

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2016 AND 2015

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, 2016 and 2015, 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, 2016 and 2015, 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.

Emphasis of Matters

As discussed in Note 1 to the financial statements, the Company adopted Governmental Accounting Standards Board (GASB) Statement No 72, *Fair Value Measurement and Application*, effective October 1, 2015.

As discussed in Note 12 to the financial statements, the Company may be liable for fishing license fees in the amount of \$2,445,585 and \$2,197,354 as of September 30, 2016 and 2015, respectively, while the balance recorded by the Company is \$526,641 and \$284,298, respectively. The differences are currently in dispute. No provision for this matter has been made in the accompanying financial statements but ultimate resolution of this matter may have a material impact on the accompanying financial statements.

Our opinion is not modified with respect to these matters.

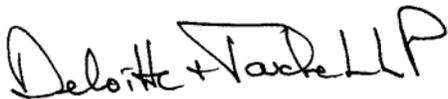
Other Matters

Required Supplementary Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 22, 2017, 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.



June 22, 2017

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

Management's Discussion and Analysis
Years Ended September 30, 2016 and 2015

The Yap State Government was required to adopt the provisions of the Government Accounting Standard 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 \$9,988,798 at the end of fiscal year 2016 represent a 18% decrease over 2015. By assessment, in 2015, total assets had decreased by 11% over 2014 to \$12,131,753. The decrease in total assets in 2016 is primarily due to a decrease in time certificates of deposit and drydocking costs. The Company financed the cost of the dry dock of its two fishing vessels in late fiscal year 2013 and 2014 without incurring additional debt.

Operating revenue generated from fish sales of \$7,897,190 represents a decrease of 9% over 2015. The Company has applied new fishing technology during the time after when Mathawmarfach was operable to fish efficiently, just gradually to recover our loss in 2015. Fuel costs decreased in 2016, which allowed the Company to recover some of its loss as shown in our financial statements.

The Company ended fiscal year 2016 with a loss from operations of \$1.5 million while the Company had a \$1.1 million loss from operations in fiscal year 2015.

The Company's cash flows from operating activities was a negative \$427,732 in 2015 and became a positive of \$356,409 in 2016. Cash and cash equivalents increased from \$1,327,408 to \$1,966,957 as of fiscal year 2016.

The following table summarizes the financial position and results of operations of the Company for 2016, 2015 and 2014.

	<u>2016</u>	<u>2015</u>	<u>2014</u>
<u>Assets</u>			
Property and equipment, net	\$ 3,427,541	\$ 3,937,151	\$ 4,852,609
Current assets	4,319,511	5,646,692	5,291,397
Other assets	<u>2,241,746</u>	<u>2,547,910</u>	<u>3,418,187</u>
Total Assets	\$ <u>9,988,798</u>	\$ <u>12,131,753</u>	\$ <u>13,562,193</u>
<u>Liabilities and Net position</u>			
Liabilities:			
Long-term debt, net of current portion	\$ 1,611,119	\$ 2,149,349	\$ 1,721,581
Current portion of long-term debt	540,483	506,798	286,915
Other current liabilities	<u>2,221,478</u>	<u>2,332,738</u>	<u>2,808,077</u>
Total Liabilities	<u>4,373,080</u>	<u>4,988,885</u>	<u>4,816,573</u>
Net position:			
Net investment in capital assets	\$ 2,020,366	\$ 2,215,411	\$ 2,844,113
Restricted	2,241,746	2,238,746	2,251,291
Unrestricted	<u>1,353,606</u>	<u>2,688,711</u>	<u>3,650,216</u>
Total Net position	<u>5,615,718</u>	<u>7,142,868</u>	<u>8,745,620</u>
Total Liabilities and Net position	\$ <u>9,988,798</u>	\$ <u>12,131,753</u>	\$ <u>13,562,193</u>

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

Management's Discussion and Analysis
Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>	<u>2014</u>
<u>Revenues, Expenses, and Changes in Net position</u>			
Operating revenues	\$ 7,912,182	\$ 8,729,026	\$ 5,864,964
Cost of sales	(9,137,064)	(9,493,479)	(9,817,981)
Operating expenses	<u>(251,927)</u>	<u>(297,431)</u>	<u>(249,383)</u>
Loss from operations	(1,476,809)	(1,061,884)	(4,202,400)
Non-operating (expenses) revenues, net	<u>(50,341)</u>	<u>(540,868)</u>	<u>58,572</u>
Change in net position	\$ <u>(1,527,150)</u>	\$ <u>(1,602,752)</u>	\$ <u>(4,143,828)</u>

Capital Assets and Long-Term Debt

The Company's acquisition of capital assets in 2016 and 2015 were related to improvements in machinery and equipment on 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.

