The Diving Seagull, Inc.
(A Component Unit of the State of Yap)

Financial Statements and
Independent Auditor's Reports
as of and for the Years Ended
September 30, 2009 and 2008

Fortenberry & Ballard, PC
Certified Public Accountants

The Diving Seagull, Inc.

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FORTENBERRY & BALLARD, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
The Diving Seagull, Inc.

We have audited the accompanying statement of net assets of The Diving Seagull, Inc., a component unit of Yap State Government, as of September 30, 2009 and 2008, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of The Diving Seagull's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of The Diving Seagull's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of The Diving Seagull, Inc., as of September 30, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 4 - 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of The Diving Seagull's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 15, 2010 on our consideration of The Diving Seagull'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

FORTENBERRY & BALLARD, PC

January 15, 2010

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MANAGEMENT'S DISCUSSION AND ANALYSIS

THE DIVING SEAGULL, INC.
(A COMPONENT UNIT OF THE STATE OF YAP)
Management Discussion and Analysis
Year Ended September 30, 2009

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

In 2009, the Company's total assets increased from $6,869,088 to $8,775,630. Total net property and equipment, including leased fishing vessel and purse net, lease hold improvements, computers, office furniture and vehicle also increased to $1,554,594 during the fiscal year ended September 30, 2009, as a consequence of the Bareboat Charter Agreement which has been extended to another 20 years, making this year its 8th year, upon inception in July 2002.

In 2005, the Company reported bad debts expense from an impairment loss on Palau Micronesian Airlines, $300,000 of which was for bad debts, and $250,000 was for an impairment loss on an investment. Palau Micronesia Air suspended operation on December 23, 2005, to reorganize and restore its business strategy. The note receivable went into effect in June 2005; however, to this date, there has been no payment or communication with Diving Seagull. Management is attempting through our legal Counsel to collect from PMAIR. The collection of the receivable is considered high priority of the Diving Seagull.

Operating revenues generated from fish sales of $5,799,278 decreased by over 50% due to a decline in fish prices, and a decrease in fish volume due to mechanical problems faced during the fishing trips.

Income from operations in the fiscal year ended September 30, 2009 was $461,509. In 2008, income from operation was $1,067,616. There was a decrease shown this year due to a decrease in revenues and an increase in cost of sales.

In 2008, total liabilities and net assets were $6,869,088 as compared to $8,775,630 in 2009. These amounts increased over 50% from 2008 to 2009, due to a long term debt, net of current portion of $2,349,927.

The table on the following page summarizes the financial condition and results of operations of the Company for the fiscal years ended 2009, 2008, and 2007.

THE DIVING SEAGULL, INC.
(A COMPONENT UNIT OF THE STATE OF YAP)
Management Discussion and Analysis
Year Ended September 30, 2009

Assets	**2009**	**2008**	**2007**
Property & equipment, net	$1,554,594	$1,212,126	$2,355,297
Current assets	4,968,656	5,605,242	4,091,711
Other assets	2,252,380	51,720	51,720
Total Assets	$8,775,630	$6,869,088	$6,498,728
Liabilities and Net Assets			
Liabilities:			
Long-term debt, net of current	$2,349,927	$1,471,875	$1,946,445
Current portion of long-term debt	1,016,717	512,737	415,084
Other current liabilities		552,313	720,079
Total liabilities	3,366,644	2,536,925	3,081,608
Net assets:			
Invested in capital assets, net of debt	618,667	1,212,127	2,355,297
Unrestricted	4,221,795	3,120,036	1,061,823
Total Net Assets	4,840,462	4,332,163	3,417,120
Total Liabilities and Net Assets	$8,775,630	$6,869,088	$6,498,728
Revenue, Expenses, and Changes in Net Assets			
Operating revenues	$6,104,827	$8,256,692	$5,501,572
Cost of sales	5,156,952	6,720,807	4,687,935
Operating expenses	486,366	468,269	353,593
Net operating revenues	$461,509	$1,067,616	$460,044

Management's Discussion and Analysis for the year ended September 30, 2009 is set forth in the Company's report on the audit of financial statement, which is dated January 15, 2010. That Discussion and Analysis explains the major factors impacting the 2009 financial statement and can be viewed at the FSM Office of the Public Auditor's Web Site.

