

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2015 AND 2014



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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, 2015 and 2014, 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, 2015 and 2014, 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.

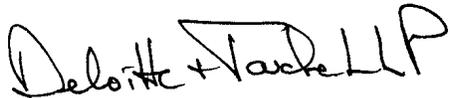
Other Matters

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 24, 2016, 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 24, 2016

THE DIVING SEAGULL, INC.

Management's Discussion and Analysis Years Ended September 30, 2015 and 2014

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 \$12,131,753 at the end of fiscal year 2015 represent a 11% decrease over 2014. By comparison, in 2014, total assets decreased by 21% over 2013 to \$13,562,193. The decrease in total assets in 2015 is primarily the result of a 30% decrease in cash and equivalents from \$1,909,279 in 2014 to \$1,327,408 in 2015. 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.

Operating revenues generated from fish sales of \$8,729,026 represents an increase of 49% over 2014. The Company has applied new fishing technology during the time after when Mathawmafach was operable to fish efficiently, which assisted in reducing losses from 2014. In addition, the price per ton of fish sold in 2015 was up by 15% when compared to 2014. Fuel cost decreased in 2015, which allowed the Company to reduce some of its expenses as shown in our financial statements.

The Company ended fiscal year 2015 with a net operating loss of \$1.3 million, which improved from fiscal year 2014 which had a net operating loss of \$4.2 million.

The Company's cash flows from operating activities was a negative \$3,641,681 in 2014 and remains at negative \$427,732 in 2015. Cash and equivalents at the end of 2015 was \$1,327,408. For the year ended September 30, 2015, cash and cash equivalents decreased from \$1,909,279 in the prior year to \$1,327,408. The decrease in cash and equivalents in 2015 was due to not being able to recoup prior losses in fishing time and mechanical problems.

The following table summarizes the financial condition and results of operations of the Company for 2015, 2014 and 2013:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
<u>Assets</u>			
Property and equipment, net	\$ 3,937,151	\$ 4,852,609	\$ 4,754,646
Current assets	5,646,692	5,291,397	9,981,504
Other assets	<u>2,547,910</u>	<u>3,418,187</u>	<u>2,534,741</u>
Total Assets	\$ <u>12,131,753</u>	\$ <u>13,562,193</u>	\$ <u>17,270,891</u>
<u>Liabilities and Net position</u>			
Liabilities:			
Long-term debt, net of current portion	\$ 2,149,349	\$ 1,721,581	\$ 2,007,169
Current portion of long-term debt	506,798	286,915	667,515
Other current liabilities	<u>2,332,738</u>	<u>2,808,077</u>	<u>1,706,759</u>
Total Liabilities	<u>4,988,885</u>	<u>4,816,573</u>	<u>4,381,443</u>
Net Position:			
Net investment in capital assets	\$ 1,281,004	\$ 2,844,113	\$ 2,079,962
Restricted	2,238,746	2,251,291	2,230,707
Unrestricted	<u>3,623,118</u>	<u>3,650,216</u>	<u>8,578,779</u>
Total Net Position	<u>7,142,868</u>	<u>8,745,620</u>	<u>12,889,448</u>
Total Liabilities and Net Position	\$ <u>12,131,753</u>	\$ <u>13,562,193</u>	\$ <u>17,270,891</u>

THE DIVING SEAGULL, INC.

Management's Discussion and Analysis Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>	<u>2013</u>
<u>Revenues, Expenses, and Changes in Net position</u>			
Operating revenues	\$ 8,729,026	\$ 5,864,964	\$ 13,185,070
Cost of sales	(9,732,856)	(9,817,981)	(10,764,100)
Operating expenses	<u>(297,431)</u>	<u>(249,383)</u>	<u>(235,716)</u>
Net operating revenues (loss)	(1,301,261)	(4,202,400)	2,185,254
Non-operating revenues (expenses)	<u>(301,491)</u>	<u>58,572</u>	<u>(128,335)</u>
Change in net position	\$ <u>(1,602,752)</u>	\$ <u>(4,143,828)</u>	\$ <u>2,056,919</u>

Capital Assets and Debt

The Company's acquisition of capital assets in 2015 and 2014 were related to improvements in machinery and equipment on the vessels with developed fishing technology which is necessary for efficient fishing. For additional information concerning capital assets, please refer to note 6 to the financial statements.

For information concerning debt, please refer to note 7 to the financial statements.