There were no debt additions during the year ended September 30, 2016. For information concerning debt, please refer to note 7 to the financial statements.

Plan of Action for 2017- Economic Outlook

In 2016, the Company established its international market to Japan to bid on its tuna catches in an attempt to obtain a better tuna price. Considering other challenges being faced with the VDS fishing days at \$4,000 per day, which required prepayment in 2016 and caused difficulties in Company operations. Management and Board of Directors have raised concerns with new regulations that make fishing so hard for its economic value to the Company, in servicing its debts with Bank of Guam and FSM Development Bank.

In FY 2017, Company struggled to pay its monthly loan payment to FSM Development Bank and Bank of Guam. Management recommended to the Board to delay shipyard of Yap Seagull until 2018, when we are cleared of debts being required to be paid off in December of 2017.

In 2016, FSM Development Bank approved a loan of \$5.2 million to purchase a vessel of \$3 million and to consolidate payoff of all its loans with Bank of Guam and FSM Development Bank. The transaction is currently on hold, due to the vessel being purchased by another buyer. It was in the plan to continue to solicit other vessels as a replacement.

Due to the cash flow situation, Board approved to change intent of that \$5.3 million loan with FSM Development Bank and infuse more cash in to stabilize cash flow difficulties. FSM Development Bank agreed to analyze our financial statement and advise its position on our request.

The above impediments slows Company recovery of all the improvements we have done to achieve fishing efficiencies. Fish prices being high in 2016 saved the Company from incurring interest expense from our line of credit with Bank of Guam.

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

Management's Discussion and Analysis
Years Ended September 30, 2016 and 2015

Below are some of the issues and challenges that will be facing the Company in 2017.

1. To pay debts with the Parties to the Nauru Agreement Office (PNAO)
2. Requirement of prepay VDS fishing days
3. Improving profit margin of the Company
4. Increase capital
5. Diversification
6. Partnership arrangements

Financial Management Contact

This financial report is designed to provide all interest users with a general overview of the Company's finances. Inquiries concerning this report, if any, may be directed to the Diving Seagull, Inc. PO Box 1036, Colonia, Yap FM 96943

The Management Discussion and Analysis for the year ended September 30, 2015 is set forth in the Company's report on the audits of financial statement, which is dated May 24, 2016. That Discussion and Analysis explains the major factors impacting the 2015 financial statements and can be viewed at the FSM Office of the Public Auditor's website.

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

Statements of Net Position
September 30, 2016 and 2015

	2016	2015
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,966,957	\$ 1,327,408
Time certificates of deposit	566,000	1,566,000
Investments	1,217,880	1,142,421
Employee and director receivables, net	74,890	66,184
Other receivables, net	35,522	185,522
Prepaid expenses	40,266	453,616
Current portion of drydocking costs	309,164	725,673
Fuel inventory	108,832	179,868
Total current assets	4,319,511	5,646,692
Restricted cash and cash equivalents	2,241,746	2,238,746
Long-term drydocking costs, net of current portion	-	309,164
Property and equipment, net	3,427,541	3,937,151
	\$ 9,988,798	\$ 12,131,753
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Current portion of long-term debt	\$ 540,483	\$ 506,798
Accounts payable	1,010,579	858,814
Net payable to broker	267,397	626,843
Accrued expenses	943,502	847,081
Total current liabilities	2,761,961	2,839,536
Long-term debt, net of current portion	1,611,119	2,149,349
Total liabilities	4,373,080	4,988,885
Commitments and contingencies		
Net position:		
Net investment in capital assets	2,020,366	2,215,411
Restricted	2,241,746	2,238,746
Unrestricted	1,353,606	2,688,711
Total net position	5,615,718	7,142,868
	\$ 9,988,798	\$ 12,131,753

