

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2014 AND 2013

INDEPENDENT AUDITORS' REPORT

The Board of Directors
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, 2014 and 2013, 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 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 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, 2014 and 2013, 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.

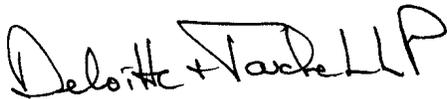
Other Matters

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 May 19, 2015, 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 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.'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.

May 19, 2015

THE DIVING SEAGULL, INC.

Management's Discussion and Analysis Years Ended September 30, 2014 and 2013

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

Total assets of \$13,562,193 at the end of fiscal year 2014 represent a 21% decrease over 2013. By comparison, in 2013, total assets had grown by 5.8% over 2012 to \$17,270,891. The decrease in total assets in 2014 is primarily the result of a 74% decrease in cash and equivalents from \$7,474,114 in 2013 to \$1,909,279 in 2014. The Company financed the cost of the dry dock of its two fishing vessels in late fiscal year 2013 and early 2014 without incurring additional debt. The Company also relied on prior year earnings to fund operations in 2014 as one of its vessels spent six months in dry dock. The competing demands for cash in 2014 resulted in a 30% increase in current liabilities at the end of the fiscal year.

Operating revenues generated from fish sales of \$5,864,964 represents a decline of 55% over 2013. The dry dock for one of the vessels took over six months to complete after which it continued to experience mechanical problems. Consequently, it was able to complete only two fishing trips during the year. Thus, the volume of fish sold in 2014 was 31% less than in 2013. In addition, the price per ton of fish sold in 2014 declined 36% when compared to 2013. Despite the reduced number of fishing trips and a slight drop in fuel prices, cost of sales decreased by 9% in 2014 as compared to 2013.

The Company ended fiscal year 2014 with a net loss of \$4.1 million – a decline of 201% over 2013. In comparison, net income from operations in the fiscal year ended September 30, 2013 declined by 63% from 2012 to \$2,185,254. The change in net position was a negative \$4,143,828 in 2014 compared to an increase of \$2,056,919 in 2013.

The Company's cash flows from operating activities was a negative \$3,641,681 in 2014 and a positive \$3,891,293 in 2013. Cash and equivalents at the end of 2014 was only \$1,909,279. For the year ended September 30, 2013, cash and cash equivalents increased from \$5,255,523 in the prior year to \$7,474,114. The increase in cash and equivalents in 2013 was 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 2014, 2013 and 2012:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
<u>Assets</u>			
Property and equipment, net	\$ 4,852,609	\$ 4,754,646	\$ 4,768,210
Current assets	5,291,397	9,981,504	9,312,612
Other assets	<u>3,418,187</u>	<u>2,534,741</u>	<u>2,230,191</u>
Total Assets	\$ <u>13,562,193</u>	\$ <u>17,270,891</u>	\$ <u>16,311,013</u>
<u>Liabilities and Net Position</u>			
Liabilities:			
Long-term debt, net of current portion	\$ 1,721,581	\$ 2,007,169	\$ 2,688,302
Current portion of long-term debt	286,915	667,515	655,562
Other current liabilities	<u>2,808,077</u>	<u>1,706,759</u>	<u>2,134,620</u>
Total Liabilities	<u>4,816,573</u>	<u>4,381,443</u>	<u>5,478,484</u>

THE DIVING SEAGULL, INC.

Management's Discussion and Analysis Years Ended September 30, 2014 and 2013

Net position:			
Net investment in capital assets	\$ 2,844,113	\$ 2,079,962	\$ 1,424,346
Restricted	2,251,291	2,230,707	2,230,191
Unrestricted	<u>3,650,216</u>	<u>8,578,779</u>	<u>7,177,992</u>
Total Net position	<u>8,745,620</u>	<u>12,889,448</u>	<u>10,832,529</u>
Total Liabilities and Net position	\$ <u>13,562,193</u>	\$ <u>17,270,891</u>	\$ <u>16,311,013</u>
<u>Revenues, Expenses, and Changes in Net position</u>			
Operating revenues	\$ 5,864,964	\$ 13,185,070	\$ 16,527,562
Cost of sales	(9,817,981)	(10,764,100)	(10,378,634)
Operating expenses	<u>(249,383)</u>	<u>(235,716)</u>	<u>(210,015)</u>
(Loss) income from operations	(4,202,400)	2,185,254	5,938,913
Non-operating revenues (expenses), net	<u>58,572</u>	<u>(128,335)</u>	<u>(147,778)</u>
Change in net position	\$ <u>(4,143,828)</u>	\$ <u>2,056,919</u>	\$ <u>5,791,135</u>

Capital Assets and Debt

The Company's acquisition of capital assets in 2014 and 2013 were related to the overhaul and replacement of machinery and equipment on the vessels during dry dock. For additional information concerning capital assets, please refer to note 6 to the financial statements.

