NATIONAL FISHERIES CORPORATION

(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

SEPTEMBER 30, 2007 AND 2006

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
National Fisheries Corporation:

We have audited the accompanying statement of net assets of the National Fisheries Corporation (NFC), a component unit of the FSM National Government, as of September 30, 2007. This financial statement is the responsibility of NFC's management. Our responsibility is to express an opinion on this financial statement 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 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.

NFC has historically consolidated its investment in Micronesia Longline Fishing Company, a 97%-owned corporation, and its investment in Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture Inc., all 50%-owned corporations. Due to the lack of either audited or unaudited financial statements for Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture Inc., the amount by which this departure would affect investments and net assets at September 30, 2007 is not reasonably determinable.

Property and equipment used in operations with a zero book value were removed from the fixed asset register. Accounting principles generally accepted in the United States of America require that property and equipment continue to be carried in the books until disposal occurs.

We were engaged to audit NFC's financial statements for the year ended September 30, 2006; however, the system of financial accounting and reporting for NFC for the year ended September 30, 2006 was inadequate. Because of inadequacies in NFC's accounting records and internal control over financial reporting, we were not able to satisfy ourselves about the account balances presented within the statement of net assets as of September 30, 2006, which enters into the determination of results of operations of NFC for the year ended September 30, 2007.

Because of the significance of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the statements of revenues, expenses, and changes in net assets and of cash flows for the years ended September 30, 2007 and 2006.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be had financial statements to support NFC's investment in Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture Inc. been available, and had property and equipment been accounted for in accordance with accounting principles generally accepted in the United States of America, the statement of net assets referred to in the first paragraph presents fairly, in all material respects, the financial position of NFC as of September 30, 2007, 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.

The Management's Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This 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 measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 12, 2009, on our consideration of NFC's internal control over financial reporting and on 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 12, 2009

NATIONAL FISHERIES CORPORATION
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)

Management Discussion and Analysis
September 30, 2007 and 2006

This section of the National Fisheries Corporation's (NFC) annual audit report presents Management's Discussion and Analysis (MD&A) for the fiscal year ended September 30, 2007. The MD&A is supplementary information required by the Governmental Accounting Standards Board Statement No. 34 (GASB 34) on the reporting model. The preparation of the MD&A is the responsibility of the management of NFC, and it is designed to help the readers in understanding the accompanying financial statements and notes to the financial statements.

Background

The National Fisheries Corporation is a government owned corporation, created under Public Law No. 3-14 by the 3rd Congress of the Federated States of Micronesia. The main purpose of NFC is to promote the development of fishing industry in the FSM. NFC is also involved in ancillary activities that support commercial fishing activities. It is for this purpose that NFC initially engaged itself with its subsidiaries; Yap Fresh Tuna Inc. (YFTI), Chuuk Fresh Tuna Inc.(CFTI), Kosrae Sea Ventures Inc. (KSVI) and Micronesia Longline Fishing Company (MLFC). However, due to the drastic decline in the number of vessels utilizing YFTI and CFTI, NFC was forced to venture into the actual operation of longline fishing vessels, trading of fishing supplies and airfreight business.

MLFC being NFC's fishing arm is operating nine longline fishing vessels. Fish catch are shipped via airfreight to Japan for auction on the sashimi market. NFC itself is managing and operating its own fishing vessel; however, its major source of income comes from airfreight business, issuing of permits to foreign fishing companies, and trading of baitfish and fishing supplies.

Due to drastic economic conditions, NFC's subsidiaries, namely YFTI, CFTI, KSVI and MLFC failed to submit audited financial statements. Latest financial statements received from CFTI were dated September 1998. In FY2006, MLFC's board of directors declared MLFC to be bankrupt. MLFC is now in trust or receivership and a new trustee has been appointed by the FSM Supreme Court.

Because of the unavailability of financial data from NFC investees, balances from these entities were excluded from NFC's financial statements. NFC started the non-inclusion of MLFC's financial data in NFC's financial statements in fiscal year 2004. The investment in CFTI, amounting to $486k, was also written off during the year.

Overview of Fiscal Year 2007

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.

In FY 2007, the financial statements of NFC include the balances of Corporate, Fishing operations, Airfreight operations, Transshipment operations and Baitfish services from previous years until FY 2006. From FY 2006 onwards, the four main activities of the company consisting of airfreight, baitfish, fishing and transshipment are no longer in operation.