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, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating revenues:		
Fish sales	\$ 7,897,190	\$ 8,724,433
Other revenues	<u>14,992</u>	<u>4,593</u>
Total operating revenues	7,912,182	8,729,026
Cost of sales	<u>9,137,064</u>	<u>9,493,479</u>
Gross loss	<u>(1,224,882)</u>	<u>(764,453)</u>
Operating expenses:		
Payroll, taxes and benefits	72,962	86,311
Professional fees	36,825	40,980
Travel	36,006	51,832
Communications and utilities	21,101	18,639
Bad debts	18,928	-
Office expense	15,667	15,510
Board fees and expenses	15,225	15,150
Bank loan fees	13,540	26,382
Rent	13,416	12,384
Depreciation and amortization	871	2,223
Insurance	385	416
Miscellaneous	<u>7,001</u>	<u>27,604</u>
Total operating expenses	<u>251,927</u>	<u>297,431</u>
Loss from operations	<u>(1,476,809)</u>	<u>(1,061,884)</u>
Nonoperating revenues (expenses), net:		
Interest expense	(164,016)	(174,108)
Investment income, net	113,675	(19,863)
Insurance proceeds	-	185,522
Fines and penalties	-	(107,520)
Loss on technical failure	<u>-</u>	<u>(424,899)</u>
Total nonoperating expenses, net	<u>(50,341)</u>	<u>(540,868)</u>
Change in net position	(1,527,150)	(1,602,752)
Net position at beginning of year	<u>7,142,868</u>	<u>8,745,620</u>
Net position at end of year	<u>\$ 5,615,718</u>	<u>\$ 7,142,868</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, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Cash received from customers	\$ 7,552,736	\$ 9,486,861
Cash payments to suppliers for goods and services	(5,365,729)	(7,641,552)
Cash payments to boat crew and employees for services	(1,830,598)	(2,273,041)
Net cash provided by (used in) operating activities	356,409	(427,732)
Cash flows from investing activities:		
Decrease (increase) in short-term investments and time certificates of deposit	35,216	(550,680)
Withdrawals from time certificates of deposit	1,000,000	-
Net cash provided by (used in) investing activities	1,035,216	(550,680)
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	(83,515)	(77,002)
Principal repayments of long-term debt	(504,545)	(352,349)
Interest paid on long-term debt	(164,016)	(174,108)
Net cash used in capital and related financing activities	(752,076)	(603,459)
Net change in cash	639,549	(581,871)
Cash and cash equivalents at beginning of year	1,327,408	1,909,279
Cash and cash equivalents at end of year	\$ 1,966,957	\$ 1,327,408
Reconciliation of loss from operations to net cash provided by (used in) operating activities:		
Loss from operations	\$ (1,476,809)	\$ (1,061,884)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Loss on technical failure	-	(424,899)
Insurance proceeds	-	185,522
Fines and penalties	-	(107,520)
Depreciation and amortization	1,318,798	1,718,138
Changes in assets and liabilities:		
Net receivable from/payable to broker	(359,446)	757,835
Employee and director receivables	(8,706)	(10,911)
Other receivables	150,000	(185,521)
Prepaid expenses	413,350	(435,731)
Drydocking costs	-	220,089
Fuel inventory	71,036	19,332
Accounts payable	151,765	(1,343,988)
Accrued expenses	96,421	241,806
Net cash provided by (used in) operating activities	\$ 356,409	\$ (427,732)

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2016 and 2015

(1) Summary of Significant Accounting Policies

Reporting Entity

The Diving Seagull, Inc. (the Company or DSI), 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 Company.

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, 2016 and 2015

(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, 2016, the Company implemented the following pronouncements:

- GASB 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 implementation of this statement required additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques.
- GASB 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 No. 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, which addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014. 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, 2016 and 2015

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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 No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 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.

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.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 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.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 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.

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

Notes to Financial Statements
September 30, 2016 and 2015

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 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.

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 are reported at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (ie, the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

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>
2017	\$ <u>309,164</u>

The above dry docking costs are recorded net of associated insurance proceeds of \$220,089.

