

**NATIONAL FISHERIES CORPORATION  
FEDERATED STATES OF MICRONESIA  
AND SUBSIDIARIES**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**SEPTEMBER 30, 2003**

## **INDEPENDENT AUDITORS' REPORT**

The Board of Directors  
National Fisheries Corporation:

We have audited the accompanying consolidated statement of net assets of the National Fisheries Corporation (NFC) and subsidiaries, a component unit of the Federated States of Micronesia National Government, as of September 30, 2003, and the related consolidated statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of NFC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraphs, 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 NFC'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, 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.

Documentary evidence supporting other income \$91,457 as of September 30, 2003 was not available for inspection. We were not able to perform alternative procedures to satisfy ourselves as to the fairness of this amount.

The September 30, 2003 financial statements of Micronesia Longline Fishing Company (MLFC), an investee of NFC, have not been audited and the ultimate impact on the accompanying financial statements is unknown.

Financial statements supporting NFC's investment in Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture Inc. at September 30, 2003, were not available for inspection.

In our opinion, except for the effects of adjustments, if any, had other income been supported, had financial statements to support NFC's investment in Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture Inc., and had audited financial statements of Micronesia Longline Fishing Company been provided, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of NFC and subsidiaries, as of September 30, 2003, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

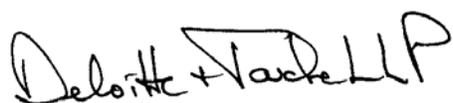
The accompanying financial statements have been prepared assuming that NFC will continue as a going concern. As discussed in note 7 to the financial statements, NFC has incurred substantial losses from operations. This condition raises substantial doubt about its ability to continue as a going concern.

Our audit of the 2003 consolidated financial statements of NFC was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The combining and consolidating statements of net assets (pages 14 and 16) and the combining and consolidating statements of revenues, expenses and changes in net assets (pages 15 and 17) are presented for purposes of additional analysis rather than to present the financial position and results of operations of the individual companies and are not a required part of the basic consolidated financial statements. This additional information is the responsibility of the Company's management. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements of National Fisheries Corporation as of and for the years ended September 30, 2003, and in our opinion, except for the effects, if any, of the matters discussed in paragraphs three to five above, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

As discussed in note 1 to the financial statements, NFC adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, as of October 1, 2002.

The Management Discussion and Analysis on pages 3 and 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 NFC'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 July 4, 2005, on our consideration of NFC'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 read in conjunction with this report in considering the results of our audit.



July 4, 2005

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

## Management Discussion and Analysis September 30, 2003

This section of the National Fisheries Corporation's (NFC) annual financial report presents our discussion and analysis of NFC's financial performance and provides an overview of NFC's activities for the fiscal year ended September 30, 2003.

The National Fisheries Corporation is a government owned corporation, created under Public Law No. 3-14 by the 3<sup>rd</sup> Congress of the Federated States of Micronesia. The main purpose of NFC is to promote the development of the fishing industry in the FSM. It is for this purpose that NFC initially engage itself with its subsidiaries; Yap Fresh Tuna Inc, Chuuk Fresh Tuna Inc., Kosrae Sea Ventures Inc., Micronesian Longline Fishing Co., etc. However, due to the drastic decline in the number of vessels utilizing YFTI and CFTI, NFC was force to venture into the actual operation of long-line fishing vessels, trading of fishing supplies and airfreight business. Micronesia Longline Fishing Co. being NFC's fishing arm is operating nine longline fishing vessels. Fish catch are shipped via airfreight to Japan for auction to the sashimi market. NFC itself is operating its own fishing vessel and manage vessels, however, it's major source of income comes from airfreight business, issuing of permits to foreign fishing company and the trading of baitfish and fishing supplies.

### Overview of Financial Statement

The financial statements presented herein include all of the activities of NFC. Included in this report are the Statement of Net Assets and the Statement of Revenue and Expense of NFC's own operations and that of Micronesia Longline Fishing Co. (MLFC). Excluded from the statements are NFC's subsidiaries; namely YFTI, CFTI, and KSVI. The accounts of NFC are organized as a proprietary fund. Proprietary funds are used by governmental units that are operated in a manner similar to private business enterprises.

NFC's budget is prepared by management with the concurrence of the board of directors. The budget is then forwarded to the President's budget committee which in turn submits it to Congress for approval.