The Management Discussion and Analysis for the year ended September 30, 2014 is set forth in the Company's report on the audit of financial statements, which is dated May 19, 2015. That Discussion and Analysis explains the major factors impacting the 2014 financial statements and can be viewed at the FSM Office of the Public Auditor's website.

Plan of Action for 2016 – Economic Outlook

In 2015, the Company secured a one million dollar line of credit and a term loan with the Bank of Guam to mitigate cash flow difficulties that had arisen due to the declining world tuna prices. 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.

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 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.

THE DIVING SEAGULL, INC.

Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

Below are some of the issues and challenges that will be facing the Company in 2016:

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, 2015 and 2014

	2015	2014
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,327,408	\$ 1,909,279
Time certificates of deposit	1,566,000	1,566,000
Investments	1,142,421	599,059
Net receivable from broker	-	130,992
Employee and director receivables, net	66,184	55,273
Other receivables, net	185,522	-
Prepaid expenses	453,616	17,885
Current portion of drydocking costs	725,673	813,709
Fuel inventory	179,868	199,200
Total current assets	5,646,692	5,291,397
Restricted cash and cash equivalents	2,238,746	2,251,291
Long-term drydocking costs, net of current portion	309,164	1,166,896
Property and equipment, net	3,937,151	4,852,609
	\$ 12,131,753	\$ 13,562,193
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Current portion of long-term debt	\$ 506,798	\$ 286,915
Accounts payable	858,814	2,202,802
Net payable to broker	626,843	-
Accrued expenses	847,081	605,275
Total current liabilities	2,839,536	3,094,992
Long-term debt, net of current portion	2,149,349	1,721,581
Total liabilities	4,988,885	4,816,573
Commitments		
Net position:		
Net investment in capital assets	2,215,411	2,844,113
Restricted	2,238,746	2,251,291
Unrestricted	2,688,711	3,650,216
Total net position	7,142,868	8,745,620
	\$ 12,131,753	\$ 13,562,193

See accompanying notes to financial statements.

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, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Operating revenues:		
Fish sales	\$ 8,724,433	\$ 5,863,899
Other revenues	4,593	1,065
Total operating revenues	<u>8,729,026</u>	<u>5,864,964</u>
Cost of sales	<u>9,493,479</u>	<u>9,817,981</u>
Gross loss	<u>(764,453)</u>	<u>(3,953,017)</u>
Operating expenses:		
Payroll, taxes and benefits	86,311	91,703
Travel	51,832	27,221
Professional fees	40,980	35,636
Bank loan fees	26,382	12,635
Communications and utilities	18,639	23,566
Office expense	15,510	11,673
Board fees and expenses	15,150	15,691
Rent	12,384	13,965
Depreciation	2,223	2,223
Insurance	416	453
Miscellaneous	27,604	14,617
Total operating expenses	<u>297,431</u>	<u>249,383</u>
Loss from operations	<u>(1,061,884)</u>	<u>(4,202,400)</u>
Nonoperating revenues (expenses):		
Loss on technical failure	(424,899)	-
Insurance proceeds	185,522	-
Investment income	36,775	63,584
Interest expense	(174,108)	(198,125)
Fines and penalties	(107,520)	-
Adjustment to final settlement	-	(133,186)
Insurance gain	-	298,102
Gain (loss) on investments	(56,638)	42,633
Loss on asset disposal	-	(14,436)
Total nonoperating revenues (expenses), net	<u>(540,868)</u>	<u>58,572</u>
Change in net position	(1,602,752)	(4,143,828)
Net position at beginning of year	<u>8,745,620</u>	<u>12,889,448</u>
Net position at end of year	<u>\$ 7,142,868</u>	<u>\$ 8,745,620</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended September 30, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash received from customers	\$ 9,486,861	\$ 5,396,284
Cash payments to suppliers for goods and services	(7,641,552)	(7,463,820)
Cash payments to boat crew and employees for services	(2,273,041)	(1,574,145)
Net cash used in operating activities	(427,732)	(3,641,681)
Cash flows from investing activities:		
Increase in short-term investments and time certificate of deposit	(550,680)	43,000
Net cash (used in) provided by investing activities	(550,680)	43,000
Cash flows from noncapital financing activities:		
Loan proceeds	1,000,000	-
Net cash provided by noncapital financing activities	1,000,000	-
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(77,002)	(1,101,841)
Principal repayments of long-term debt	(352,349)	(666,188)
Interest paid on long-term debt	(174,108)	(198,125)
Net cash used in capital and related financing activities	(603,459)	(1,966,154)
Net change in cash	(581,871)	(5,564,835)
Cash and cash equivalents at beginning of year	1,909,279	7,474,114
Cash and cash equivalents at end of year	\$ 1,327,408	\$ 1,909,279
Reconciliation of loss from operations to net cash used in operating activities:		
Loss from operations	\$ (1,061,884)	\$ (4,202,400)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Loss on technical failure	(424,899)	
Insurance proceeds	185,522	
Insurance gain	-	298,102
Fines and penalties	(107,520)	-
Adjustment to final settlement	-	(133,186)
Depreciation and amortization expense	1,718,138	1,449,964
Changes in assets and liabilities:		
Net receivable from broker	130,992	(130,992)
Employee and director receivables	(10,911)	(4,650)
Other receivables	(185,521)	1,580
Prepaid expenses	(435,731)	859
Current portion of drydocking costs	88,035	(706,363)
Fuel inventory	19,332	(37,200)
Long-term drydocking costs, net of current portion	132,054	(1,278,713)
Accounts payable	(1,343,988)	1,296,030
Net payable to broker	626,843	(635,790)
Accrued expenses	241,806	441,078
Net cash used in operating activities	\$ (427,732)	\$ (3,641,681)

