

Marine Aquarium Council, Inc. and Subsidiary

(A Nonprofit Organization)

**Consolidated Financial Statements
December 31, 2006 and 2005**

Marine Aquarium Council, Inc. and Subsidiary

(A Nonprofit Organization)

Index

December 31, 2006 and 2005

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Report of Independent Auditor

To the Board of Directors of
Marine Aquarium Council, Inc.

I have audited the accompanying consolidated statement of financial position of Marine Aquarium Council, Inc. and subsidiary as of December 31, 2006, and the related consolidated statements of activities and cash flows for the year then ended. These financial statements are the responsibility of Marine Aquarium Council, Inc.'s management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Marine Aquarium Council, Inc. and subsidiary as of December 31, 2006, and the changes in their net assets and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The financial statements of Marine Aquarium Council, Inc. as of December 31, 2005 and for the year then ended were audited by other auditors whose report, dated September 22, 2006, expressed an unqualified opinion on those statements.

James P. Hasselman, CPA, LLC

Honolulu, Hawai'i
April 27, 2007

Marine Aquarium Council, Inc. and Subsidiary
(A Nonprofit Organization)
Consolidated Statements of Financial Position
December 31, 2006 and 2005

| | 2006 | 2005 |
|---|-------------------|---------------------|
| Assets | | |
| Current assets | | |
| Cash | \$ 185,042 | \$ 1,357,261 |
| Grant and contract receivables | 224,246 | 303,701 |
| Advances to subcontractors | 190,907 | 12,980 |
| Other receivables | 6,426 | 19,906 |
| Total current assets | <u>606,621</u> | <u>1,693,848</u> |
| Other assets | 794 | 227 |
| Total assets | <u>\$ 607,415</u> | <u>\$ 1,694,075</u> |
| Liabilities and Net Assets | | |
| Current liabilities | | |
| Accounts payable and accrued expenses | \$ 68,320 | \$ 99,362 |
| Accrued payroll and related expenses | 67,302 | 48,283 |
| Advance funding on grants and contracts | 468,846 | 1,550,466 |
| Total current liabilities | <u>604,468</u> | <u>1,698,111</u> |
| Commitments and contingencies | | |
| Net assets | | |
| Unrestricted | <u>2,947</u> | <u>(4,036)</u> |
| Total net assets | <u>2,947</u> | <u>(4,036)</u> |
| Total liabilities and net assets | <u>\$ 607,415</u> | <u>\$ 1,694,075</u> |

The accompanying notes are an integral part of the financial statements.

Marine Aquarium Council, Inc. and Subsidiary
(A Nonprofit Organization)
Consolidated Statements of Activities
Years Ended December 31, 2006 and 2005

| | 2006 | 2005 |
|--|------------------|-------------------|
| Change in unrestricted net assets | | |
| Revenue and income | | |
| Grant and contract revenues | \$ 2,699,487 | \$ 2,822,633 |
| Other income | 8,817 | 6,783 |
| Total revenue and income | <u>2,708,304</u> | <u>2,829,416</u> |
| Costs and expenses | | |
| Grant and contract costs | | |
| Direct | 2,447,697 | 2,410,436 |
| Allocated general and administrative | 253,624 | 376,448 |
| | <u>2,701,321</u> | <u>2,786,884</u> |
| Other expenses | - | 34,016 |
| Total costs and expenses | <u>2,701,321</u> | <u>2,820,900</u> |
| Increase in net assets | 6,983 | 8,516 |
| Net assets | | |
| Beginning of year | <u>(4,036)</u> | <u>(12,552)</u> |
| End of year | <u>\$ 2,947</u> | <u>\$ (4,036)</u> |

The accompanying notes are an integral part of the financial statements.

Marine Aquarium Council, Inc. and Subsidiary
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Consolidated Statements of Cash Flows
Years Ended December 31, 2006 and 2005

| | 2006 | 2005 |
|--|--------------------|---------------------|
| Increase (Decrease) In Cash | | |
| Cash flows from operating activities | | |
| Increase in net assets | \$ 6,983 | \$ 8,516 |
| Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities | | |
| Bad debt expense | - | 34,016 |
| Effect of exchange rate changes on cash | 3,560 | (1,562) |
| Decrease (increase) in assets | | |
| Grant and contract receivables, gross | 79,455 | (31,778) |
| Advances to subcontractors | (177,927) | (12,980) |
| Other receivables | 13,480 | (16,364) |
| Other assets | (567) | (17) |
| Increase (decrease) in liabilities | | |
| Accounts payable and accrued expenses | (31,042) | 42,617 |
| Accrued payroll and related expenses | 19,019 | 38,354 |
| Advance funding on grants and contracts | (1,081,620) | 1,276,256 |
| Net cash provided by (used in) operating activities | <u>(1,168,659)</u> | <u>1,337,058</u> |
| Exchange rates | | |
| Effect of exchange rate changes on cash | <u>(3,560)</u> | <u>1,562</u> |
| Net (decrease) increase in cash | <u>(1,172,219)</u> | <u>1,338,620</u> |
| Cash | | |
| Beginning of year | <u>1,357,261</u> | <u>18,641</u> |
| End of year | <u>\$ 185,042</u> | <u>\$ 1,357,261</u> |
| Supplementary Information | | |
| Interest received | \$ 6,022 | \$ 2,086 |

The accompanying notes are an integral part of the financial statements.