### Summary Statement of Net Assets

Assets:	
Current assets	\$ 2,223,084
Fixed assets, net	<u>2,738,634</u>
Total assets	\$ <u>4,961,718</u>
Liabilities:	
Current liabilities	\$ <u>11,244,812</u>
Total liabilities	<u>11,244,812</u>
Net assets:	
Invested in capital assets, net of related debt	1,525,694
Unrestricted	<u>(7,808,788)</u>
Total net assets	<u>(6,283,094)</u>
Total liabilities and net assets	\$ <u>4,961,718</u>

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Management Discussion and Analysis  
September 30, 2003

## Financial Highlights

The major portion of the \$2.2 million of current assets is inventory, which accounts for 40%, amounting to \$889 K. This is comprised of inventories of baitfish, fishing gear and packing materials, and MLFC accounts for most of it. Cash accounts for 22% of current assets with the value of \$491K. NFC accounts for \$404K, mainly from its airfreight and transshipment operation. Accounts receivable and inter-company receivables account for 18% and 16% respectively, again mainly from NFC. The remaining 4% is from advances and prepayments. The total fixed assets of more than \$2.7 are mainly from MLFCs fishing vessels and spare parts, which accounts for \$1.9 million, which is approximately 70%; the remaining 30% is from NFC's owned fishing vessels / spare parts and office equipment.

The total current liabilities of more than \$11 million are mainly due to the \$8.2 million loan from the National Government. That balance comprises 73% of the total (\$3.6 million by NFC and \$4.6 million by MLFC). Accounts payable (Trade) accounts for 8% at \$910K, interest payable accounts for 9% of which approximately \$1 million is MLFC's, and NFC's lease payable of \$992K accounts for the other 9%.

A decrease of about \$1.1 million in the total net assets was brought about by losses from operations for the fiscal year bringing the total Net Assets for the year to approximately negative \$6.3 million.

## Summary Statement of Revenue and Expense

Sales	\$ 8,209,498
Cost of Sales	<u>7,582,134</u>
Gross Profit	627,364
Operating Expenses	<u>1,966,912</u>
Loss from Operations	(1,339,548)
Other Income (Expense)	<u>197,066</u>
Decrease in Net Assets	\$ <u>(1,142,482)</u>

## Financial Highlights

The total sales of approximately \$8 million is divided equally between NFC and MLFC. MLFC's main source of revenue is from fish sales while NFC's is divided between the airfreight operation and trading baitfish and supplies. The main component of the cost of sales of \$7,582K are fuel, airfreight fees, baitfish and supplies, crew salaries, port and transshipment fees, provisioning, and packing materials.

The Operating cost of \$1.9 million is mainly due to the allowance for bad debts which accounts for 41%, which equates to \$805K. Next is payroll, which accounts for 25%, \$482K, depreciation and rent accounts for 10% and 8%, respectively. Communication, utilities, repairs and maintenance, office, professional fees, taxes and miscellaneous expense account for the remaining 16%.

Adding the National Government's subsidy of \$231,178 for NFCs operations less the \$34,112 from other income and expense, results in a total decrease in net assets of \$1,142,482.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

## Consolidated Statement of Net Assets September 30, 2003

### ASSETS

Current assets:		
Cash	\$	491,167
Accounts receivable, net		395,378
Advances receivable		43,324
Inventory		889,063
Due from affiliates, net		352,245
Prepays and other assets		<u>51,907</u>
Total current assets		2,223,084
Property and equipment, net		<u>2,738,634</u>
	\$	<u><u>4,961,718</u></u>

### LIABILITIES AND NET ASSETS

Current liabilities:		
Notes payable	\$	8,196,907
Accounts payable		910,289
Interest payable		1,070,704
Lease payable		992,228
Accrued liabilities		<u>74,684</u>
Total liabilities		<u>11,244,812</u>
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt		1,525,694
Unrestricted		<u>(7,808,788)</u>
Total net assets		<u>(6,283,094)</u>
	\$	<u><u>4,961,718</u></u>

See accompanying notes to consolidated financial statements.

## NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

### Consolidated Statement of Revenues, Expenses and Changes in Net Assets Year Ended September 30, 2003

Sales	\$ 8,209,498
Cost of sales	<u>7,582,134</u>
Gross profit	<u>627,364</u>
Operating expenses:	
Bad debts	805,903
Salaries and wages	482,341
Depreciation and amortization	198,159
Rent	162,046
Repairs and maintenance	56,205
Telephone and communication	52,936
Utilities	38,903
Payroll and other taxes	37,186
Office expense	36,300
Travel and entertainment	33,821
Representation	9,186
Contractual services	5,949
Miscellaneous	<u>47,977</u>
Total operating expenses	<u>1,966,912</u>
Loss from operations	<u>(1,339,548)</u>
Other income (expense):	
FSM National Government operating subsidies	231,178
Other income, net	209,182
Interest expense	<u>(243,294)</u>
Total other income, net	<u>197,066</u>
Decrease in net assets	(1,142,482)
Total net assets at beginning of year	<u>(5,140,612)</u>
Total net assets at end of year	<u>\$ (6,283,094)</u>

See accompanying notes to consolidated financial statements.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