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

Notes to Financial Statements
September 30, 2016 and 2015

(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 over 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 amortized 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 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, 2016 and 2015

(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, 2016 and 2015, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit was \$4,774,703 and \$5,132,154, respectively, and the corresponding bank balances were \$4,810,877 and \$5,119,936, respectively. Of the bank balances, \$2,983,153 and \$3,329,845, respectively, is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2016 and 2015, 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, 2016 and 2015, the Company did not hold an investment in any one issuer that represented more than 5% of the Company's total investments.

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

Notes to Financial Statements
September 30, 2016 and 2015

(3) Investments, Continued

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.

Investments and related investment earnings are reported at fair value using quoted market prices. Fair value is the price that would be received to sell an asset or paid to transfer a liability (ie, the exit price) in an orderly transaction between market participants at the date as of which the fair value of an asset or liability is determined.

As of September 30, 2016 and 2015, investments at fair value comprise the following:

	<u>2016</u>	<u>2015</u>
Fixed income securities:		
U.S. Treasury obligations	\$ 186,618	\$ 220,358
U.S. Government agencies	37,056	77,691
Corporate notes	<u>247,099</u>	<u>164,506</u>
	<u>470,773</u>	<u>462,555</u>
Other investments:		
Common equities	710,604	628,528
Money market funds	<u>36,503</u>	<u>51,338</u>
	<u>747,107</u>	<u>679,866</u>
	<u>\$ 1,217,880</u>	<u>\$ 1,142,421</u>

As of September 30, 2016, the Company's fixed income securities had the following ratings and 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	\$ 160,870	\$ 25,604	\$ 135,266	\$ -
U.S. Treasury obligations	Not rated	25,747	-	-	25,747
U.S. Government agencies obligations	AAA	37,056	15,039	22,017	-
Corporate notes	A1	20,243	10,052	10,191	-
Corporate notes	A2	89,829	22,093	41,197	26,539
Corporate notes	A3	70,277	-	35,792	34,485
Corporate notes	AA2	15,767	-	15,767	-
Corporate notes	BAA1	26,000	12,021	-	13,979
Corporate notes	BAA2	12,234	-	12,234	-
Corporate notes	BAA3	<u>12,750</u>	<u>-</u>	<u>-</u>	<u>12,750</u>
		<u>\$ 470,773</u>	<u>\$ 84,809</u>	<u>\$ 272,464</u>	<u>\$ 113,500</u>

THE DIVING SEAGULL, INC.
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Notes to Financial Statements
September 30, 2016 and 2015

(3) Investments, Continued

As of September 30, 2015, the Company's fixed income securities had the following ratings and maturities:

		Fair Value	Less than 1 Year	1 to 5 Years	6 to 10 Years
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>

The Company categorizes its fair value measurements within the fair value hierarchy established by GASB Statement No. 72. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The Company has the following recurring fair value measurements as of September 30, 2016 and 2015:

	September 30, 2016	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Fixed income securities:				
U.S. Treasury obligations	\$ 186,618	\$ -	\$ 186,618	\$ -
U.S. Government agencies	37,056	-	37,056	-
Corporate notes	<u>247,099</u>	<u>-</u>	<u>247,099</u>	<u>-</u>
Total fixed income	<u>470,773</u>	<u>-</u>	<u>470,773</u>	<u>-</u>
Equity securities:				
Common equities	<u>710,604</u>	<u>710,604</u>	<u>-</u>	<u>-</u>
Total investments at fair value	1,181,377	\$ <u>710,604</u>	\$ <u>470,773</u>	\$ <u>-</u>
Investments measured at amortized cost:				
Money market funds	<u>36,503</u>			
	<u>\$ 1,217,800</u>			

	September 30, 2015	<u>Fair Value Measurements Using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Fixed income securities:				
U.S. Treasury obligations	\$ 220,358	\$ -	\$ 220,358	\$ -
U.S. Government agencies	77,691	-	77,691	-
Corporate notes	<u>164,506</u>	<u>-</u>	<u>164,506</u>	<u>-</u>
Total fixed income	<u>462,555</u>	<u>-</u>	<u>462,555</u>	<u>-</u>
Equity securities:				
Common equities	<u>628,528</u>	<u>628,528</u>	<u>-</u>	<u>-</u>
Total investments at fair value	1,091,083	\$ <u>628,528</u>	\$ <u>462,555</u>	\$ <u>-</u>
Investments measured at amortized cost:				
Money market funds	<u>51,338</u>			
	<u>\$ 1,142,421</u>			

THE DIVING SEAGULL, INC.
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Notes to Financial Statements
September 30, 2016 and 2015

(4) Net Receivable from/Payable to Broker

Approximately 45% and 100% of fish sales in the years ended September 30, 2016 and 2015, respectively, were conducted with a broker based in Taiwan. Approximately 55% and 0% of fish sales in the years ended September 30, 2016 and 2015, respectively, were conducted with a broker based in Japan. 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 \$267,397 and \$626,843 at September 30, 2016 and 2015, respectively.