Additional questions or comments, can be addressed to Carmen Kigimnang at Diving Seagull, Email address: car@mail.fm.

Plan of Action for 2009- Economic outlook

1. Revised business plan
2. 2nd boat in operational
3. Control and minimized cost
4. Training of staff
5. Work policies and regulation
6. Line of credit assistance

FINANCIAL STATEMENTS

THE DIVING SEAGULL, INC.
(A COMPONENT UNIT OF THE STATE OF YAP)
Exhibit A
Statement of Net Assets
September 30, 2009 and 2008

ASSETS	2009	2008
Current Assets:		
Cash and cash equivalents	$ 301,726	$ 2,295,170
Time certificates of deposit	3,566,000	2,566,000
Short-term investments	466,896	392,711
Net receivable from broker	534,846	34,549
Employee and director receivables	37,916	23,936
Other receivables, net	26,100	28,364
Deferred charges	-	250,027
Prepaid expenses	35,172	14,485
Total current assets	4,968,656	5,602,024
Restricted cash and cash equivalents	2,052,380	51,720
Escrow payment for Yap Seagull	200,000	-
Property & equipment, net	1,554,594	1,212,126
Total Assets	$ 8,775,630	$ 6,869,088
LIABILITIES & NET ASSETS		
Current liabilities:		
Current portion of long- term debt	$ 1,016,717	$ 512,737
Accounts payable	287,128	381,302
Accrued expenses	281,396	171,011
Total current liabilities	1,585,241	1,065,050
Long-term debt, net of current portion	2,349,927	1,471,875
Total liabilities	3,935,168	2,536,925
Net assets:		
Invested in capital assets, net of related debt	618,667	1,212,127
Restricted expendable	2,052,380	-
Unrestricted	2,169,415	3,120,036
Total net assets	4,840,462	4,332,163
Total Liabilities & Net Assets	$ 8,775,630	$ 6,869,088

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.
(A COMPONENT UNIT OF THE STATE OF YAP)
Exhibit B
Statement of Revenues, Expenses and Changes in Net Assets
September 30, 2009 and 2008

	2009	2008
Operating revenues:		
Fish sales	$ 5,799,278	$ 8,256,692
Other revenues	305,549	-
Total operating revenues	6,104,827	8,256,692
Cost of sales	5,156,952	6,720,807
Gross margin	947,875	1,535,885
Selling, general and administrative expenses:		
Payroll, taxes and benefits	72,251	79,885
Survey	43,855	50,436
Travel	213,826	26,557
Communications and utilities	5,031	14,875
Rent	10,354	12,384
Office expense	29,241	6,973
Depreciation	10,910	11,725
Miscellaneous	100,898	265,434
Total selling, general and administrative expenses	486,366	468,269
Income from operations	461,509	1,067,616
Non-operating revenues (expenses):		
Interest expense	(114,166)	(190,450)
Investment income	86,771	83,692
Gain on investments	74,185	(45,815)
Total non-operating revenues (expenses), net	46,790	(152,573)
Change in net assets	508,299	915,043
Net assets at beginning of year	4,332,163	3,417,120
Net assets at end of year	$ 4,840,462	$ 4,332,163