## Consolidated Statement of Cash Flows Year Ended September 30, 2003

Cash flows from operating activities:	
Cash received from customers	\$ 8,055,090
Cash paid to suppliers and employees	<u>(10,230,633)</u>
Net cash used by operating activities	<u>(2,175,543)</u>
Cash flows from noncapital financing activities:	
FSM National Government operating subsidies	<u>231,178</u>
Net cash provided by noncapital financing activities	<u>231,178</u>
Cash flows from capital and related financing activities:	
Additions to long-term debt	(3,728,123)
Proceeds from disposal of fixed assets	5,744,011
Interest expense and others	<u>(257,760)</u>
Net cash provided by capital and related financing activities	<u>1,758,128</u>
Net decrease in cash	(186,237)
Cash at beginning of year	<u>677,404</u>
Cash at end of year	\$ <u><u>491,167</u></u>
Cash flows from operating activities:	
Loss from operations	\$ (1,339,548)
Adjustments to reconcile loss from operations to net cash used in operating activities:	
Depreciation and amortization	805,903
Bad debts	198,159
Other	(613,241)
(Increase) decrease in assets:	
Accounts receivable	(783,036)
Advances receivable, net	(32,889)
Inventory	60,230
Due from affiliates	(121,475)
Prepays and other assets	67,735
Increase (decrease) in liabilities:	
Accounts payable	(195,855)
Accrued liabilities	<u>(221,526)</u>
Net cash used in operating activities	\$ <u><u>(2,175,543)</u></u>

See accompanying notes to consolidated financial statements.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
September 30, 2003

## (1) Summary of Significant Accounting Policies

### Reporting Entity

The National Fisheries Corporation (NFC) was created under FSM Public Law No. 3-14 by the third Congress of the Federated States of Micronesia (FSM).

The purpose of the National Fisheries Corporation is to promote the development of commercial pelagic fisheries and related industries within the Federated States of Micronesia's 200 mile Exclusive Economic Zone. NFC is also involved in ancillary activities that support commercial fishery activities. These activities include technical and infrastructure services, manpower training and other related activities promoting commercial fisheries development.

The NFC is a component unit (proprietary fund type) of the FSM National Government. The financial statements of the NFC are incorporated into those of the FSM National Government. Debts and obligations of the NFC are not obligations of the FSM National Government unless specifically authorized by the FSM National Government. To date, no such authorization has been made.

### Principles of Consolidation

The consolidated financial statements include the accounts of NFC and its 97% owned subsidiary, Micronesia Longline Fishing Co., Inc. There are significant intercompany transactions and balances that have not been eliminated in the accompanying financial statements due to the unavailability of financial information from the subsidiaries.

### Basis of Accounting and Basis of Presentation

National Fisheries Corporation operates as a proprietary fund type component unit of the FSM National Government. This fund type is used to account for those operations that are financed and operated in a manner similar to a private business. Because of its fund type, NFC uses the accrual basis of accounting.

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. NFC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

### Allowance for Doubtful Accounts

The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables charged to expenses.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
September 30, 2003

## (1) Summary of Significant Accounting Policies, Continued

### Property and Equipment

Property and equipment are stated at cost or estimated historical cost, less accumulated depreciation. Donated fixed assets are recorded at estimated fair market value at the date received. The provision for depreciation is computed by the straight line method over the estimated useful lives of the assets, ranging from 3 to 15 years depending on the nature of the asset. A singular piece of equipment, vehicles, office equipment, etc. that equals or exceeds \$5,000 is capitalized, except for those assets of the investees, where no set threshold for capitalization of fixed assets has been established.

### Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. In accordance with the provisions of Statement of Financial Accounting Standards No. 43, "Accounting for Compensated Absences," no liability is recorded for nonvesting accumulating rights to receive such pay benefits.

### Investment and Business Development

NFC, in prior years, has invested in various joint ventures with respective agencies in the four states which are directly involved in the exploitation and development of the FSM's fisheries industry. The NFC involvement in these joint ventures varies in nature.

NFC is directly involved in the management of the joint ventures through management and marketing agreements entered into with the respective parties. NFC owns approximately 50% of each of the above joint ventures. NFC also owns 50% of Yap Fresh Tuna, Inc. (YFTI). In prior years, YFTI was consolidated with NFC as NFC management, through a management contract, had effective control. Subsequently, YFTI has been controlled by another party and therefore, YFTI is no longer included in the consolidated entity. The investment in YFTI is carried at a zero balance as such was its carrying value at September 30, 1998.

In addition to the above, the NFC also manages various longline fishing vessels for municipal governments in the FSM. It is expected that the NFC will be involved in similar arrangements with additional entities in the future.

### Cash

For the purpose of the statement of net assets and the statement of cash flows, cash is defined as cash on hand, in savings accounts and time certificates of deposit with initial maturities of ninety days or less. NFC does not require collateralization of its cash in excess of Federal Deposit Insurance Corporation (FDIC) insurance limits; therefore any amounts in excess of these limits are uncollateralized. As of September 30, 2003, \$300,000 is subject to FDIC coverage.

### 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 disclosures 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.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
September 30, 2003

## (1) Summary of Significant Accounting Policies, Continued

### Inventory

Inventory of fishing supplies is valued at the lower of cost (first-in, first-out) or market.