For the current year, NFC corporate office activities includes combined activities from fishing operations, licensing of foreign boats, leasing of two fishing vessels and regular corporate and administrative functions.

Revenue sources of NFC operations are from the FSM National Government subsidy of $100k, fish grading of $24k, vessel lease of $18k and licensing fees from vessels licensed under the NFC/NORMA agreement of $39k, which represented $365k from licensing fees of which $326k or 89% was remitted to NORMA.

Financial Highlights

NFC implemented the financial reporting standards in accordance with Governmental Accounting Standards Board (GASB) principles in fiscal year 2003. Adopting the GASB principles provide the new financial reporting of the following basic financial statements:

1. Statement of Net Assets (SNA)

The SNA presents what NFC owns (assets), owes (liabilities) and the net assets (the difference between total assets and total liabilities) at the end of the fiscal year. The "net assets" is one indicator of the current financial condition of NFC while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year.

The Statement of Net Assets at September 30, 2007 consists of the balances of Corporate, Fishing, Airfreight, Transshipment and Baitfish Services operations of NFC but does not include the operations of MLFC. NFC started the non-inclusion of MLFC's financial data in NFC's financial statements in fiscal year 2004. In FY2006, MLFC's board of directors declared the MLFC to be bankrupt.

Comparative Statements of Net Assets at September 30, 2007, 2006 and 2005 are summarized below:

	FY 2007	FY 2006	FY 2005
Assets:			
Current assets	$ 129,425	$ 187,239	$ 1,160,215
Noncurrent assets	111,704	719,758	895,842
Total Assets	$ 241,129	$ 906,997	$ 2,056,057
Liabilities:			
Current liabilities	$ 3,862,942	$ 4,880,694	$ 4,859,636
Net assets:			
Invested in capital assets	111,704	232,904	408,987
Unrestricted	(3,733,517)	(4,206,601)	(3,212,566)
	(3,621,813)	(3,973,697)	(2,803,579)
Total Liabilities and net assets	$ 241,129	$ 906,997	$ 2,056,057

Assets: Total assets of $241k are comprised of $129k (or 54%) current assets and $112k (or 46%) fixed assets.

Current assets: The major portion of the $129k current assets is in inventory, which accounts for 69% or $89k. Cash account is $24k or 19% of current assets and the remaining 12% is accounts receivable of $16k. The receivables comprise net trade accounts receivables, advances receivable, and inter-company receivables due from subsidiary companies.

The decline in current assets of $143k is the result of an additional provision for doubtful accounts and the reduction in receivables due from subsidiary companies as well as the write-off of accounts with no supporting documents.

Noncurrent assets: Total noncurrent assets of $112k comprise of property and equipment, net of accumulated depreciation. Total noncurrent assets declined by $608k due to depreciation expense, write-off of the investment in CFTI and the retirement of fixed assets that are no longer in the possession of NFC .

Liabilities: NFC's liabilities of $3.863 million are all current and consist of a $3.6 million loan from the FSM National Government, which comprises 93% of total NFC liabilities, other accounts payable and accrued liabilities of $263k.

2. Summary Statement of Revenues, Expenses and Changes in Net Assets (SRECNA)

The SRECNA provides information on the financial performance of the current year in terms of revenues and expenses. It presents operating revenues and expenses and the corresponding net operating results, as well as non-operating revenues and expenses. Below is the comparative summary of SRECNA for fiscal years ended September 30, 2007, 2006 and 2005:

	FY 2007	FY 2006	FY 2005
Sales	$ 98,415	$ 276,808	$ 1,375,051
Cost of sales	15,315	176,508	1,268,726
Gross profit	83,100	100,300	106,325
Operating expenses	872,270	1,494,295	651,738
Loss from operations	(789,170)	(1,494,295)	(545,413)
Other income (expense)	1,141,054	223,877	469,645
Change in net assets	351,884	(1,170,118)	(75,768)
Beginning net assets	(3,973,697)	(2,803,579)	(2,727,811)
Ending net assets	$ (3,621,813)	$ (3,973,697)	$ (2,803,579)

Total sales of $98k are from NFC corporate operational activities. Fishing operations closed in May 2006 thus eliminating revenue from sales of fish and reject fish, which is the main reason for the decrease in sales of $178k. The main components of the cost of sales of $15k are fuel, supplies provisioning and packing materials.