(5) Other Receivables

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

	<u>2016</u>	<u>2015</u>
Palau Micronesia Air (PMAir)	\$ 550,000	\$ 550,000
Insurance company	35,522	185,522
Others	<u>31,140</u>	<u>31,140</u>
	616,662	766,662
Less: allowance for doubtful accounts	<u>(581,140)</u>	<u>(581,140)</u>
	\$ <u>35,522</u>	\$ <u>185,522</u>

(6) Property and Equipment

Property and equipment consist of the following at September 30, 2016 and 2015:

	Beginning Balance Oct. 1, 2015	Transfers and Additions	Transfers and Disposals	Ending Balance Sept. 30, 2016
Leased fishing vessel and purse seine net	\$ 7,376,247	\$ 16,065	\$ -	\$ 7,392,312
Purchased fishing vessel and purse seine net	6,242,316	-	-	6,242,316
Leasehold improvements	1,400,691	67,450	-	1,468,141
Vessel improvements	393,143	-	-	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	15,481,910	83,515	-	15,565,425
Less accumulated depreciation and amortization	<u>(11,544,759)</u>	<u>(593,125)</u>	<u>-</u>	<u>(12,137,884)</u>
	\$ <u>3,937,151</u>	\$ <u>(509,610)</u>	\$ <u>-</u>	\$ <u>3,427,541</u>

THE DIVING SEAGULL, INC.
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Notes to Financial Statements
September 30, 2016 and 2015

(6) Property and Equipment, Continued

	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 and amortization	<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>

(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 \$1,407,175 and \$1,721,740 as at September 30, 2016 and 2015, respectively.

On April 30, 2015, a \$1,000,000 loan was obtained from a bank to fund fishing operations. The loan is collateralized by a \$2,031,271 time certificates of deposit. Interest of 2.12% and principal are payable in monthly installments of \$17,605, which began on June 10, 2015. The loan balance was \$744,427 and \$934,407 as at September 30, 2016 and 2015, respectively.

Future debt service on the above long-term debt is as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 540,483	\$ 126,818	\$ 667,301
2018	577,014	90,287	667,301
2019	616,614	50,687	667,301
2020	<u>417,491</u>	<u>10,128</u>	<u>427,619</u>
	<u>\$ 2,151,602</u>	<u>\$ 277,920</u>	<u>\$ 2,429,522</u>

THE DIVING SEAGULL, INC.
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Notes to Financial Statements
September 30, 2016 and 2015

(7) Long-Term Debt, Continued

Changes in long-term debt during the years ended September 30, 2016 and 2015 follows:

<u>2016</u>				
<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending</u> <u>Balance</u>	<u>Due Within</u> <u>One Year</u>
\$ <u>2,656,147</u>	\$ <u> -</u>	\$ <u>(504,545)</u>	\$ <u>2,151,602</u>	\$ <u>540,483</u>

<u>2015</u>				
<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending</u> <u>Balance</u>	<u>Due Within</u> <u>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>

(8) Commitments

Lease

The Company leases a fishing vessel and a 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, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
Fuel	\$ 2,373,040	\$ 2,949,386
License, agent and port fees	1,812,693	557,010
Crew salaries and wages	1,361,154	2,006,841
Depreciation and amortization	1,317,927	1,715,915
Repair and maintenance	661,277	268,058
Insurance	319,385	529,632
Salt and provisioning	275,880	332,234
Crew travel	262,593	106,301
Management fee	221,604	304,483
Supplies and freight	166,761	283,950
Communications	127,528	71,931
Stevedoring	93,496	114,788
Other vessel expenses	<u>143,726</u>	<u>252,950</u>
	<u>\$ 9,137,064</u>	<u>\$ 9,493,479</u>

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

Notes to Financial Statements
September 30, 2016 and 2015

(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.