### Net Assets

Net assets represent the residual interest in NFC's assets after liabilities are deducted and consist of three sections: invested in capital assets, net of related debt; restricted and unrestricted. Net assets invested in capital assets, net of debt include capital assets, restricted and unrestricted, net of accumulated depreciation, reduced by outstanding debt net of debt service reserve. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. All other net assets are unrestricted.

### Adoption of New Accounting Principle

For the year ended September 30, 2003, NFC adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement No. 37 and applied those standards on a retroactive basis. 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 the following four net asset categories:

- Invested in capital assets, net of related debt:  
Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
  - Nonexpendable – Net assets subject to externally imposed stipulations that require NFC to maintain them permanently. For the year ended September 30, 2003, NFC does not have nonexpendable net assets.
  - Expendable – Net assets whose use by NFC is subject to externally imposed stipulations that can be fulfilled by actions of NFC pursuant to those stipulations or that expire by the passage of time.
- Unrestricted:  
Net assets that are not subject to externally imposed stipulations. Unrestricted net assets 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.

For fiscal year 2005, NFC will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3) and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. NFC has not evaluated the financial statement impact of the implementation of GASB Statement Nos. 40 and 42.

## NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
September 30, 2003

### (2) Accounts Receivable

Accounts receivable in 2003 are net of an allowance for doubtful accounts as follows:

	<u>Gross</u>	<u>Allowance</u>	<u>Net</u>
Trade	\$ 1,096,517	\$ 701,139	\$ 395,378
Due from affiliates	<u>1,158,148</u>	<u>805,903</u>	<u>352,245</u>
	<u>\$ 2,254,665</u>	<u>\$ 1,507,042</u>	<u>\$ 747,623</u>

### (3) Related Party Transactions

The Company has entered into various transactions with the FSM National Government. These transactions are as follows:

- Operating subsidies of \$231,178 were received in 2003.
- Various loans have been obtained from the FSM National Government or the FSM Development Bank, a component unit of the FSM National Government. These loans are disclosed in note 5.

### (4) Property and Equipment, Net

Detail of property and equipment, net as of September 30, 2003 is as follows:

	<u>Balance at Beginning of Year</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at End of Year</u>
Machinery and equipment	\$ 1,995,965	\$ -	\$(1,967,541)	\$ 28,424
Fishing vessels – purchased	4,103,181	-	(723,210)	3,379,971
Fish processing plant	5,765,282	-	(5,765,282)	-
Fishing vessels – donated	2,351,454	-	-	2,351,454
Fishing equipment – purchased	224,062	-	(135,007)	89,055
Fishing equipment – donated	464,099	-	-	464,099
Office furniture and equipment	308,808	-	(59,999)	248,809
Warehouse tools and equipment	15,246	2,321	-	17,567
Vehicles	<u>63,760</u>	<u>1,806</u>	<u>-</u>	<u>65,566</u>
	15,291,857	4,127	(8,651,039)	6,644,945
Less accumulated depreciation	<u>(6,611,054)</u>	<u>(805,903)</u>	<u>3,510,646</u>	<u>(3,906,311)</u>
	<u>\$ 8,680,803</u>	<u>\$ (801,776)</u>	<u>\$ (5,140,393)</u>	<u>\$ 2,738,634</u>

### (5) Notes Payable

	<u>Balance at Beginning of Year</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at End of Year</u>
National Fisheries Corporation	\$ 3,600,000	\$ -	\$ -	\$ 3,600,000
Micronesia Longline Fishing Co.	5,477,157	-	880,250	4,596,907
Chuuk Fresh Tuna	<u>3,894,526</u>	<u>-</u>	<u>3,894,526</u>	<u>-</u>
	<u>\$12,971,683</u>	<u>\$ -</u>	<u>\$4,774,776</u>	<u>\$ 8,196,907</u>

## NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
September 30, 2003

### (5) Notes Payable, Continued

Notes payable of NFC consist of the following at September 30, 2003:

Loan payable to the FSM National Government due in annual installments of \$44,153, non-interest bearing, collateralized by NFC's shares in YFC, with a term of 16 years, beginning March 1994, ending March 2010.	\$ 750,640
Loan payable to the FSM National Government due in annual installments of \$86,639, non-interest bearing, with a term of 13 years, beginning July 1994, ending July 2007.	1,212,940
Loan payable to the FSM National Government due in annual installments of \$23,363, non-interest bearing, with a term of 16 years, beginning September 1994, ending September 2010.	397,176
Loan payable to FSM National Government due in annual installments of \$29,412, non-interest bearing, with a term of 17 years, beginning October 1995, ending October 2011.	500,000
Loan payable to the FSM National Government due in annual installments of \$5,000, non-interest bearing, with a term of 20 years, beginning April 1995, ending April 2014.	100,000
Loan payable to the FSM National Government due in annual installments of \$1,962, non-interest bearing, with a term of 20 years, beginning April 1995, ending April 2014.	39,244
Loan payable to the FSM National Government due in annual installments of \$5,000, non-interest bearing, with a term of 20 years, beginning November 1994, ending April 2013. 100,000	
Loan payable to the FSM National Government with no terms.	<u>500,000</u>
Total debt of NFC	3,600,000
Micronesia Longline Fishing Company (MLFC) note payable	<u>4,596,907</u>
Total debt of NFC and subsidiaries	8,196,907
Less current portion	<u>(8,196,907)</u>
Long-term debt, net of current portion	\$ <u>          -</u>