Total operating expenses for the year is $872k, which comprises of bad debts of $476k, depreciation expense of $181k, salaries and wages of $106k, rental expense of $29k, utilities of $28k, contractual services of $13k, office expense of $13k, telephone expense of $11k, payroll and other taxes of $7k, travel and entertainment of $5k, repairs and maintenance of $2k and representation and miscellaneous expense of $1k.

Other income of $3,698 million primarily represents write-off of payables that were carried from previous years and correcting entries from previous years. Subsidy from the FSM National Government consists of $100k of other income.

Other expenses of $1.240 million include a loss on investment in CFTI of $487k, recording of loss of $199k from sale of FV Captain Honda, which was sold in January 2006, and a loss of $56k from the sale of FV NFC Kosrae on January 2007.

3. Summary Statement of Cash Flows (SCF)

The SCF presents information about changes in the cash position using the direct method of reporting sources and uses of cash. The direct method reports all major cash inflows and outflows at gross amounts, differentiating the activities into cash flows arising from operating activities, non capital financing and capital and related financing activities.

Below is the summary statement of cash flows:

	FY 2007	FY 2006	FY 2005
Used in operating activities	$ (94,170)	$ (114,374)	$ (317,127)
Provided by non capital financing activities	100,000	135,000	100,000
Used in capital and related financing activities	(979)	(4,274)	-
Net change in cash	4,851	16,352	(217,127)
Cash at beginning of year	19,823	3,471	220,598
Cash at year end	$ 24,674	$ 19,823	$ 3,471

Management's Discussion and Analysis for the year ended September 30, 2006 is set forth in NFC's report on the audit of financial statements, which is dated January 10, 2008. That Discussion and Analysis explains the major factors impacting the 2006 financial statements and can be obtained from the FSM Office of the National Public Auditor's website at www.fsmpublicauditor.fm.

4. Debt and Capital Asset Activities

No significant debt or capital asset activities occurred during the year ended September 30, 2007. For additional information on fixed assets, please refer to Note 4 to the consolidated financial statements.

Economic Outlook

NFC has incurred substantial losses from its regular operations, including investments in Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Ventures, Inc. The accumulated losses of NFC from its investments have severely affected NFC's regular operations. These conditions raise substantial doubt about NFC's ability to continue as a going concern. Currently, NFC is dependent on the FSM National Government for its operating budgets. Financial assistance from the FSM National Government is needed to rehabilitate and to continue the operations of NFC.

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Statements of Net Assets
September 30, 2007 and 2006

	2007	2006
ASSETS		
Current assets:		
Cash	$ 24,674	$ 19,823
Receivables, net of allowance for uncollectible accounts of $715,783 in 2007 and $1,957,095 in 2006	15,898	93,254
Advances	-	128,886
Inventory	88,853	30,748
Total current assets	129,425	272,711
Investment	-	486,854
Property and equipment, net	111,704	232,904
	$ 241,129	$ 992,469
LIABILITIES AND NET ASSETS		
Current liabilities:		
Notes payable	$ 3,600,000	$ 3,600,000
Accounts payable	248,725	367,946
Lease payable	-	992,228
Accrued liabilities	14,217	5,992
Total current liabilities	3,862,942	4,966,166
Contingencies		
Net assets:		
Invested in capital assets	111,704	232,904
Unrestricted	(3,733,517)	(4,206,601)
Total net assets	(3,621,813)	(3,973,697)
	$ 241,129	$ 992,469

See accompanying notes to financial statements.

NATIONAL FISHERIES CORPORATION
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Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2007 and 2006

	2007	2006
Sales	$ 98,415	$ 276,808
Cost of sales	(491,235)	(1,191,732)
Gross loss	(392,820)	(914,924)
Operating expenses:		
Depreciation and amortization	181,238	180,357
Salaries and wages	105,845	129,847
Rent	29,118	44,717
Utilities	28,375	50,100
Contractual services	13,250	5,256
Office expense	12,785	7,931
Telephone and communication	10,631	7,733
Payroll and other taxes	6,766	17,454
Travel and entertainment	5,239	33,541
Repairs and maintenance	1,530	1,625
Representation	1,211	32
Miscellaneous	362	478
Total operating expenses	396,350	479,071
Loss from operations	(789,170)	(1,393,995)
Other income (expense):		
FSM National Government operating subsidy	100,000	135,000
Other income, net	1,586,967	88,877
Loss on disposal of fixed assets	(59,059)	-
Loss on investment in subsidiary	(486,854)	-
Total other income (expense), net	1,141,054	223,877
Change in net assets	351,884	(1,170,118)
Net assets at beginning of year	(3,973,697)	(2,803,579)
Net assets at end of year	$ (3,621,813)	$ (3,973,697)

See accompanying notes to financial statements.