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.
(A COMPONENT UNIT OF THE STATE OF YAP)
Exhibit C
Statement of Cash Flows
September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Cash received from customers	$ 5,592,814	$ 9,068,149
Cash payments to suppliers for goods and services	(4,017,578)	(5,213,206)
Cash payments to boat crew and employees for services	(993,940)	(1,087,389)
Net cash provided by operating activities	581,296	2,767,554
Cash flows from investing activities:		
Acquisition of property and equipment	(728,717)	(1,870)
Increase in short - term investments and time certificate of deposit	(3,200,660)	(1,438,526)
Interest received from short - term investments	86,771	83,691
Net cash used in investing activities	(3,842,606)	(1,356,705)
Cash flows from capital and related financing activities:		
Principal repayments of long - term debt	(617,968)	(376,917)
Interest paid on long - term debt	(114,166)	(190,450)
Proceeds from issuance of long - term debt	2,000,000	-
Net cash (used in) provided by capital and related financing activities	1,267,866	(567,367)
Net change in cash	(1,993,444)	843,482
Cash and equivalents at beginning of year	2,295,170	1,451,688
Cash and equivalents at end year	$ 301,726	$ 2,295,170
Reconciliation of income from operating to net cash provided by operating activities:		
Operating income	$ 461,509	$ 1,067,616
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	386,249	1,145,039
Changes in assets and liabilities:		
Employee and director receivables	(13,980)	50,609
Other receivables	2,264	(3,218)
Prepaid expenses	(20,687)	-
Net receivable from Broker	(500,297)	781,936
Deferred charges	250,027	(116,662)
Accounts payable	(94,174)	-
Accounts payable - SA	-	(16,492)
Accounts payable - other	-	460
Accrued expenses	110,385	(141,734)
Net cash provided by operating activities	$ 581,296	$ 2,767,554

See accompanying notes to financial statements.

NOTES TO THE FINANCIAL STATEMENTS

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 seven 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 twenty-five year lease agreement for use of the fishing vessel, Mathawmarfach, and purse seine fishing net. This Bareboat Charter Agreement expires in March 2022.

Basis of Accounting

The financial statements of the Company have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. Governmental Accounting Standards Board (GASB) Statement No. 20, "*Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting,*" requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Company has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

The Company adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34 (Basic Financial Statements – Management's Discussion and Analysis for State and Local Governments). GASB Statement No. 34 establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into four net asset categories:

a. Invested in capital assets, net of related debt – Capital assets, net of accumulated depreciation, and outstanding principle balances of debt attributable to the acquisition, construction, or improvement of those assets.

b. Restricted Nonexpendable – Net assets subject to externally imposed stipulations that require the Company to maintain them permanently.

c. *Restricted Expendable* – Net assets whose use by the Company is subject to externally imposed stipulations that can be fulfilled by actions of the Company pursuant to those stipulations or that expire by the passage of time.

d. *Restricted Unrestricted* – Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

The Company's 6,500,000 shares of authorized, issued and outstanding common stock with par value of $1 per share represent capital net assets. 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 balance sheets.

Operating and Non-Operating Revenue and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of the Company. Non-operating revenues and expenses result from capital and financing activities, costs and related recoveries from natural disasters, and certain other non-recurring income and costs.

New Accounting Standards

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions,* which establishes standards for the measurement, recognition, and display of other post-employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local government employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations.* GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments.* GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* GASB Statement No. 53 is intended to improve how state and local governments manage specific risks or make investments – in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Company.

Cash and Equivalents

Cash includes cash on hand as well as cash in various bank accounts and time certificates of deposits with an initial maturity date of three months or less. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified as short-term investments.

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.

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:

Computer and office furniture and equipment	3-5 years
Leased equipment	5-20 years
Leasehold improvements	3-10 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 measureable.

Translation of Foreign Currencies

Gains and losses that arise from exchange rate changes on transactions denominated in a currency other than U.S. dollars are included in the statement of income as incurred.

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.

Deferred Charges

Direct costs incurred for ongoing fishing trips are recognized as deferred charges. Deferred charges primarily comprise fuel inventory on hand, crew salaries, license fees, port fees and other direct expenses related to the trip, but exclude depreciation.

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.