No additional debt was obtained in fiscal year 2014 and 2013. For more information concerning debt, please refer to note 7 to the financial statements.

The Management's Discussion and Analysis for the year ended September 30, 2013 is set forth in the Company's report on the audit of financial statements, which is dated June 17, 2014. That Discussion and Analysis explains the major factors impacting the 2013 financial statements and can be viewed at the FSM Office of the Public Auditor's website.

Plan of Action for 2015 – Economic Outlook

In 2015, the Company secured a one million line of credit and a term loan with the Bank of Guam to mitigate cash flow difficulties that had arose due to the declining world tuna prices over the past ten months. To bolster working capital, management is considering soliciting other international markets such as the EU and Japan to bid on its tuna catch in an attempt to obtain a better tuna price than what is currently being realized from sales to the Thailand market. In addition, the Company is looking into the viability of other fishing techniques or methods that may require state-of-the-art technologies as possible strategies to allow the business to remain profitable in this period of historically low tuna prices.

THE DIVING SEAGULL, INC.

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

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 in 2012 was the "Vessels Day Scheme" which established a quota on the number of days vessels are allowed to fish in the territorial waters for each PNA member country.

In early part of 2014, the company began negotiations with the FSM National Government officials seeking to obtain a waiver of the fishing day's fees as it would add on top of other measures that had been implemented in 2010, a period when PNAO was created. These measures had negatively impacted the Company's fishing operations in the Western Pacific region for the past five years and will continue to affect operations in the years to come.

The above impediments present growing obstacles to improving our profit margin as we have seen with great impact on our financial report. Therefore, it is obvious that some form of diversification initiative needs to be undertaken into other sectors since fishing for economic value presents major challenges to the Company now and in the foreseeable future.

Below are some of the issues and challenges that will be facing the Company in 2015:

1. Challenges with FSM/PNA fishing regulations
2. Improving profit margin of fishing vessels
3. Diversification
4. Increased capital
5. International trade agreement

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, and FM 96943.

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

Statements of Net Position
September 30, 2014 and 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Current assets:		
Cash and cash equivalents	\$ 1,909,279	\$ 7,474,114
Time certificates of deposit	1,566,000	1,566,000
Investments	599,059	556,426
Net receivable from broker	130,992	-
Employee and director receivables, net	55,273	50,623
Other receivables, net	-	1,580
Prepaid expenses	17,885	18,744
Current portion of drydocking costs	813,709	152,017
Fuel inventory	199,200	162,000
Total current assets	5,291,397	9,981,504
Restricted cash and cash equivalents	2,251,291	2,230,707
Long-term drydocking costs, net of current portion	1,166,896	304,034
Property and equipment, net	4,852,609	4,754,646
	\$ 13,562,193	\$ 17,270,891
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Current portion of long-term debt	\$ 286,915	\$ 667,515
Accounts payable	2,202,802	906,772
Net payable to broker	-	635,790
Accrued expenses	605,275	164,197
Total current liabilities	3,094,992	2,374,274
Long-term debt, net of current portion	1,721,581	2,007,169
Total liabilities	4,816,573	4,381,443
Contingencies and commitments		
Net position:		
Net investment in capital assets	2,844,113	2,079,962
Restricted	2,251,291	2,230,707
Unrestricted	3,650,216	8,578,779
Total net position	8,745,620	12,889,448
	\$ 13,562,193	\$ 17,270,891

See accompanying notes to financial statements. 6

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

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2014 and 2013

	2014	2013
Operating revenues:		
Fish sales	\$ 5,863,899	\$ 13,166,650
Other revenues	1,065	18,420
Total operating revenues	5,864,964	13,185,070
Cost of sales	9,817,981	10,764,100
Gross (loss) profit	(3,953,017)	2,420,970
Operating expenses:		
Payroll, taxes and benefits	91,703	88,164
Professional fees	35,636	42,248
Travel	27,221	25,145
Communications and utilities	23,566	11,305
Board fees and expenses	15,691	10,323
Rent	13,965	12,384
Bank loan fees	12,635	7,527
Office expense	11,673	9,605
Depreciation	2,223	966
Insurance	453	493
Miscellaneous	14,617	27,556
Total operating expenses	249,383	235,716
(Loss) income from operations	(4,202,400)	2,185,254
Nonoperating revenues (expenses):		
Insurance gain	298,102	-
Interest expense	(198,125)	(229,628)
Adjustment to final settlement	(133,186)	-
Loss on asset disposal	(14,436)	-
Investment income	63,584	43,268
Gain on investments	42,633	58,025
Total nonoperating revenues (expenses), net	58,572	(128,335)
Change in net position	(4,143,828)	2,056,919
Net position at beginning of year	12,889,448	10,832,529
Net position at end of year	\$ 8,745,620	\$ 12,889,448