The Company is in default on its debt issues and therefore all related debt has been classified as current.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements  
September 30, 2003

## (5) Notes Payable, Continued

Due to the absence of audited financial statements of MLFC, no detail of this debt has been provided hence, required disclosures have not been provided.

## (6) Contingencies

### Litigation

NFC is party to several legal proceedings arising from operations. External legal counsel represents that the ultimate outcome of the lawsuits cannot be predicted at this time, therefore, no provision for any related liability is made in the financial statements.

## (7) Going Concern

The Company has incurred substantial losses from operations. This condition raises substantial doubt about the Company's ability to continue as a going concern. The Company, as a component unit of the FSM National Government, is dependent on the FSM National Government for its cash flows.

## (8) Risk Management

National Fisheries Corporation is substantially self-insured for all risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

## (9) Reconciliation of Opening Deficit and Opening Cash

### Deficit:

Balance previously reported as of September 30, 2002	\$ (4,786,917)
Non-inclusion of CFTI and KSVI	<u>(353,695)</u>
Balance as reported in the accompanying financial statements	\$ <u>(5,140,612)</u>

### Cash:

Balance previously reported as of September 30, 2002	\$ 688,543
Non-inclusion of CFTI and KSVI	<u>(11,139)</u>
Balance as reported in the accompanying financial statements	\$ <u>677,404</u>

**NATIONAL FISHERIES CORPORATION (NFC) AND SUBSIDIARIES**

Combining Statements of Net Assets - NFC  
September 30, 2003

<u>ASSETS</u>	<u>Corporate</u>	<u>Fishing Operations</u>	<u>Airfreight Operations</u>	<u>Transshipment Operations</u>	<u>Baitfish Services</u>	<u>Total</u>
Current assets:						
Cash	\$ 20,964	\$ 11,748	\$ 106,807	\$ 212,088	\$ 52,517	\$ 404,124
Accounts receivable, net	538	24,604	67,800	26,458	207,553	326,953
Advances receivable, net	1,764	300	3,448	342	-	5,854
Inventory	-	-	-	-	150,563	150,563
Due from affiliates	-	(6)	164,945	38,380	148,926	352,245
Intercompany receivable, net	-	<u>(243,565)</u>	<u>152,527</u>	<u>12,385</u>	<u>89,380</u>	<u>10,727</u>
 Total current assets	 23,266	 (206,919)	 495,527	 289,653	 648,939	 1,250,466
Investments	486,855	-	-	-	-	486,855
Fixed assets, net	-	<u>828,709</u>	-	-	<u>4,100</u>	<u>832,809</u>
	<u>\$ 510,121</u>	<u>\$ 621,790</u>	<u>\$ 495,527</u>	<u>\$ 289,653</u>	<u>\$ 653,039</u>	<u>\$ 2,570,130</u>
 <u>LIABILITIES AND NET ASSETS</u>						
Current liabilities:						
Current portion of notes payable	\$ 1,787,060	\$ 1,312,940	\$ 500,000	\$ -	\$ -	\$ 3,600,000
Accounts payable	16,747	3,375	420,276	71,562	54,651	566,611
Lease payable	-	-	992,228	-	-	992,228
Accrued liabilities	<u>2,033</u>	<u>4,125</u>	<u>846</u>	<u>623</u>	<u>-</u>	<u>7,627</u>
 Total liabilities	 <u>1,805,840</u>	 <u>1,320,440</u>	 <u>1,913,350</u>	 <u>72,185</u>	 <u>54,651</u>	 <u>5,166,466</u>
Net assets:						
Unrestricted	<u>(1,295,719)</u>	<u>(698,650)</u>	<u>(1,417,823)</u>	<u>217,468</u>	<u>598,388</u>	<u>(2,596,336)</u>
 Total net assets	 <u>(1,295,719)</u>	 <u>(698,650)</u>	 <u>(1,417,823)</u>	 <u>217,468</u>	 <u>598,388</u>	 <u>(2,596,336)</u>
	<u>\$ 510,121</u>	<u>\$ 621,790</u>	<u>\$ 495,527</u>	<u>\$ 289,653</u>	<u>\$ 653,039</u>	<u>\$ 2,570,130</u>

See accompanying independent auditors' report.