NATIONAL FISHERIES CORPORATION
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Statements of Cash Flows
Years Ended September 30, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Cash received from customers	$ 305,358	$ 104,242
Cash paid to suppliers for goods and services	(295,142)	(73,874)
Cash paid to employees for services	(104,386)	(144,742)
Net cash used in operating activities	(94,170)	(114,374)
Cash flows from noncapital financing activities:		
FSM National Government operating subsidies	100,000	135,000
Net cash provided by noncapital financing activities	100,000	135,000
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(979)	(4,274)
Net cash used for capital and related financing activities	(979)	(4,274)
Net change in cash	4,851	16,352
Cash at beginning of year	19,823	3,471
Cash at end of year	$ 24,674	$ 19,823
Reconciliation of loss from operations to cash flows used in operating activities:		
Loss from operations	$ (789,170)	$ (1,393,995)
Adjustments to reconcile loss from operations to net cash used in operating activities:		
Depreciation and amortization	181,238	180,357
Bad debts	475,920	1,015,224
(Increase) decrease in assets:		
Accounts receivable	78,057	(43,680)
Advances	128,886	(128,886)
Inventory	(58,105)	153,927
Increase (decrease) in liabilities:		
Accounts payable	(119,221)	100,120
Accrued liabilities	8,225	2,559
Net cash used in operating activities	$ (94,170)	$ (114,374)

See accompanying notes to financial statements.

(1) 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 NFC 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.

NFC is a discretely presented component unit of the FSM National Government. The financial statements of NFC are incorporated into those of the FSM National Government. Debts and obligations of 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.

(2) Summary of Significant Accounting Policies

The accounting policies of NFC conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. 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 Principles 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.

GASB issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modify certain other financial statement disclosure requirements.

To conform to the requirements of GASB Statement 34, retained earnings are presented in the following net asset categories:

- Investment in capital assets; capital assets, net of accumulated depreciation, plus construction or improvement of those assets.

- 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.

(2) Summary of Significant Accounting Policies, Continued

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.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. Expenses not meeting this definition are reported as nonoperating expenses.

Cash

Custodial credit risk is the risk that in the event of a bank failure, NFC'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. NFC does not have a deposit policy for custodial credit risk.

As of September 30, 2007 and 2006, the carrying amount of NFC's total cash and cash equivalents and time certificates of deposit were $24,674 and $19,823, respectively, and the corresponding bank balances were $28,931 and $38,008, respectively, all of which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2007 and 2006, all bank deposits were FDIC insured. NFC 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. NFC has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on its deposits.

(2) Summary of Significant Accounting Policies, Continued

Investments 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 has previously been directly involved in the management of certain joint ventures through management and marketing agreements entered into with the respective parties. The investment in Micronesia Longline Fishing Company (MLFC), Yap Fishing Corporation (YFC), Yap Fresh Tuna, Inc. (YFTI), Chuuk Fresh Tuna, Inc. (CFTI), and Kosrae Sea Venture Inc. (KSVI) are accounted for using the equity method and, accordingly, the carrying values of these investments have been reduced to $0. In 2007 and 2006, financial statements for these joint ventures were not available and, therefore the financial position and results of operations of these joint ventures has not been consolidated with NFC's financial statements.

Receivables

Receivables from fishing and ancillary activities are based on contracted prices, which are both interest free and uncollateralized and are primarily due from government agencies, businesses and individuals located within the FSM. 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 collectability of these accounts and prior collection experience. The allowance is established through a provision for uncollectible receivables recorded in the statement of revenues, expenses and changes in net assets.

Inventory

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

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. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

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, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of NFC.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* GASB Statement No. 43 establishes standards for the measurement, recognition, and display of other postemployment 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, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of NFC.