Marine Aquarium Council, Inc. and Subsidiary

(A Nonprofit Organization)

Notes to Consolidated Financial Statements

December 31, 2006 and 2005

1. Organization and Operations

The Marine Aquarium Council, Inc. (the “Company”) is a not-for-profit corporation established in Delaware. The Company’s mission is to conserve coral reefs and other marine ecosystems by creating standards and certification for those engaged in the collection and care of ornamental marine life from reef to aquarium. The Company has three Core Standards which outline the requirements for third-party certification of quality and sustainability in the marine aquarium industry from reef to retail:

- The Ecosystem and Fishery Management Core Standard addresses in-situ habitat, stock and species management and conservation by verifying that the collection area is managed according to principles that ensure ecosystem health and the sustainable use of the marine aquarium fishery.
- The Collection, Fishing and Holding Core Standard addresses harvesting of fish, coral, live rock and other coral reef organisms, handling prior to export, holding, plus packaging and transport to ensure the health of the collection area, sustainable use of the marine aquarium fishery and optimal health of the harvested organisms.
- The Handling, Husbandry and Transport Core Standard addresses the handling of marine life during export, import and retail to ensure their optimal health, their segregation from uncertified organisms and proper documentation to show that they pass only from one certified industry operator to another.

The Company’s main office is located in Honolulu, Hawai‘i. The Company has a subsidiary in the United Kingdom and also conducts operations in the Republic of the Fiji Islands (a British Commonwealth), the Republic of the Philippines and the Republic of Indonesia.

The Company is a tax-exempt organization for Federal and State income tax purposes, under Internal Revenue Code Section 501(c)(3).

2. Summary of Significant Accounting Policies

Financial Statement Presentation

The financial statements of the Company are presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America established for not-for-profit organizations.

The Company classifies net assets, support and revenues, and expenses based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Company and changes therein are classified and reported as follows:

- **Unrestricted net assets** – Net assets not subject to donor-imposed stipulations or received with restrictions that were satisfied in the same period.

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- **Temporarily restricted net assets** – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Company and/or the passage of time. At December 31, 2006 and 2005 there were no temporarily restricted net assets.
- **Permanently restricted net assets** – Net assets subject to donor-imposed stipulations that must be maintained permanently by the Company. At December 31, 2006 and 2005 there were no permanently restricted net assets.

Consolidation

The consolidated financial statements present the accounts of the Company – including the combined accounts of foreign operations – and the accounts of a subsidiary entity consolidated under AICPA Statement of Position 94-3: Reporting of Related Entities by Not-for-Profit Organizations (“SOP 94-3”). SOP 94-3 dictates consolidation when one not-for-profit entity has both control over, and an economic interest in, another not-for-profit entity. Intercompany accounts and transactions have been eliminated in consolidation.

Foreign Currency Translation and Transactions

Assets and liabilities of foreign operations and subsidiaries, where the local currency is the functional currency, have been translated at year end exchange rates and statement of activity accounts have been translated using weighted average yearly exchange rates. Adjustments resulting from translation have been recorded as other income or expense in unrestricted net assets within the statement of activities. The cumulative translation adjustments are a component of unrestricted net assets.

Assets, liabilities and transactions that are denominated in currencies other than the Company’s functional currency are remeasured into the functional currency using period end and weighted average exchange rates commensurate with the remeasurement date or period. Adjustments resulting from transaction remeasurement have been recorded as incurred as increases or decreases in unrestricted net assets within the statement of activities.

Use of Estimates in Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles 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. Significant items subject to such estimates and assumptions include the allowance for doubtful accounts, liabilities related to close-out audits, and the carrying value and useful lives of property and equipment. Actual results could differ from those estimates.

Grant and Contract Receivables

Year end grant and contract receivable balances represent billed and unbilled amounts due to the Company from grantors and contractors for reimbursable expenditures incurred by the Company prior to year end. Management analyzes the collectibility of these receivables and establishes an allowance for doubtful accounts when the receivable is deemed uncollectible.