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. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1: Deposits that are federally insured or collateralized with securities held by the Company or its agent in the Company's name;
Category 2: Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the Company's name;
Category 3: pledging financial institution's trust department or agent but not in the Company's name and non-collateralized deposits.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those 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, 2009, and 2008, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit was $6,587,002 and $4,912,890, respectively, and the corresponding bank balances were $6,049,592and $5,046,758, respectively. Of the bank balances, $6,049,592 and $3,111,944, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2009 and 2008, bank deposits in the amount of $549,686 and $153,448, respectively, were FDIC insured. The Company does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. The Company has not experienced any losses on such accounts and management believes it is not exposed to any significant credit risk on its deposits.

3. Investments

Except for (1) nonparticipating investment contracts and for (2) participating interest-earning investment contract and money market investments that had a remaining maturity at the time of purchase of one year or less, investments are reported at fair value, which is based on quoted market price. Nonparticipating investment contracts such as repurchase agreements and nonnegotiable certificates of deposit are reported at cost. Participating interest earning investment contracts and money market investments that had a remaining maturity at the time of purchase of one year or less are reported at amortized cost.

Interest Rate Risk. Interest Rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Investments held for longer periods are subject to increased risk of adverse interest rate changes. Under this method, the notes provide an actual list of the maturities for different individual investments.

Concentration of Credit Risk. Disclosures of investments by amount and issuer for any issuer that represents five percent or more of total investments is required. This requirement does not apply to investments issued or explicitly guaranteed by the U.S. government, investments in mutual funds and external investment pools, and other pooled investments. As of September 30, 2009, the Company had the following investments:

Investment	Fair	% of	Interest	Investment maturities in years		
Type	Value	Investments	Rate	> 1	1-5	6-10
Total Government & Government Sponsored Entity Bonds:						
Federal National Mortgage Assn	$5,335	3.28%	4.625%	15,131		
U.S. Treasury Notes	10,075	2.16%	1.75%	10,075		
Federal National Mortgage Assn	12,667	2.71%	4.125%		12,443	
Federal National Mortgage Assn	10,646	2.28%	4.75%		10,503	
U.S. Treasury Notes	10,586	2.27%	4.50%		21,410	
Federal National Mortgage Assn	15,842	3.39%	3.625%		15,773	
U.S. Treasury Notes	10,838	2.32%	5.0%		10,774	
U.S. Treasury Notes	4,376	0.94%	4.875%		4,351	
U.S. Treasury Notes	10,933	2.34%	4.0%		10,782	
Federal National Mortgage Assn	10,866	2.33%	4.375%		10,847	
Federal National Mortgage Assn	10,958	2.35%	4.500%			
U.S. Treasury Notes Series	32,050	6.86%	4.25%		31,866	
Federal National Mortgage Assn	7,790	1.67%	4.625%			7,641
U.S. Treasury Notes	4,330	0.93%	4.00%			4,310
U.S. Treasury Notes	11,091	2.38%	4.50%			11,034
Federal National Mortgage Assn	8,898	1.91%	5.00%			8,845
U.S. Treasury Notes	4,374	0.94%	4.25%			4,310
Total Government & Government Sponsored Entity Bonds	191,655	41.05%				

Other Investments:		
Equity mutual funds	19,842	4.25%
Equity securities-- domestic	200,074	42.85%
Equity securities-- international	55,325	11.85%
Total Other Investments	275,241	58.95%
Total Investments	$ 466,896	100.00%

Credit Risk. Credit Risk is the risk that an insurer or other counterparty to an investment will not fulfill its obligations. The Company does not presently have a formal policy that addresses credit risk.

Custodial Credit Risk - Investments. Custodial credit risk is defined as the risk that, in the event of a financial institutions failure, the city will not be able to recover the value of its investments. The Company does not have a formal investment policy that addresses custodial credit risk. As of September 30, 2009, none of the Company's investment balance was insured and was exposed to custodial credit risk as follows:

Uninsured & uncollateralized	$ -
Uninsured and collateral held by pledging bank's trust department not in Company's name	466,896
Total	$466,896

4. Net Receivable from/Payable to Broker

Approximately 100% of fish sales in the years ended September 30, 2009 and 2008 were conducted with a single broker based in Taiwan. Upon offloading the fish catch from the vessel to a designated third party, the broker pays 95% of the estimated settlement. When the final settlement is determined, the Company may either be entitled to an additional amount due from the broker or be liable for an amount due to the broker. The net broker account is a receivable of $534,846, at September 30, 2009 and $34,549, at September 30, 2008.