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2015 and 2014

(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

DSI utilizes the flow of economic resources measurement focus. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Net Position

Net position represents the residual interest in DSI's assets after liabilities are deducted and consists of the following categories:

Net investment in capital assets - includes capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt, net of debt service reserve.

Restricted nonexpendable - net position subject to externally imposed stipulations that require DSI to maintain them permanently.

Restricted expendable - net position whose use is subject to externally imposed stipulations that can be fulfilled by actions of DSI pursuant to those stipulations or that expire with the passage of time.

Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

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

Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

Net Position, Continued

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.

Restricted net position consists of cash accounts restricted in support of certain debt.

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, 2015, the Company implemented the following pronouncements:

- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

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

Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The provisions in Statement 72 are effective for fiscal years beginning after June 15, 2015. Management believes that the implementation of this statement only requires additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques and will not have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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

Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The provisions in Statement No. 76 are effective for fiscal years beginning after June 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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

The Company uses the deferral method for accounting for dry dock costs. Dry docking costs are capitalized and amortized on a straight line basis over three years as follows:

<u>Year ending September 30,</u>	<u>Amortization</u>
2016	\$ 725,673
2017	<u>309,164</u>
	\$ <u>1,034,837</u>

Dry docking costs amortized are recorded at net of insurance proceeds associated \$220,089.

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

Notes to Financial Statements
September 30, 2015 and 2014

(1) Summary of Significant Accounting Policies, Continued

Fuel Inventory

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

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, 2015 and 2014

(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, 2015 and 2014, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit was \$5,132,154 and \$5,726,570, respectively, and the corresponding bank balances were \$5,119,936 and \$5,718,350, respectively. Of the bank balances, \$3,329,845 and \$3,847,057, respectively, is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2015 and 2014, 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, 2015 and 2014, 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, 2015 and 2014

(3) Investments, Continued

As of September 30, 2015 and 2014, investments at fair value comprise the following:

	<u>2015</u>	<u>2014</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 220,358	\$ 78,690
U.S. Government agencies	77,691	27,532
Corporate notes	<u>164,506</u>	<u>76,862</u>
	<u>462,555</u>	<u>183,084</u>
Other investments:		
Common equities	628,528	388,032
Money market funds	<u>51,338</u>	<u>27,943</u>
	<u>679,866</u>	<u>415,975</u>
	<u>\$ 1,142,421</u>	<u>\$ 599,059</u>

As of September 30, 2015, 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	\$ 220,358	\$ 46,376	\$ 152,859	\$ 21,123
U.S. Government agencies obligations	AAA	77,691	40,486	37,205	-
Corporate Notes	A1	15,421	5,104	10,317	-
Corporate Notes	A2	87,740	-	62,051	25,689
Corporate Notes	A3	45,570	-	25,106	20,464
Corporate Notes	AA2	<u>15,775</u>	<u>-</u>	<u>-</u>	<u>15,775</u>
		<u>\$ 462,555</u>	<u>\$ 91,966</u>	<u>\$ 287,538</u>	<u>\$ 83,051</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>-</u>	<u>-</u>
		<u>\$ 183,084</u>	<u>\$ 52,889</u>	<u>\$ 92,331</u>	<u>\$ 37,864</u>

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

Notes to Financial Statements
September 30, 2015 and 2014

(4) Net Receivable from/Payable to Broker

Approximately 100% of fish sales in the years ended September 30, 2015 and 2014 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 \$626,843 at September 30, 2015 and a receivable of \$130,992 at September 30, 2014.