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Advances to Subcontractors

The Company engages subcontractors to assist in the performance of programmatic activity. For subcontractors who are advanced funds, the Company reduces the advance balance and recognizes grant and contract expenses as those expenses are incurred by the subcontractor and reported to the Company. Any balance of funds advanced to subcontractors, but not expended in the current year, is recognized as advances to subcontractors, which is a current asset on the statement of financial position. Advances to subcontractors are either expended by the subcontractor or returned to the Company in the subsequent year.

Furniture, Fixtures and Equipment

Furniture, fixtures and equipment are stated at cost or, in the case of donated assets, at fair value at date of donation. Purchased or donated assets in excess of \$1,000 are capitalized. Renewals and betterments that materially extend the asset lives are capitalized. Capitalized items are depreciated or amortized using the straight-line method over the estimated useful lives of the assets. Repairs and maintenance expenditures are currently expensed. Gains or losses on asset retirement or disposition are reflected in the statement of activities.

Furniture, fixtures and equipment purchased with grant or contract proceeds are expensed as the donor retains an interest in and control over the furniture, fixtures and equipment. At the conclusion of the grant period, the furniture, fixtures and equipment may be utilized by the Company in support of continued activities, may be purchased from the donor or may be reverted back to the donor, depending on the donor's instructions.

Revenue Recognition

A substantial percentage of the Company's revenue is from reimbursable grants and contracts. Revenue is deemed earned and recorded when expenditures are incurred in compliance with specific contract or grant restrictions. Amounts received but not yet earned from grants and contracts are recorded as advance funding on grants and contracts in the statement of financial position.

Grant and contract amounts presented in the statements of activities consist of grants and contracts awarded to the Company from the government or other organizations that require compliance with grant and contract restrictions.

Expenditures under a number of the Company's grant and contract programs are subject to final audits that could result in adjustments to revenue previously recognized and the recognition of liabilities to the grantors and contractors. Management believes that liabilities, if any, resulting from such audits will not have a material effect on the financial statements.

Contributions received for which restrictions are satisfied during the same reporting period are reported as unrestricted revenue.

Allocated General and Administrative Expenses

Allocated general and administrative expenses consists of non-project and non-program expenses including support, communication, administration and other general expenses, funded by grants and contracts.

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Concentrations of Risk

The Company maintains cash with various financial institutions in the State of Hawai'i and other countries. Cash balances maintained in the State of Hawai'i accounts may at times exceed Federally insured limits. Balances in foreign accounts may not be covered by insurance.

Significant portions of the Company's grant and contract revenue are derived from concentrated sources. Disruptions in funding from these sources may have a material adverse affect on the Company's future ability to operate. See note 6 for more information.

Significant portions of the Company's operations are performed in foreign locations and transacted in foreign currencies. However, most of the Company's grants and contracts are denominated in U.S. Dollars. The Company does not hedge against foreign currency fluctuations and is exposed to the risk that fluctuations in exchange rates may cause assets, liabilities or commitments denominated in foreign currencies to be settled in amounts different from those previously reported or budgeted.

Reclassifications

Certain prior-year amounts have been reclassified to conform to the current year presentation.

3. Grants and Contracts Receivable

Grants and contracts receivable at December 31, 2006 and 2005 consisted of the following:

| | 2006 | 2005 |
|---------------------------------|-------------------|-------------------|
| Billed | \$ 124,777 | \$ 71,966 |
| Unbilled | 133,485 | 265,751 |
| Allowance for doubtful accounts | (34,016) | (34,016) |
| | <u>\$ 224,246</u> | <u>\$ 303,701</u> |

Bad debt expense, included in other expenses, amounted to \$0 and \$34,016 in 2006 and 2005, respectively.

4. Advance Funding on Grants and Contracts

Advance funding on contracts were held from the following grantors and contractors at December 31, 2006 and 2005:

| | 2006 | 2005 |
|---|-------------------|---------------------|
| International Finance Corporation | \$ 330,784 | \$ 1,277,879 |
| The David and Lucile Packard Foundation | 126,877 | - |
| Academy for Educational Development | - | 105,111 |
| The John D. and Catherine T. MacArthur Foundation | 4,884 | 118,232 |
| Others | 6,301 | 49,244 |
| | <u>\$ 468,846</u> | <u>\$ 1,550,466</u> |

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5. Lease Commitments

The Company has certain operating leases, primarily for leased building space in various locations, with noncancelable portions through November 2007. The Company also has month-to-month leases or leases with prepaid rent balances. As of December 31, 2006, the future minimum rentals under the noncancelable portions of leases total \$41,140, all of which becomes due in 2007.

Total lease rent expense amounted to \$78,588 and \$81,569 in 2006 and 2005, respectively.