5. Property and Equipment

Property and equipment consist of the following as of September 30, 2009 and 2008:

	Beginning Balance Oct.1,2008	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30,2009
Leased fishing vessel and purse seine net	$ 6,320,962	$ 500,050	$ -	$ 6,821,012
Leasehold improvements	3,849,555	-	-	3,849,555
Computer and office furniture and equipment	32,200	-	-	32,200
Vehicle	26,568		-	26,568
Construction in progress	-	228,667		228,667
Total cost	10,229,285	728,717	-	10,958,002
Less accumulated depreciation	(9,017,159)	(386,249)	-	(9,403,408)
	$ 1,212,126	$ 342,468	$ -	$ 1,554,594

	Beginning Balance Oct.1,2007	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30,2008
Leased fishing vessel and purse seine net	$ 6,320,962	$ -	$ -	$ 6,320,962
Leasehold improvements	3,847,985	1,570	-	3,849,555
Computer and office furniture and equipment	31,900	300	-	32,200
Vehicle	26,568	-	-	26,568
Total cost	10,227,415	1,870	-	10,229,285
Less accumulated depreciation	(7,872,119)	(1,145,040)	-	(9,017,159)
	$ 2,355,296	$ (1,143,170)	$ -	$ 1,212,126

6. Long-Term Debt

On July 28, 2006, the Company signed a five-year loan agreement with the Federated States of Micronesia Development Bank (FSMDB) authorizing a maximum loan of $1,300,000 to cover the dry-dock costs of the fishing vessel. The agreement stipulates a 1.5% loan fee and interest rate of 9%. Interest is due monthly during the six-month grace period. Interest and principal are payable in monthly installments of $26,986 beginning January 30, 2007. Part of the agreement requires the Company to establish a joint account with FSMDB and to make deposits therein as required by that agreement. As of September 30, 2009 and 2008, the balance of this restricted account for both years was $52,380.

On February 16, 2007, a new loan was granted by FSMDB amounting to $1,370,000, to cover additional dry dock costs of the fishing vessel at an interest rate of 9%. Interest and principal are payable in monthly installments of $28,606 beginning June 15, 2007.

On September 29, 2009, a new loan in the amount of $2,000,000 was granted by the Bank of Guam, with an interest rate of 2.755%, to assist in the purchase of a new vessel after the end of the fiscal year. The proceeds from this loan are shown as restricted cash in the Statement of Net Assets. Interest and principal are payable in monthly installments of $35,777.94, beginning on October 29, 2009. More information on this purchase can be found in Note 11, Subsequent Events.

All notes are collateralized by a chattel mortgage on all property and equipment, including the fishing vessel Mathawmarfach.

A summary of changes in long-term debt is provided below:

	2009	2008
Balance at beginning of year	$ 1,984,612	$ 2,361,529
Additions	2,000,000	-
Payments	(617,968)	(376,917)
Balance at end of year	3,366,644	1,984,612
Less current portion	(1,016,717)	(512,737)
Long - term debt	$ 2,349,927	$ 1,471,875

Future debt service on the above debt is as follows:

Period Ending	Principal	Interest
9/30/10	$ 946,454	$ 163,963
9/30/11	1,021,163	90,707
9/30/12	538,035	31,690
9/30/13	411,613	17,722
9/30/14	419,379	6,238
Total	$ 3,336,644	$ 310,319

7. Lease Commitments

The Company leases the fishing vessel and purse seine fishing net from Yap Investment Trust, a fund of the Yap State Government (the "State"), with a lease term through July 2022. Common stock was issued by the Company as total consideration for the agreement.

