THE DIVING SEAGULL, INC.

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

Deloitte.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: +1 671 646 3884
Fax: +1 671 649 4932
www.deloitte.com

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying statements of net assets of The Diving Seagull, Inc. (the Company) as of September 30, 2006 and 2005, and the related statement of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. 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 for 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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, 2006 and 2005 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.

Management's discussion and analysis on pages 2 - 4 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 Company's management. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurements and presentation of the required 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 a report dated February 7, 2007, on our consideration of the Diving Seagull, Inc.'s internal control over financial reporting and our tests of its compliance with certain 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 considered in assessing the results of our audit.

Deloitte & Touche LLP

February 7, 2007

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

In 2006, the Company showed a slight increase in its total current assets to $3,571,564. Depreciation expense for all assets; leased fishing vessel and purse seine net, leasehold improvements, computers, office furniture and vehicle also slightly increased to $131,503 during the fiscal year ended September 30, 2006, as a consequence of the Bareboat Charter Agreement, which has been extended for another 20 years.

In 2005, the Company reported bad debt expense from and an impairment loss on Palau Micronesian Airlines, $300,000 of which is for bad debts and $250,000 is for an impairment loss on an investment. Palau Micronesian Air suspended operations on December 23, 2004 to reorganize and restructure its business strategy. The note receivable went on effect in June 2005; however, to this date, there has been no payment or communication to The Diving Seagull, Inc. Management is attempting to collect from PMAir. It is considered a first priority of The Diving Seagull, Inc.

In 2002, the FSM Development Bank disbursed $1,152,778 to pay for dry-docking in New Zealand. The Company paid off its loan with the FSM Development Bank in September 2006. The Board decided to make another loan request to the same bank for $1.3 million, which is to be paid off within the next five years. The purpose of this loan is for dry-docking the FV Mathawmarfach at Tropical Reef Ship Yard, in Cairns, Australia.

A portion of the loan was received in September 2006 and will continue to be received in fiscal year 2007.

Operating revenues generated from fish sales of $5,299,294 increased by 4% due to fish price increases and due to an increase in fish volume, and a minimal rejection rate. These factors contributed to the 4% increase in fish sale revenues.

Income from operations in the fiscal year ended September 30, 2006 was $35,215 and in 2005, income from operations was $532,840. There is a decrease shown this year due to expenses increasing while income slightly increased.

The Company's operating cash flows totaled $434,136 in 2006 and $901,728 in 2005. On September 30, 2006, cash and equivalents increased from $1,090,029 to $1,468,879. The increase in cash and equivalents is due to increases in fish prices that increased to $1,300 per metric ton during the 2006 fiscal year and the receipts on the new loan referred to above.

The following table summarizes the financial condition and results of operations of the Company for 2006, 2005 and 2004:

	2006	2005	2004
Assets:			
Property and equipment, net	$ 911,388	$ 1,051,206	$ 1,182,328
Current assets	3,571,564	3,210,927	2,777,541
Other assets	51,030	50,556	50,461
	$ 4,533,982	$ 4,312,689	$ 4,010,330

THE DIVING SEAGULL, INC.

Management Discussion and Analysis
Year Ended September 30, 2006

	2006	2005	2004
Liabilities and Net Assets:			
Long-term debt, FSMDB loan	$ 633,515	$ 772,838	$ 873,780
Current portion of long-term debt	159,859	100,942	92,577
Other current liabilities	665,185	415,980	555,837
Net assets:			
Invested in capital assets	911,338	1,051,206	1,182,328
Unrestricted	2,164,035	1,971,723	1,305,808
	$ 4,533,982	$ 4,312,689	$ 4,010,330

	2006	2005	2004
Revenues, Expenses, and Changes in Net Assets:			
Operating revenues	$ 5,299,294	$ 5,113,127	$ 4,452,272
Cost of sales	(5,010,798)	(3,844,084)	(3,305,073)
Operating expenses	(253,281)	(736,203)	(816,037)
Net operating revenues	35,215	532,840	331,162
Interest income and other	80,285	85,775	10,144
Interest expense and other	(63,006)	(83,822)	(98,513)
Net other income and (expenses)	17,279	1,953	(88,369)
Change in net assets	$ 52,494	$ 534,793	$ 242,793

Management's Discussion and Analysis for the year ended September 30, 2005 is set forth in the Company's report on the audit of financial statements, which is dated May 17, 2006. That Discussion and Analysis explains the major factors impacting the 2005 financial statements and can be viewed at the FSM Office of the Public Auditor's website at www.fsmpublicauditor.fm.