See accompanying notes to financial statements. 7

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

Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Cash received from customers	\$ 5,396,284	\$ 15,317,435
Cash payments to suppliers for goods and services	(7,463,820)	(9,764,103)
Cash payments to boat crew and employees for services	(1,574,145)	(1,662,039)
Net cash (used in) provided by operating activities	(3,641,681)	3,891,293
Cash flows from investing activities:		
Increase in short-term investments and time certificate of deposit	43,000	42,752
Net cash provided by investing activities	43,000	42,752
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(1,101,841)	(816,645)
Principal repayments of long-term debt	(666,188)	(669,180)
Interest paid on long-term debt	(198,125)	(229,629)
Net cash used in capital and related financing activities	(1,966,154)	(1,715,454)
Net change in cash	(5,564,835)	2,218,591
Cash and cash equivalents at beginning of year	7,474,114	5,255,523
Cash and cash equivalents at end of year	\$ 1,909,279	\$ 7,474,114
Reconciliation of (loss) income from operations to net cash (used in) provided by operating activities:		
(Loss) income from operations	\$ (4,202,400)	\$ 2,185,254
Adjustments to reconcile operating income to net cash provided by operating activities:		
Insurance gain	298,102	-
Adjustment to final settlement	(133,186)	-
Depreciation expense	1,449,964	830,209
Changes in assets and liabilities:		
Net receivable from broker	(130,992)	1,496,575
Employee and director receivables	(4,650)	(7,773)
Other receivables	1,580	(1,580)
Prepaid expenses	859	84,520
Current portion of drydocking costs	(706,363)	(152,017)
Fuel inventory	(37,200)	188,000
Long-term drydocking costs, net of current portion	(1,278,713)	(304,034)
Accounts payable	1,296,030	(694,524)
Net payable to broker	(635,790)	635,790
Accrued expenses	441,078	(369,127)
Net cash (used in) provided by operating activities	\$ (3,641,681)	\$ 3,891,293

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2014 and 2013

(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) *Net Investment in Capital Assets* – include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt, net of debt service reserves.
- (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.

All of the Company's restricted net position is expendable.

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 statements of net position.

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

Notes to Financial Statements
September 30, 2014 and 2013

(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, 2014, the Company implemented the following pronouncements:

- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued 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 68 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect 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.
(A COMPONENT UNIT OF THE YAP STATE GOVERNMENT)

Notes to Financial Statements
September 30, 2014 and 2013

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect 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 as follows:

<u>Year ending September 30,</u>	<u>Amortization</u>
2015	\$ 813,709
2016	813,709
2017	<u>353,187</u>
	\$ <u>1,980,605</u>

Fuel Inventory

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

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

Notes to Financial Statements
September 30, 2014 and 2013

(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 statements 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.
(A COMPONENT UNIT OF THE YAP STATE GOVERNMENT)

Notes to Financial Statements
September 30, 2014 and 2013

(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, 2014 and 2013, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit was \$5,726,570 and \$11,270,821, respectively, and the corresponding bank balances were \$5,718,350 and \$11,508,967, respectively. Of the bank balances, \$3,847,057 and \$9,672,848, respectively, is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2014 and 2013, bank deposits in the amount of \$500,000, in each of those years, 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, 2014 and 2013, 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.
(A COMPONENT UNIT OF THE YAP STATE GOVERNMENT)

Notes to Financial Statements
September 30, 2014 and 2013

(3) Investments, Continued

As of September 30, 2014 and 2013, investments at fair value comprise the following:

	<u>2014</u>	<u>2013</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 78,690	\$ 63,856
U.S. Government agencies	27,532	28,027
Corporate notes	<u>76,862</u>	<u>87,224</u>
	<u>183,084</u>	<u>179,107</u>
Other investments:		
Common equities	388,032	349,430
Money market funds	<u>27,943</u>	<u>27,889</u>
	<u>415,975</u>	<u>377,319</u>
	\$ <u>599,059</u>	\$ <u>556,426</u>

As of September 30, 2014, 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	\$ 78,690	\$ 30,359	\$ 25,670	\$ 22,661
U.S. Government agencies obligations	AAA	27,531	17,315	10,216	-
Corporate Notes	A1	15,637	-	15,637	-
Corporate Notes	A2	45,916	-	30,713	15,203
Corporate Notes	A3	10,095	-	10,095	-
Corporate Notes	AA2	<u>5,215</u>	<u>5,215</u>	-	-
		\$ <u>183,084</u>	\$ <u>52,889</u>	\$ <u>92,331</u>	\$ <u>37,864</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>5,398</u>	-
		\$ <u>179,107</u>	\$ <u>22,852</u>	\$ <u>108,974</u>	\$ <u>47,281</u>

THE DIVING SEAGULL, INC.
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Notes to Financial Statements
September 30, 2014 and 2013

(4) Net Receivable from/Payable to Broker

Approximately 100% and 72%, respectively, of fish sales in the years ended September 30, 2014 and 2013 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 \$130,992 at September 30, 2014 and a payable of \$635,790 at September 30, 2013.