**NATIONAL FISHERIES CORPORATION (NFC) AND SUBSIDIARIES**

Combining Statement of Revenues, Expenses and Changes in Net Assets - NFC  
Year Ended September 30, 2003

	<u>Corporate</u>	<u>Fishing Operations</u>	<u>Airfreight Operations</u>	<u>Transshipment Operations</u>	<u>Baitfish Services</u>	<u>Total</u>
Sales	\$ 22,911	\$ 278,255	\$ 3,341,716	\$ 42,846	\$ 593,667	\$ 4,279,395
Cost of sales	-	303,763	3,069,891	-	417,766	3,791,420
Gross profit (loss)	<u>22,911</u>	<u>(25,508)</u>	<u>271,825</u>	<u>42,846</u>	<u>175,901</u>	<u>487,975</u>
Operating expenses:						
Depreciation and amortization	-	194,574	-	-	683	195,257
Salaries and wages	82,076	35,328	126,908	42,254	8,006	294,572
Bad debts	276,430	38,535	122,433	250,200	118,305	805,903
Rent	54,016	7,200	48,267	-	9,900	119,383
Telephone and communication	17,713	-	20,852	-	-	38,565
Travel and entertainment	16,486	4,060	2,279	855	2,221	25,901
Utilities	-	-	5,975	-	29,234	35,209
Payroll and other taxes	5,256	2,984	12,138	2,294	-	22,672
Repairs and maintenance	-	37,365	-	-	-	37,365
Office expense	4,794	643	23,480	505	170	29,592
Representation	5,218	-	994	-	-	6,212
Contractual services	-	-	1,900	-	-	1,900
Miscellaneous	7,321	2,023	5,900	7,336	1,789	24,369
Total operating expenses	<u>469,310</u>	<u>322,712</u>	<u>371,126</u>	<u>303,444</u>	<u>170,308</u>	<u>1,636,900</u>
Operating income (loss)	<u>(446,399)</u>	<u>(348,220)</u>	<u>(99,301)</u>	<u>(260,598)</u>	<u>5,593</u>	<u>(1,148,925)</u>
Other income (expense):						
FSM appropriation	145,000	-	86,178	-	-	231,178
Other income (expense), net	109,850	(2,867)	(75,453)	206,559	(29,541)	208,548
Interest expense	(2,840)	-	-	-	-	(2,840)
Total other income (expense), net	<u>252,010</u>	<u>(2,867)</u>	<u>10,725</u>	<u>206,559</u>	<u>(29,541)</u>	<u>436,886</u>
Decrease in net assets	(194,389)	(351,087)	(88,576)	(54,039)	(23,948)	(712,039)
Total net assets at beginning of year	<u>(1,101,330)</u>	<u>(347,563)</u>	<u>(1,329,247)</u>	<u>271,507</u>	<u>622,336</u>	<u>(1,884,297)</u>
Total net assets at end of year	\$ <u>(1,295,719)</u>	\$ <u>(698,650)</u>	\$ <u>(1,417,823)</u>	\$ <u>217,468</u>	\$ <u>598,388</u>	\$ <u>(2,596,336)</u>

See accompanying independent auditors' report.

**NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES**

Consolidating Statement of Net Assets  
September 30, 2003

ASSETS	National	Micronesia	Combined	Consolidating		Consolidated
	Fisheries	Longline Fishing		Entries		
	Corporation	Co., Inc.	Balance	Debit	Credit	Balance
<b>Current assets:</b>						
Cash	\$ 404,124	\$ 87,043	\$ 491,167	\$ -	\$ -	\$ 491,167
Accounts receivable, net	326,953	68,425	395,378	-	-	395,378
Advances receivable, net	5,854	37,470	43,324	-	-	43,324
Inventory	150,563	738,500	889,063	-	-	889,063
Due from affiliates	352,245	-	352,245	-	-	352,245
Intercompany receivables, net	10,727	-	10,727	-	10,727	-
Prepays and other assets	-	51,907	51,907	-	-	51,907
<b>Total current assets</b>	<b>1,250,466</b>	<b>983,345</b>	<b>2,233,811</b>	<b>-</b>	<b>10,727</b>	<b>2,223,084</b>
Investments	486,855	-	486,855	-	486,855	-
Fixed assets, net	832,809	1,905,825	2,738,634	-	-	2,738,634
	<u>\$ 2,570,130</u>	<u>\$ 2,889,170</u>	<u>\$ 5,459,300</u>	<u>\$ -</u>	<u>\$ 497,582</u>	<u>\$ 4,961,718</u>
<b>LIABILITIES AND NET ASSETS</b>						
<b>Liabilities:</b>						
Current portion of notes payable	\$ 3,600,000	\$ 4,596,907	\$ 8,196,907	\$ -	\$ -	\$ 8,196,907
Accounts payable	566,611	343,678	910,289	-	-	910,289
Interest payable	-	1,070,704	1,070,704	-	-	1,070,704
Lease payable	992,228	-	992,228	-	-	992,228
Accrued liabilities and others	7,627	77,784	85,411	10,727	-	74,684
<b>Total current liabilities</b>	<b>5,166,466</b>	<b>6,089,073</b>	<b>11,255,539</b>	<b>10,727</b>	<b>-</b>	<b>11,244,812</b>
<b>Net assets:</b>						
Investment in fixed assets	-	-	-	-	1,525,694	1,525,694
Unrestricted	(2,596,336)	(3,199,903)	(5,796,239)	2,012,549	-	(7,808,788)
<b>Total net assets</b>	<b>(2,596,336)</b>	<b>(3,199,903)</b>	<b>(5,796,239)</b>	<b>2,012,549</b>	<b>1,525,694</b>	<b>(6,283,094)</b>
	<u>\$ 2,570,130</u>	<u>\$ 2,889,170</u>	<u>\$ 5,459,300</u>	<u>\$ 2,023,276</u>	<u>\$ 1,525,694</u>	<u>\$ 4,961,718</u>