Plan of Action for 2007

1. ***Review Vessel Management Agreement/Captain's contract***
2. ***Maintain accuracy on vessel petty cash reports***
3. ***Attend offloading of the vessel***
4. ***Research outside financial assistance***
5. ***Aggressive collection on aging receivables***
6. ***Minimize/control fuel purchases***
7. ***Diversification Plan***
8. ***Revised company policy***
9. ***Training of staff***
10. ***Revised business plan for next 5 years***

THE DIVING SEAGULL, INC.

Statements of Net Assets
September 30, 2006 and 2005

ASSETS	2006	2005
Current assets:		
Cash and equivalents	$ 1,468,879	$ 1,090,029
Short-term investments	1,566,000	1,566,000
Employee and director receivables	15,744	456
Other receivables	24,667	7,285
Deferred charges	481,789	471,236
Prepaid expenses	14,485	75,921
Total current assets	3,571,564	3,210,927
Restricted cash and equivalents	51,030	50,556
Property and equipment, net	911,388	1,051,206
	$ 4,533,982	$ 4,312,689
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current portion of long-term debt	$ 159,859	$ 100,942
Accounts payable	342,402	89,217
SA accounts payable	26,492	27,604
Net payable to broker	157,104	156,889
Accrued expenses	139,187	142,270
Total current liabilities	825,044	516,922
Long-term debt, net of current portion	633,515	772,838
Total liabilities	1,458,559	1,289,760
Contingencies and commitments		
Net assets:		
Invested in capital assets	911,388	1,051,206
Unrestricted	2,164,035	1,971,723
Total net assets	3,075,423	3,022,929
	$ 4,533,982	$ 4,312,689

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2006 and 2005

	2006	2005
Operating revenues:		
Fish sales	$ 5,298,811	$ 5,103,243
Other revenues	483	9,884
Total operating revenues	5,299,294	5,113,127
Cost of sales	5,010,798	3,844,084
Gross margin	288,496	1,269,043
Selling, general and administrative expenses:		
Payroll, taxes and benefits	102,831	86,125
Office expense	32,895	10,228
Travel expenses	29,499	21,958
Other expenses	19,859	3,112
Communications and utilities	14,995	10,171
Depreciation	9,211	8,758
Rent expense	8,405	5,760
Survey	5,513	2,041
SA expenses	5,290	5,159
Bad debts	-	300,000
Impairment loss on investment	-	250,000
Contractual services	-	5,165
Miscellaneous expense	24,783	27,726
Total selling, general and administrative expenses	253,281	736,203
Income from operations	35,215	532,840
Nonoperating revenues (expenses):		
Interest expense, net	(63,006)	(83,822)
Interest and other income	80,285	85,775
Total nonoperating revenues (expenses)	17,279	1,953
Change in net assets	52,494	534,793
Net assets at beginning of year	3,022,929	2,488,136
Net assets at end of year	$ 3,075,423	$ 3,022,929

See accompanying notes to financial statements.

THE DIVING SEAGULL, INC.

Statements of Cash Flows
Years Ended September 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Receipts from customers	$ 5,266,839	$ 5,139,780
Cash payments for goods and services	(3,487,830)	(2,733,710)
Cash payments to boat crew and employees	(1,344,873)	(1,504,342)
Net cash provided by operating activities	434,136	901,728
Cash flows from investing activities:		
Contributions to PMAir	-	(550,000)
Interest income	80,285	85,775
Net cash provided by (used in) investing activities	80,285	(464,225)
Cash flows from noncapital financing activities:		
FSMDB loan principal repayments	(873,780)	(92,577)
Interest paid	(63,006)	(83,822)
FSMDB loan proceeds	793,374	-
Net cash used in noncapital financing activities	(143,412)	(176,399)
Cash flows from capital financing activities:		
Acquisition of property and equipment	(17,185)	(590)
Proceeds from sale of asset	25,500	-
Net cash provided by (used in) capital financing activities	8,315	(590)
Net change in cash	379,324	260,514
Cash and equivalents at beginning of year	1,140,585	880,071
Cash and equivalents at end of year	$ 1,519,909	$ 1,140,585
Reconciliation of income from operations to net cash provided by operating activities:		
Operating income	$ 35,215	$ 532,840
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	131,503	131,712
Bad debt expense	-	300,000
Impairment loss on investment	-	250,000
Changes in assets and liabilities:		
Employee and director receivables	(15,288)	5,194
Accounts receivable - other	(17,382)	580
Deferred charges	(10,553)	(141,785)
Prepaid expense	61,436	(36,956)
Net payable to broker	215	26,653
Accounts payable-SA	(1,112)	-
Accounts payable - other	253,185	(73,823)
Accrued expenses	(3,083)	(92,687)
Net cash provided by operating activities	$ 434,136	$ 901,728

