u>	<u>2012</u>
Palau Micronesia Air (PMAir)	\$ 550,000	\$ 550,000
Others	<u>32,720</u>	<u>31,140</u>
	582,720	581,140
Less: allowance for doubtful accounts	<u>(581,140)</u>	<u>(581,140)</u>
	\$ <u>1,580</u>	\$ <u>-</u>

(6) Property and Equipment

Property and equipment consist of the following at September 30, 2013 and 2012:

	Beginning Balance Oct. 1, 2012	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2013
Leased fishing vessel and purse seine net	\$ 6,821,012	\$ -	\$ -	\$ 6,821,012
Purchased fishing vessel and purse seine net	5,717,316	-	-	5,717,316
Leasehold improvements	4,148,549	735,348	-	4,883,897
Vessel improvements	261,236	77,024	-	338,260
Office furniture and equipment	33,785	4,273	-	38,058
Vehicle	<u>26,568</u>	<u>-</u>	<u>-</u>	<u>26,568</u>
Total cost	17,008,466	816,645	-	17,825,111
Less accumulated depreciation	<u>(12,240,256)</u>	<u>(830,209)</u>	<u>-</u>	<u>(13,070,465)</u>
	\$ <u>4,768,210</u>	\$ <u>(13,564)</u>	\$ <u>-</u>	\$ <u>4,754,646</u>

**THE DIVING SEAGULL, INC.**

Notes to Financial Statements  
September 30, 2013 and 2012

(6) Property and Equipment, Continued

	Beginning Balance Oct. 1, 2011	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2012
Leased fishing vessel and purse seine net	\$ 6,821,012	\$ -	\$ -	\$ 6,821,012
Purchased fishing vessel and purse seine net	5,717,316	-	-	5,717,316
Leasehold improvements	3,871,346	277,203	-	4,148,549
Vessel improvements	183,872	77,364	-	261,236
Office furniture and equipment	33,785	-	-	33,785
Vehicle	<u>26,568</u>	<u>-</u>	<u>-</u>	<u>26,568</u>
Total cost	16,653,899	354,567	-	17,008,466
Less accumulated depreciation	<u>(11,507,418)</u>	<u>(732,838)</u>	<u>-</u>	<u>(12,240,256)</u>
	<u>\$ 5,146,481</u>	<u>\$ (378,271)</u>	<u>\$ -</u>	<u>\$ 4,768,210</u>

(7) Long-Term Debt

On October 27, 2009, a \$3,000,000 loan was obtained from the FSM Development Bank to purchase a fishing vessel. Interest of 9% and principal are payable in monthly installments of \$38,003, which began on April 25, 2010. The balance outstanding on the loan was \$2,269,592 and \$2,509,851 as at September 30, 2013 and 2012, respectively.

On September 29, 2010, a loan of \$2,000,000 was granted by the Bank of Guam, with interest of 2.12%, to assist in the purchase of a new vessel. Interest and principal are payable in monthly installments of \$35,778, which began on October 29, 2010. Part of the agreement requires the Company to have on deposit with the Bank of Guam a \$2,000,000 certificate of deposit. The balance of this restricted certificate of deposit at September 30, 2013 and 2012 was \$2,026,404 and \$2,023,901, respectively. The balance on the loan was \$405,092 and \$834,013 as at September 30, 2013 and 2012, respectively.

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>
2014	\$ 667,515	\$ 198,113	\$ 865,628
2015	287,040	168,996	456,036
2016	313,966	142,070	456,036
2017	343,418	112,618	456,036
2018	375,633	80,403	456,036
2019-2020	<u>687,112</u>	<u>54,081</u>	<u>741,193</u>
	<u>\$ 2,674,684</u>	<u>\$ 756,281</u>	<u>\$ 3,430,965</u>

**THE DIVING SEAGULL, INC.**

Notes to Financial Statements  
September 30, 2013 and 2012

(7) Long-Term Debt, Continued

Changes in debt during the years ended September 30, 2013 and 2012 follows:

2013				
<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
\$ <u>3,343,864</u>	\$ <u>      -</u>	\$ <u>(669,180)</u>	\$ <u>2,674,684</u>	\$ <u>667,515</u>
2012				
<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
\$ <u>4,252,562</u>	\$ <u>      -</u>	\$ <u>(908,698)</u>	\$ <u>3,343,864</u>	\$ <u>655,562</u>

(8) 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.

(9) Cost of Sales

Details of cost of sales for the years ended September 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Fuel	\$ 4,759,354	\$ 4,751,869
Crew salaries and wages	1,341,411	1,518,928
License, agent and port fees	1,217,203	991,891
Repair and maintenance	892,909	757,292
Depreciation	829,243	732,310
Insurance	506,150	449,577
Salt and provisioning	358,484	407,152
Crew travel	247,359	150,214
Management fee	202,214	256,892
Communications	131,083	107,334
Supplies and freight	116,350	157,239
Stevedoring	108,272	78,515
Other vessel expenses	<u>54,068</u>	<u>19,421</u>
	<u>\$ 10,764,100</u>	<u>\$ 10,378,634</u>

(10) 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. The Company 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.

## **THE DIVING SEAGULL, INC.**

Notes to Financial Statements  
September 30, 2013 and 2012

### (11) Related Parties

The Company has entered into significant transactions with the State, as discussed in Note 8. Several board members and officers of the Company hold management positions and other positions of influence with the State. Furthermore, included in employee and director receivables is \$24,980 and \$26,700 at September 30, 2013 and 2012, respectively, of amounts owed by previous board members and current management to the Company for reimbursement of travel expenses, net of an allowance for doubtful accounts of \$33,013 and \$33,013, respectively.

**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, in accordance with the 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, the financial statements of the Company, which comprise the statements of net position as September 30, 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated June 17, 2014.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

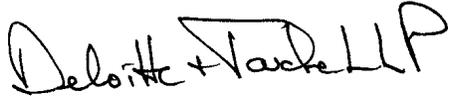
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Company's financial statements are free from 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*.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

June 17, 2014