See accompanying independent auditors' report.

**NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES**

Consolidating Statement of Revenues, Expenses and Changes in Net Assets  
Year Ended September 30, 2003

	National Fisheries Corporation	Micronesia Longline Fishing Co., Inc.	Combined Balance	Consolidating Entries		Consolidated Balance
				Debit	Credit	
Sales	\$ 4,279,395	\$ 3,930,103	\$ 8,209,498	\$ -	\$ -	\$ 8,209,498
Cost of Sales	<u>3,791,420</u>	<u>3,790,714</u>	<u>7,582,134</u>	<u>-</u>	<u>-</u>	<u>7,582,134</u>
Gross profit	<u>487,975</u>	<u>139,389</u>	<u>627,364</u>	<u>-</u>	<u>-</u>	<u>627,364</u>
Operating Expenses:						
Depreciation and amortization	195,257	2,902	198,159	-	-	198,159
Salaries and wages	294,572	187,769	482,341	-	-	482,341
Bad debts	805,903	-	805,903	-	-	805,903
Rent	119,383	42,663	162,046	-	-	162,046
Telephone and communication	38,565	14,371	52,936	-	-	52,936
Travel and entertainment	25,901	7,920	33,821	-	-	33,821
Utilities	35,209	3,694	38,903	-	-	38,903
Payroll and other taxes	22,672	14,514	37,186	-	-	37,186
Repairs and maintenance	37,365	18,840	56,205	-	-	56,205
Office expense	29,592	6,708	36,300	-	-	36,300
Representation	6,212	2,974	9,186	-	-	9,186
Contractual services	1,900	4,049	5,949	-	-	5,949
Miscellaneous	<u>24,369</u>	<u>23,608</u>	<u>47,977</u>	<u>-</u>	<u>-</u>	<u>47,977</u>
Total operating expenses	<u>1,636,900</u>	<u>330,012</u>	<u>1,966,912</u>	<u>-</u>	<u>-</u>	<u>1,966,912</u>
Operating loss	<u>(1,148,925)</u>	<u>(190,623)</u>	<u>(1,339,548)</u>	<u>-</u>	<u>-</u>	<u>(1,339,548)</u>
Other income (expense):						
FSM appropriation	231,178	-	231,178	-	-	231,178
Other income (expenses), net	208,548	634	209,182	-	-	209,182
Interest expense	<u>(2,840)</u>	<u>(240,454)</u>	<u>(243,294)</u>	<u>-</u>	<u>-</u>	<u>(243,294)</u>
Total other income (expense), net	<u>436,886</u>	<u>(239,820)</u>	<u>197,066</u>	<u>-</u>	<u>-</u>	<u>197,066</u>
Increase (decrease) in net assets	(712,039)	(430,443)	(1,142,482)	-	-	(1,142,482)
Total net assets at beginning of year	<u>(1,884,297)</u>	<u>(2,769,460)</u>	<u>(4,653,757)</u>	<u>486,855</u>	<u>-</u>	<u>(5,140,612)</u>
Total net assets at end of year	<u><u>\$ (2,596,336)</u></u>	<u><u>\$ (3,199,903)</u></u>	<u><u>\$ (5,796,239)</u></u>	<u><u>\$ 486,855</u></u>	<u><u>\$ -</u></u>	<u><u>\$ (6,283,094)</u></u>

See accompanying independent auditors' report.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED  
UPON THE ENGAGEMENT TO AUDIT PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

The Board of Directors  
National Fisheries Corporation:

We have audited the financial statements of the National Fisheries Corporation (NFC), as of and for the year ended September 30, 2003, and have issued our report thereon dated July 4, 2005, which report was qualified due to our inability to examine evidence regarding investments in and disclosures related to investees and other income. 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**

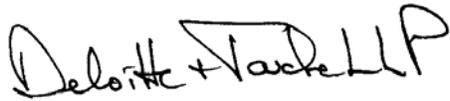
In planning and performing our audit, we considered NFC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect NFC's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings as items 2003-1 through 2003-5.

A material weakness is a reportable 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we believe finding numbers 2003-1 through 2003-5 to be material weaknesses.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether NFC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 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 NFC, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Deloitte + Tuckers LLP". The signature is written in a cursive, stylized font.