See accompanying notes to 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 a 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 Company utilizes accounting principles generally accepted in the United States of America as applicable to proprietary funds of governmental entities. Such funds are accounted for using the flow of economic resources measurement focus. Thus, revenues are recorded when earned and liabilities at the time expenses are incurred.

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.

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During fiscal year 2006, the Company implemented the following pronouncements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its serviced utility has declined significantly and unexpectedly.

- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1,* which improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34.

- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.

- GASB Statement No. 47, *Accounting for Termination of Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.

- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

The implementation of these pronouncements did not have a material impact on the accompanying financial statements.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform financial reporting for other postemployment benefit plans by state and local governments. 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 DSI.

In July 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment 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 governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of DSI.

In December 2004, GASB issued Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers. Management does not believe the implementation of this pronouncement will have a material effect on the financial statements of DSI.

(1) Summary of Significant Accounting Policies, Continued

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. The majority of the Company's bank accounts are with federally insured banks. Approximately $148,199 and $178,208 of such deposits as of September 30, 2006 and 2005, respectively, are subject to coverage by federal insurance with the remaining balance exceeding insurable limits. There are no significant differences between cash balances per book and per bank.

Short-term investments of $1,566,000 in 2006 and 2005 represent certificate of deposits with an initial maturity date of one year with a non-federally insured credit union. Therefore, these deposits are exposed to custodial credit risk.

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 equipment	3-5 years
Leased equipment	5 years
Leasehold improvements	up to 20 years
Vehicles	5 years

Leased assets and leasehold improvements are capitalized over the lesser of the useful life or the lease term. Capitalization thresholds are $1,000 for leasehold improvements and $500 for all other assets.

Revenue Recognition

The Company's primary source of revenue is derived from the sale of fish. Sales of fish are only considered earned upon offloading the catch to a designated third party. The sales are estimated, less a provision for rejected fish, based on broker commitments per ton and are adjusted upon receipt of a final settlement from the broker.

Other revenue is recorded when earned and measurable.

Translation of Foreign Currencies

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

(1) Summary of Significant Accounting Policies, Continued

Deferred Charges

Direct costs incurred for ongoing fishing trips are recognized as deferred charges. Deferred charges primarily comprise 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.

A. Deposits:

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 — Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the Company's name and non-collateralized deposits.

(2) Deposits, Continued

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 DSI does not have a deposit policy for custodial credit risk.

As of September 30, 2006 and 2005, the carrying amount of the Company's total cash and cash equivalents and time certificates of deposit approximated bank balances. Of the bank balances, $1,326,096 and $1,027,580, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006 and 2005, bank deposits in the amount of $148,199 and $178,208, 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) Net Payable to Broker

Approximately 100% of fish sales in the years ended September 30, 2006 and 2005 were conducted with a single broker based in Taiwan. Upon offloading the fish catch from the vessel to a designated third party, the broker pays 95% of the estimated settlement. When the final settlement is determined, the Company may either be entitled to an additional amount due from the broker or be liable for an amount due to the broker. The net broker account is a payable of $157,104 and $156,889 at September 30, 2006 and 2005, respectively.

(4) Notes and Other Receivables

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

	2006	2005
Palau Micronesia Air (PMAir)	$ 550,000	$ 550,000
Fishing companies	55,234	55,234
Micronesian Petroleum Company (MPC) Yap	40,631	40,631
National Fisheries Corporation (NFC)	3,477	3,477
	649,342	649,342
Less: allowance for doubtful accounts	(649,342)	(649,342)
	$ -	$ -

(5) Property and Equipment

Property and equipment consist of the following at September 30, 2006 and 2005:

	Beginning Balance Oct. 1, 2005	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2006
Leased fishing vessel and purse seine net	$ 6,345,962	$ -	$ 25,000	$ 6,320,962
Leasehold improvements	1,552,372	-	-	1,552,372
Computer and office furniture and equipment	21,604	17,185	-	38,789
Vehicle	34,804	-	500	34,304
Total cost	7,954,742	17,185	25,500	7,946,427
Less accumulated depreciation	(6,903,536)	(131,503)	-	(7,035,039)
	$ 1,051,206	$ (114,318)	$ 25,500	$ 911,388

	Beginning Balance Oct. 1, 2004	Transfers and Additions	Transfers and Disposals	Ending Balance Sept.30, 2005
Leased fishing vessel and purse seine net	$ 6,345,962	$ -	$ -	$ 6,345,962
Leasehold improvements	1,552,372	-	-	1,552,372
Computer and office furniture and equipment	21,014	590	-	21,604
Vehicle	34,804	-	-	34,804
Total cost	7,954,152	590	-	7,954,742
Less accumulated depreciation	(6,771,824)	(131,712)	-	(6,903,536)
	$ 1,182,328	$ (131,122)	$ -	$ 1,051,206

(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. The note is collateralized by a chattel mortgage on all property and equipment, including the fishing vessel Mathawmarfach. Part of the loan agreement requires the Company to establish a joint account with FSMDB and to deposit $3,000 per month until the loan is fully paid. A summary of changes in long-term debt is provided below:

	2006	2005
Balance at beginning of year	$ 873,780	$ 966,357
Additions	793,374	-
Payments	(873,780)	(92,577)
Balance at end of year	793,374	873,780
Less current portion	(159,859)	(100,942)
Long-term debt	$ 633,515	$ 772,838

(6) Long-Term Debt, Continued

Future debt service on the above debt is as follows:

Year ending September 30,	Principal	Interest
2007	$ 159,859	$ 83,014
2008	230,575	93,255
2009	252,204	71,626
2010	150,736	44,536
	$ 793,374	$ 292,431

On August 11, 2006, the Company paid-off its existing loan with FSMDB as a condition to the granting of the new loan.

(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 is provided hereunder:

	2006	2005
Fuel	$ 1,572,502	$ 1,276,731
Crew salaries and wages	1,184,121	1,142,230
Repair and maintenance	910,787	296,579
License, agent and port fees	326,475	275,229
Insurance	269,058	246,015
Management fee	249,054	169,400
Depreciation	122,292	122,954
Salt and provisioning	96,465	88,647
Communications	73,378	75,725
Crew travel	86,153	60,625
Stevedoring	57,921	55,321
Supplies and freight	62,592	34,025
Other vessel expenses	-	603
	$ 5,010,798	$ 3,844,084

(9) Contingencies

The Company is obligated by insurance requirements to have a survey performed by a qualified agent every three to four years. This survey is used to determine whether the vessel should be placed into dry dock for maintenance necessary to meet specifications under all policies. The most recent dry-dock occurred in May 2002 and management has obtained funding to finance its next dry-docking, which will occur in fiscal year 2007.

(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. It 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 Diving Seagull, Inc. (the "Company") has entered into significant transactions with the State, as discussed in Note 6. 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.

(12) Impairment of Investment

In September 2004, the Company advanced $500,000 to Palau Rock Island, a corporation incorporated under the laws of the Republic of Palau and doing business as Palau Micronesia Air (PMAir), a start-up passenger airline. From October 2004 to January 3, 2005, the Company advanced an additional $550,000 to PMAir. Of the total $1,050,000 advanced, $550,000 is subject to a promissory note signed on January 12, 2005, the other $500,000 is intended to represent an equity investment; however, only 2,500 shares of common stock at $100 par value per share were issued to the Company on December 9, 2004. Additional shares have not been received. PMAir has ceased significant operations, has not submitted audited financial statements and has not evidenced an ability to fulfill the going concern assumption. Therefore, these assets are considered to be impaired and an impairment expense has accordingly been recorded.

Deloitte.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: +1 671 646 3884
Fax: +1 671 649 4932
www.deloitte.com

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 the financial statements of The Diving Seagull, Inc. (the Company), as of and for the year ended September 30, 2006, and have issued our report thereon dated February 7, 2007. 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 Company's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation 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 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*.

However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Company in a separate letter dated February 7, 2007.

This report is intended for the information of the Board of Directors and management of the Company, federal awarding agencies, pass-through entities, cognizant audit and other federal agencies and is not intended to be, and should not be, used by anyone other than those specified parties.

Deloitte & Touche LLP

February 7 2007