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>2015</u>	<u>2014</u>
Palau Micronesia Air (PMAir)	\$ 550,000	\$ 550,000
Insurance company	185,522	-
Others	<u>31,140</u>	<u>31,140</u>
	766,662	581,140
Less: allowance for doubtful accounts	<u>(581,140)</u>	<u>(581,140)</u>
	<u>\$ 185,522</u>	<u>\$ -</u>

(6) Property and Equipment

Property and equipment consist of the following at September 30, 2015 and 2014:

	Beginning Balance Oct. 1, 2014	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2015
Leased fishing vessel and purse seine net	\$ 7,376,247	\$ -	\$ -	\$ 7,376,247
Purchased fishing vessel and purse seine net	6,242,316	-	-	6,242,316
Leasehold improvements	1,381,621	19,070	-	1,400,691
Vessel improvements	335,211	57,932	-	393,143
Office furniture and equipment	42,945	-	-	42,945
Vehicle	<u>26,568</u>	<u>-</u>	<u>-</u>	<u>26,568</u>
Total cost	15,404,908	77,002	-	15,481,910
Less accumulated depreciation	<u>(10,552,299)</u>	<u>(992,460)</u>	<u>-</u>	<u>(11,544,759)</u>
	<u>\$ 4,852,609</u>	<u>\$ (915,458)</u>	<u>\$ -</u>	<u>\$ 3,937,151</u>

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

Notes to Financial Statements
September 30, 2015 and 2014

(6) Property and Equipment, Continued

	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>

(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. The loan is collateralized by the vessel and the bank and DSI's joint savings deposit of \$150,000. Interest of 9% and principal are payable in monthly installments of \$38,003, which began on April 25, 2010. The loan balance was \$1,721,740 and \$2,008,496 as at September 30, 2015 and 2014, respectively.

On April 30, 2015, a \$1,000,000 loan was obtained from the Bank of Guam to fund fishing operations. The loan is collateralized by DSI's TCD of \$2,031,271. Interest of 2.12% and principal are payable in monthly installments of \$17,605, which began on June 10, 2015. The loan balance was \$934,407 as at September 30, 2015.

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>
2016	\$ 506,798	\$ 160,503	\$ 667,301
2017	540,635	126,824	667,459
2018	576,959	90,342	667,301
2019	616,554	50,746	667,300
2020	<u>415,201</u>	<u>10,172</u>	<u>425,373</u>
	<u>\$ 2,656,147</u>	<u>\$ 438,587</u>	<u>\$ 3,094,734</u>

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

Notes to Financial Statements
September 30, 2015 and 2014

(7) Long-Term Debt, Continued

Changes in debt during the years ended September 30, 2015 and 2014 follows:

<u>2015</u>				
<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
\$ <u>2,008,496</u>	\$ <u>1,000,000</u>	\$ <u>(352,349)</u>	\$ <u>2,656,147</u>	\$ <u>506,798</u>
<u>2014</u>				
<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>

(8) Commitments

Lease

The Company leases a 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, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Fuel	\$ 2,949,386	\$ 3,539,880
Crew salaries and wages	2,006,841	1,188,584
Depreciation and amortization	1,715,915	1,447,741
License, agent and port fees	557,010	504,152
Insurance	529,632	544,871
Repair and maintenance	507,435	1,442,754
Salt and provisioning	332,234	388,127
Management fee	304,483	144,640
Supplies and freight	283,950	83,525
Stevedoring	114,788	57,206
Crew travel	106,301	320,253
Communications	71,931	114,467
Other vessel expenses	<u>252,950</u>	<u>41,781</u>
	<u>\$ 9,732,856</u>	<u>\$ 9,817,981</u>

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

Notes to Financial Statements
September 30, 2015 and 2014

(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 an insurance gain of \$298,102 for settlement of injury and damages to a 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 \$16,690 and \$21,740 at September 30, 2015 and 2014, 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.

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, 2015, 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 24, 2016.

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.

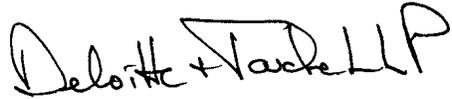
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

May 24, 2015