8. Cost of Sales

The detail of cost of sales for the years ended September 30, 2009 and 2008 are as follows:

	2009	2008
Fuel	$ 1,869,050	$ 2,590,275
Depreciation	375,339	1,133,314
Crew salaries and wages	1,032,074	1,038,059
Repair and maintenance	639,870	888,447
License, agent and port fees	371,963	409,241
Insurance	259,471	255,785
Management fee	153,350	155,600
Salt and provisioning	82,871	44,376
Supplies and freight	17,689	49,686
Crew travel	111,346	41,115
Communications	183,691	54,657
Stevedoring	50,413	51,430
Other vessel expenses	9,825	8,822
	$ 5,156,952	$ 6,720,807

9. 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.

10. Related Parties

The Company has entered into significant transactions with the State, as discussed in Note 7. Several Board members and officers of the Company hold management positions and other positions of influence with the State. Certain officers of the Company represented on the Board of the Yap Investment Trust, the sole owner of the Company, also represent the State on the Board of Palau Micronesia Air.

11. Subsequent Events

On October 27, 2009, subsequent to the date of the financial statements presented in this report, the Company consummated a loan from FSM Development Bank in the amount of

$3,000,000. This loan will be repaid over a period of five and one-half years (5½) at an interest rate of 9%.

The proceeds of this loan-- along with the proceeds of a $2,000,000 loan, reported as restricted net assets on the Statement of Net Assets, and further described in Note 7-- will be used to purchase an additional fishing vessel. This approximately 800 ton vessel is being purchased for $3,000,000. Additional dry dock improvements, which will cost approximately $1,600,000, are underway and their completion will be necessary before this vessel commences operation.

REPORT REQUIRED BY GOVERNMENT AUDITING STANDARDS (GAS)

FORTENBERRY & BALLARD, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors
The Diving Seagull, Inc.

We have audited the financial statements of the The Diving Seagull, Inc. as of and for the year ended September 30, 2009, and have issued our report thereon dated January 15, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control over Financial Reporting
In planning and performing our audit, we considered the Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying schedule of findings and questioned costs (Finding 2009-1) to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Corporation's internal control.

AICPA & MSCPA
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P.O. Box A, Kolonia, Pohnpei FM 96941, Telephone (691) 320-8657

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies, and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe the significant deficiency described above is not a material weakness.

<u>Compliance and Other Matters</u>
As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors and management of The Diving Seagull, Inc., and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

FORTENBERRY & BALLARD, PC

January 15, 2010

FINDINGS, CORRECTIVE ACTION PLAN AND AUDIT FOLLOW-UP

The Diving Seagull, Inc.
Schedule of Findings and Questioned Costs
For the Years Ended September 30, 2009 and 2008

Section 1: Summary Schedule of Auditor's Results:

Financial Statements:

1. Type of auditor's report issued on the financial statements: Unqualified.

2. Material noncompliance relating to the financial statements? No.

3. Internal control over financial reporting:

    a. Material weakness(es) identified? No.
    b. Significant deficiency(ies) identified that are not considered to be material weaknesses? Yes.

Section 2: Findings Relating to the Financial Statements

<u>Finding 2009-1</u>

Condition: Supporting documentation was unavailable to substantiate purchases made with the board's credit card.

Cause: Board members overrode purchasing controls during the use of The Diving Seagull's credit card. Existing purchasing procedures of retaining supporting documentation for expenditures were not followed.

Effect: Payments of $69,701.18 for credit card expenditures were misclassified and their appropriate use was not ascertainable with verifiable documentation.

Recommendation: We recommend that all credit card purchases be supported by original invoices or itemized receipts and that all payments to the credit card company be classified in the financial according to their specific nature or use (travel, meals, etc.)

Auditee Response and Corrective Action Plan: All credit card purchases shall be supported by original invoices or itemized receipts. Any payment to the credit card company will be classified and recorded according to its specific use.

Responsible Party: Carmen Kigimnang