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of NFC.

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 NFC.

In May 2007, GASB issued Statement No. 50, *Pension Disclosures an Amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe the implementation of this statement will have a material effect on the financial statements of NFC.

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 NFC.

(3) Related Party Transactions

NFC has entered into various transactions with the FSM National Government. 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

Capital asset activity for the years ended September 30, 2007 and 2006 follows:

	October 1, 2006	Additions	Deletions	September 30, 2007
Machinery and equipment	$ 28,424	$ -	$ (14,674)	$ 13,750
Fishing vessels – purchased	543,423	-	(543,423)	-
Fishing vessels – donated	2,351,454	-	(853,836)	1,497,618
Fishing equipment – purchased	89,055	-	(89,055)	-
Fishing equipment – donated	464,099	-	(464,099)	-
Office furniture and equipment	212,745	979	(181,409)	32,315
Vehicles	12,745	-	(12,745)	-
	3,701,945	979	(2,159,241)	1,543,683
Less accumulated depreciation	(3,469,041)	(181,238)	2,218,300	(1,431,979)
	$ 232,904	$ (180,259)	$ 59,059	$ 111,704

	October 1, 2005	Additions	Deletions	September 30, 2006
Machinery and equipment	$ 28,424	$ -	$ -	$ 28,424
Fishing vessels – purchased	543,423	-	-	543,423
Fishing vessels – donated	2,351,454	-	-	2,351,454
Fishing equipment – purchased	89,055	-	-	89,055
Fishing equipment – donated	464,099	-	-	464,099
Office furniture and equipment	208,471	4,274	-	212,745
Vehicles	12,745	-	-	12,745
	3,697,671	4,274	-	3,701,945
Less accumulated depreciation	(3,288,684)	(180,357)	-	(3,469,041)
	$ 408,987	$ (176,083)	$ -	$ 232,904

(5) Notes Payable

Notes payable consist of the following at September 30, 2007 and 2006:

	2007	2006
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	$ 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	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.		397,176 397,176
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	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	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	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	100,000	
Loan payable to the FSM National Government with no terms.	500,000	500,000
	$ 3,600,000	$ 3,600,000

NFC is in default on its notes payable and, therefore, all related debt has been classified as current.

Changes in debt during the years ended September 30, 2007 and 2006 are as follows:

Balance at Beginning of Year 2007	Additions	Deletions	Balance at End of Year 2007
$ 3,600,000	$ -	$ -	$ 3,600,000

(5) Notes Payable, Continued

Balance at Beginning of Year 2006	Additions	Deletions	Balance at End of Year 2006
$ 3,600,000	$ -	$ -	$ 3,600,000

(6) Contingencies

NFC is party to various 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 has been made in the financial statements. As of September 30, 2006, NFC owed Aero Micronesia, Inc. $992,228 for the previous lease of an airplane. The Board of Directors approved the write-off of this liability during the year ended September 30, 2007.

NFC is liable for Micronesia Longline Fishing Company's (MLFC) loans payable to the Asian Development Bank. MLFC has defaulted on this loan; however, the FSM National Government has been making required debt service payments on behalf of NFC and it is not possible to predict the ultimate outcome of this matter. No provision for this matter has been made in the accompanying financial statements. The MLFC debt is, instead, recorded in the financial statements of the FSM National Government.

(7) Going Concern

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

(8) Risk Management

NFC 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) Other Income

During the year ended September 30, 2007, NFC recorded net non-operating income of $1,586,967, which represents the write-off of aircraft lease payable, totaling $992,228, and the reconciliation of various asset and liability accounts amounting to a net total of $594,739.

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

The Board of Directors
National Fisheries Corporation:

We have audited the statement of net assets of the National Fisheries Corporation (NFC), as of September 30, 2007, and have issued our report thereon dated February 12, 2009, which was qualified with respect to equity investments and property and equipment, and stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the statements of revenues, expenses, and changes in net assets and of cash flows due to inadequacies in the accounting records and internal control over financial reporting.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered NFC'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 NFC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of NFC's internal control over financial reporting.

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 accounting principles generally accepted in the United States of America 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 deficiencies described in the accompanying Schedule of Findings and Responses (pages 19 through 22) as items 2007-1 through 2007-4 to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or a 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 entity's internal control.