The Broker reported high salt fish rejection to the Company and it paid additional compensation of \$133,186 to crews during the year ended September 30, 2014.

(5) Notes and Other Receivables

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

	<u>2014</u>	<u>2013</u>
Palau Micronesia Air (PMAir)	\$ 550,000	\$ 550,000
Others	<u>31,140</u>	<u>32,720</u>
	581,140	582,720
Less: allowance for doubtful accounts	<u>(581,140)</u>	<u>(581,140)</u>
	\$ <u> -</u>	\$ <u> 1,580</u>

(6) Property and Equipment

Property and equipment consist of the following at September 30, 2014 and 2013:

	Beginning Balance Oct. 1, 2013	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2014
Leased fishing vessel and purse seine net	\$ 6,821,012	\$ 555,235	\$ -	\$ 7,376,247
Purchased fishing vessel and purse seine net	5,717,316	525,000	-	6,242,316
Leasehold improvements	4,883,897	246,446	(3,748,722)	1,381,621
Vessel improvements	338,260	45,471	(48,520)	335,211
Office furniture and equipment	38,058	8,633	(3,746)	42,945
Vehicle	<u>26,568</u>	<u> -</u>	<u> -</u>	<u>26,568</u>
Total cost	17,825,111	1,380,785	(3,800,988)	15,404,908
Less accumulated depreciation	<u>(13,070,465)</u>	<u>(989,442)</u>	<u>3,507,608</u>	<u>(10,552,299)</u>
	\$ <u>4,754,646</u>	\$ <u>391,343</u>	\$ <u>(293,380)</u>	\$ <u>4,852,609</u>

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Notes to Financial Statements
September 30, 2014 and 2013

(6) Property and Equipment, Continued

	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>

(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 \$2,008,496 and \$2,269,592 as at September 30, 2014 and 2013, 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>
2015	\$ 286,915	\$ 169,121	\$ 456,036
2016	313,830	142,206	456,036
2017	343,269	112,767	456,036
2018	375,470	80,566	456,036
2019	410,692	45,344	456,036
2020	<u>278,320</u>	<u>9,043</u>	<u>287,363</u>
	<u>\$ 2,008,496</u>	<u>\$ 559,047</u>	<u>\$ 2,567,543</u>

At September 30, 2013, current portion of long-term debt included \$405,092, which was the outstanding balance of a \$2,000,000 loan to Bank of Guam, with interest of 2.12%, secured by a time certificate of deposit account with the bank. The loan was paid off during the year ended September 30, 2014.

THE DIVING SEAGULL, INC.
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Notes to Financial Statements
September 30, 2014 and 2013

(7) Long-Term Debt, Continued

Changes in debt during the years ended September 30, 2014 and 2013 follows:

2014				
<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
\$ <u>2,674,684</u>	\$ <u> -</u>	\$ <u>(666,188)</u>	\$ <u>2,008,496</u>	\$ <u>286,915</u>
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>

(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, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Fuel	\$ 3,539,880	\$ 4,759,354
Depreciation and amortization	1,447,741	829,243
Repair and maintenance	1,442,754	892,909
Crew salaries and wages	1,188,584	1,341,411
Insurance	544,871	506,150
License, agent and port fees	504,152	1,217,203
Salt and provisioning	388,127	358,484
Crew travel	320,253	247,359
Management fee	144,640	202,214
Communications	114,467	131,083
Supplies and freight	83,525	116,350
Stevedoring	57,206	108,272
Other vessel expenses	<u>41,781</u>	<u>54,068</u>
	<u>\$ 9,817,981</u>	<u>\$ 10,764,100</u>

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

Notes to Financial Statements
September 30, 2014 and 2013

(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 Company recorded \$298,102 of insurance gain for the settlement of injury and damage to fishing net during the year ended September 30, 2014.

(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 \$21,740 and \$24,980 at September 30, 2014 and 2013, 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, in each of those years.

(12) Subsequent Event

On April 30, 2015, a \$1,000,000 bank loan was obtained to fund fishing operations. Interest is at 2.12% and principal is payable in monthly installments of \$17,605, which commences on June 10, 2015.

**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 statement of net position as September 30, 2014, 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 May 19, 2015.

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.

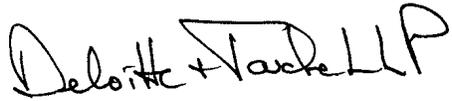
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not 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 + Touche LLP". The signature is written in a cursive, flowing style.

May 19, 2015