(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 \$12,671 and \$16,690 at September 30, 2016 and 2015, respectively, of amounts owed by previous board members and current management for reimbursement of travel expenses, net of an allowance for doubtful accounts of \$33,013, in each of those years.

(12) Contingencies

The Company may be liable for fishing license fees incurred for the years ended September 30, 2016 and 2015 with the Parties to the Nauru Agreement Office (Nauru Agreement). Outstanding unpaid fishing license fees under demand from the Nauru Agreement are \$2,445,585 and \$2,197,354 as of September 30, 2016 and 2015, respectively, while the balances recorded by the Company are \$526,641 and \$284,298, respectively. No provision for this matter has been made in the accompanying financial statements. Resolution of this matter may have a material impact on the Company's financial statements due to our inability to predict the ultimate outcome.

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 Diving Seagull, Inc. (the Company), which comprise the statement of net position as of September 30, 2016, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated June 22, 2017.

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items 2016-001 and 2016-002 that we consider to be material weaknesses.

Compliance and Other Matters

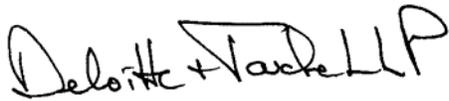
As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2016-001 and 2016-002.

The Company's Responses to Findings

The Company's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 + Tardell LLP". The signature is written in a cursive, slightly stylized font.

June 22, 2017

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

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding No. 2016-001 – Fishing License Fees Payable

Criteria: The Company should perform periodic reconciliations of accounts payable.

Condition: The Company may be liable for fishing license fees of \$2,445,585 and \$2,197,354 as of September 30, 2016 and 2015, respectively, while the balances recorded by the Company are \$526,641 and \$284,298, respectively. No provision for this difference has been made in the financial statements.

Cause: The cause of this condition is primarily due to the absence of accounts payable reconciliations.

Effect: The effect of this condition is that the Company's financial statements may not include all liabilities.

Recommendation: Management should implement controls over periodic accounts payable reconciliations. In addition, management should prepare reconciliations of fishing license fees and pay or resolve outstanding liabilities with the Parties to the Nauru Agreement.

Auditee Response and Corrective Action Plan: DSI agrees to implement controls over periodic accounts payable reconciliations. Management continues reconciliation of fishing license fees and resolve the outstanding liabilities with Parties to the Nauru Agreement.

Auditee Response and Corrective Action Plan: DSI agrees to implement controls over periodic accounts payable reconciliations. Management continues reconciliation of fishing license fees and resolve the outstanding liabilities with Parties to the Nauru Agreement.

THE DIVING SEAGULL, INC.
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Schedule of Findings and Responses, Continued
Year Ended September 30, 2016

Finding No. 2016-002 – Reconciliation

Criteria: The Company should maintain an adequate system of accounting and should be able to reconcile the general ledger (GL) with subsidiary ledgers.

Condition: Management did not maintain an adequate system of accounting during the year. Reconciliations of numerous GL accounts were not performed, such as for investments, inventories, prepaid expenses, accounts receivable, fixed assets, accounts payable, accrued expenses, loans, salaries and sales.

Cause: The cause of this condition is primarily due to the lack of adequate accounting assistance, absence of management supervision and lack of adequate filing and document maintenance systems.

Effect: The effect of this condition is a possible inability to substantiate financial statement balances, financial statement transactions and compliance with laws and regulations.

Recommendation: Management should acquire adequate accounting assistance, should prepare monthly financial statements that are supported by the books and records, and should maintain an adequate filing and retention system and be able to demonstrate compliance with laws and regulations.

Auditee Response and Corrective Action Plan: DSI agrees to acquire adequate accounting assistance, by preparing monthly financial statements supported by books and records, and shall maintain an adequate filing and retention system and be able to demonstrate compliance with laws and regulations.

Auditee Response and Corrective Action Plan: DSI agrees to acquire adequate accounting assistance, by preparing monthly financial statements supported by books and records, and shall maintain an adequate filing and retention system and be able to demonstrate compliance with laws and regulations.

**THE DIVING SEAGULL, INC.
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Unresolved Prior Year Findings
Year Ended September 30, 2016

There are no prior year findings unresolved as of September 30, 2016.