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 that the significant deficiencies described above are 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 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, management, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

February 12, 2009

Other Income

Finding No. 2007-1

Criteria: Adequate documentation, including subsidiary records, should be available to support amounts and items reported in the financial statements.

Condition: Detailed records supporting $1,289,625 of other income were not available for inspection.

Cause: The root cause of the weakness is that subsidiary records are not correctly maintained.

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

Recommendation: We recommend that NFC ensure appropriate maintenance of all subsidiary ledgers to support amounts reported in the financial statements.

Auditee Response: Poor record keeping was a problem in prior years but is now corrected as part of the new management accounting procedures and system. In an effort to clean up the financial statements of NFC and to ensure that the balances reflected are properly supported with details and documents, all account were revisited. The cited entries were the result of this cleaning-up process.

Other income entry of $992K is a write-off of payable to Aero Micronesia which was incurred from previous years until September 1998. There are no supporting documents and as of this date no demand from creditors thus NFC management has agreed to write it off. Entries totaling to $264k is also a result of write off of payable from previous years that were not supported by documents in NFC divisions namely: fishing, baitfish and supplies and corporate. These are intercompany accounts are supposed to be offset or zeroed out during the applicable fiscal year. However due to poor record keeping from previous years these was only cleaned-up in 2007. The total of $24k is made to correct double posting of accounts payable from previous years. The $1k entry is a write-off of payable to MLFC. This company was already declared bankrupt and no demand from them to collect the balance was initiated. All of these entries are supported by journal vouchers duly signed by NFC management. The cited write-offs were also approved by NFC's board of directors.

Other Expense

Finding No. 2007-2

Criteria: Adequate documentation, including subsidiary records, should be available to support amounts and items reported in the financial statements.

Condition: Detailed records supporting $753,945 of other expense were not available for inspection.

Cause: The root cause of the weakness is that subsidiary records are not correctly maintained.

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

Recommendation: We recommend that NFC ensure appropriate maintenance of all subsidiary ledgers to support amounts reported in the financial statements.

Auditee Response: As mentioned above, poor record keeping was a problem in prior years but is now corrected as part of the new management accounting procedures and system. In an effort to clean up the financial statements of NFC and to ensure that the balances reflected are properly supported with details and documents, all account were revisited. The cited entries were the result of this cleaning-up process.

The entry of $486k is the write-off of investment in CFTI. Last audited financial statement submitted from CFTI was on September 1998. Thus the true value of the investment can not be ascertained. Because of these conditions, NFC's Board of Directors approved to write it off. The total entry of $255k is a result from loss of sale of NFC fishing vessels, Captain Honda and NFC Kosrae. The total of $12k entries were the result of adjusting entries to correct the beginning cash balances for the FY 2007. These entries were supported by journal vouchers that are duly approved by NFC's management.

Journal Voucher Entries

Finding No. 2007-3

Criteria: Adjustments to the general ledger should be correct and valid.

Condition: Based on nine journal voucher entries tested, we found that all were incorrect and invalid.

Cause: The root cause of the condition is that the JVs were incorrectly prepared.

Effect: Corrections were made through the audit process.

Recommendation: We recommend that NFC management scrutinize each adjusting journal entry as to correctness and validity before it is entered into the accounting system.

Auditee Response: We concur to this finding and recommendation. Most the cited entries are made to retained earnings when recording adjustments to/ recording opening balance of various accounts at the beginning of the fiscal year. We have already reversed and corrected entries to retained earnings during FY 2007.

Absence of Investee's Financial Statements

Finding No. 2007-4

Criteria: Adequate documentation, i.e. investee's audited financial statements, should be available to support amounts reported in the financial statements.

Condition: Financial statements supporting NFC's investment in Chuuk Fresh Tuna, Inc., Yap Fresh Tuna, Inc., Kosrae Sea Venture, Inc., and Micronesia Longline Fishing Company are not available for inclusion in the NFC consolidation.

Cause: The cause of this condition is that financial statements from the investees 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 management ensure that its investees provide audited financial statements on an annual basis.

Auditee Response: Because of the unavailability of financial data from NFC subsidiaries, balances from these investee's were excluded from NFC's financial statement. NFC started the non-inclusion of MLFC's financial data in NFC's consolidated financial statement in fiscal year 2004. Investment balance from CFTI amounting to $486k was also written off during the year.