July 4, 2005

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

## Schedule of Findings and Questioned Costs Year Ended September 30, 2003

### Investee's Financial Statements

#### Finding No. 2003-1

Criteria: NFC should ensure that its investees are audited at the end of each fiscal year.

Condition: The September 30, 2003, financial statements of Micronesia Longline Fishing Company, investee of NFC, have not been audited and the ultimate impact on the financial statements is uncertain.

Cause: The cause of this condition is unknown.

Effect: The effect of this condition is the potential misstatement of the financial statements at September 30, 2003.

Prior Year Status: This condition was reported in the National Fisheries Corporation audits for fiscal years 1997, 1998, 1999, 2000, 2001, and 2002.

Recommendation: We recommend that NFC ensure that its investees provide audited financial statements.

Auditee Response: This has been an Audit Finding since 2000 and NFC can not do anything since we cannot afford to finance the audit cost of our investees.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

## Schedule of Findings and Questioned Costs Year Ended September 30, 2003

### Absence of Investee's Financial Statements

#### Finding No. 2003-2

Criteria: NFC should ensure that its equity investments are properly valued.

Condition: Financial statements supporting NFC's investment in Yap Fishing Corporation, Yap Fresh Tuna, Inc. and Chuuk Fresh Tuna, Inc. were not available for inspection.

Cause: The cause of this condition is that financial statements for these entities have not been provided.

Effect: The effect of this condition is a potential material misstatement of the financial statements.

Prior Year Status: This condition has been reported in prior year audits.

Recommendation: We recommend that NFC ensure that its investees provide audited financial statements on an annual basis.

Auditee Response: This has been an Audit Finding since 2000 and NFC can not do anything since we cannot afford to finance the audit cost of our investees.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

## Schedule of Findings and Questioned Costs Year Ended September 30, 2003

### Unsubstantiated Income

#### Finding No. 2003-3

Criteria: General ledger activities should be supported by documentary evidence.

Condition: Details supporting \$91,457 of other income were not available for inspection.

Cause: The cause of this condition is that this matter appears to have resulted from a reconciliation of intercompany accounts. The reconciliation resulted in a net difference of \$91,457, which was therefore not able to be substantiated.

Effect: The effect of this condition is a qualification of the opinion on the financial statements.

Recommendation: We recommend that NFC ensure that all transactions recorded in its general ledger are supported by documentary evidence.

Auditee Response: This is the result of continually reconciling the Inter Company account and to finally close the account which has a balance of \$551,613 in fiscal year 2001 when we started to do the reconciliation. Discrepancies were brought about mainly in booking AP and AR from investees, namely KSVI, CFTI, YFTI and MLFC.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

## Schedule of Findings and Questioned Costs Year Ended September 30, 2003

### Depreciation Expense

#### Finding No. 2003-4

Criteria: Depreciation expense should be calculated correctly and recorded accordingly.

Condition: Assets that had been written off as no longer useful were still depreciated. Additionally, assets that were fully depreciated were also being depreciated in the subsidiary ledger.

Cause: The cause of this condition is that the subsidiary ledger should be adjusted.

Effect: Misstatements arising from the condition were corrected during the audit process.

Recommendation: We recommend that NFC ensure that subsidiary records reconcile with the general ledger at the end of each fiscal year.

Auditee Response: The Fixed Assets module of our Peachtree Accounting System has been corrupted, we cannot ask for support from the supplier because the version we are using is outdated. We will do the depreciation manually and do adjustments thru GL entries until such time that we upgrade our Accounting Programs.

# NATIONAL FISHERIES CORPORATION AND SUBSIDIARIES

## Schedule of Findings and Questioned Costs Year Ended September 30, 2003

### Intercompany Transactions

#### Finding No. 2003-5

Criteria: NFC should ensure that intercompany transactions are properly reconciled and eliminated from the consolidated financial statements.

Condition: NFC's intercompany receivables and payables and intercompany income and expense were not reconciled by \$10,728 as of September 30, 2003. Since the amount did not eliminate in consolidation, it has been included in accrued liabilities and others within the statement of net assets.

Cause: The cause of this condition is because of the numerous general ledgers kept to account for NFC's activities, inter-fund receivable/payable and income/expense out-of balance conditions continue to occur.

Effect: The effect of this condition is a potential misstatement of the financial statements.

Prior Year Status: This condition was reported in the National Fisheries Corporation audits for fiscal years 1997, 1998, 1999, 2000, 2001, and 2002.

Recommendation: We recommend that NFC maintain only one general ledger for Corporate, Fishing, Air-freight, Baitfish, Transshipment, and Chartered Boat divisions to mitigate the risk of having inter-company receivable/payable and income/expense out-of-balance conditions.

Auditee Response: I will bring this up to our next Board Meeting and have the approval of our Board, once approved I will work on the consolidation of the financial books of all NFC Divisions.