6. Concentration of Revenues

Significant portions of the Company's grant and contract revenue earned in 2006 and 2005 were derived from concentrated sources, summarized as follows:

| | 2006 | 2005 |
|---|---------------------|---------------------|
| International Finance Corporation | \$ 1,741,994 | \$ 1,621,711 |
| U.S. Agency for International Development | 281,062 | 255,042 |
| Academy for Educational Development | 210,107 | 24,823 |
| Ministry of Foreign Affairs - The Netherlands | 155,090 | 293,307 |
| The John D. and Catherine T. MacArthur Foundation | 113,349 | 270,476 |
| Others | 197,885 | 357,274 |
| | <u>\$ 2,699,487</u> | <u>\$ 2,822,633</u> |

7. Foreign Currency Translations and Transactions

The cumulative translation adjustment resulting from the Company's operations where a foreign currency was the functional currency is summarized as a component of unrestricted net assets as follows:

| | Cumulative Translation Adjustment | Other Unrestricted Net Assets | Total Unrestricted Net Assets |
|-----------------------------|--|--|--|
| Balance, January 1, 2005 | \$ - | \$ (12,552) | \$ (12,552) |
| 2005 increase in net assets | - | 8,516 | 8,516 |
| Balance, December 31, 2005 | <u>-</u> | <u>(4,036)</u> | <u>(4,036)</u> |
| 2006 increase in net assets | 1,835 | 5,148 | 6,983 |
| Balance, December 31, 2006 | <u>\$ 1,835</u> | <u>\$ 1,112</u> | <u>\$ 2,947</u> |

Increases or decreases in the cumulative translation adjustment are included in other income or expense, respectively, in the statement of activities.

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Foreign currency gains and losses resulting from transactions denominated in currencies other than the Company's functional currencies are included in the statement of activities as reductions or increases in grant and contract costs. The Company had a \$1,763 gain and a \$9,377 loss from foreign currency transactions in 2006 and 2005, respectively.

8. Functional Allocation of Expenses

Grant and contract costs were comprised of the following expenses:

| 2006 Grant and Contract Costs | | | |
|--|---------------------|---|---------------------|
| | Direct | Allocated General and Administrative | Total |
| Salary and benefits | \$ 576,510 | \$ 63,281 | \$ 639,791 |
| Travel | 179,631 | 8,215 | 187,846 |
| Supplies and equipment | 124,815 | 2,582 | 127,397 |
| Contractual services | 1,428,479 | 127,890 | 1,556,369 |
| Communication | 58,739 | 13,862 | 72,601 |
| Workshops and meetings | 22,548 | 390 | 22,938 |
| Rent and maintenance - office and equipment | 52,918 | 25,771 | 78,689 |
| Miscellaneous | 4,057 | 11,633 | 15,690 |
| | <u>\$ 2,447,697</u> | <u>\$ 253,624</u> | <u>\$ 2,701,321</u> |

| 2005 Grant and Contract Costs | | | |
|--|---------------------|---|---------------------|
| | Direct | Allocated General and Administrative | Total |
| Salary and benefits | \$ 640,902 | \$ 133,074 | \$ 773,976 |
| Travel | 178,776 | 16,865 | 195,641 |
| Supplies and equipment | 115,295 | 3,845 | 119,140 |
| Contractual services | 1,342,698 | 138,138 | 1,480,836 |
| Communication | 45,622 | 14,161 | 59,783 |
| Workshops and meetings | 21,660 | 853 | 22,513 |
| Rent and maintenance - office and equipment | 44,677 | 37,615 | 82,292 |
| Miscellaneous | 20,806 | 31,897 | 52,703 |
| | <u>\$ 2,410,436</u> | <u>\$ 376,448</u> | <u>\$ 2,786,884</u> |

9. Related Parties

The Company is governed by a board of directors consisting of individuals representing the industry, conservation organizations and other stakeholders in the regions that the Company serves.

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Much of the Company's grant and contract activity is incurred in support of programs that benefit local industry operators (e.g. fishers, companies) and local communities. The directors have positions of leadership in the areas and/or among the industry, conservation organizations and other stakeholders critical to the mission of the Company.

10. Defined Contribution Retirement Plans

The Company sponsors two defined contribution plans for its United States employees. A 403(b) plan, completely funded by employee contributions, is available to all employees upon the start of their employment. A SEP IRA plan, available to employees after their second employment anniversary, is completely funded by monthly Company contributions equal to 10% of an employee's monthly salary. Employees are fully vested at the start of their participation in the SEP IRA plan. Company contributions to the SEP IRA plan amounted to \$21,697 and \$14,590 for the years ended December 31, 2006 and 2005, respectively. The Company has not paid any administrative expenses on behalf of the plans in the years ended December 31, 2006 and 2005.

11. Subsequent Event

In 2007, several employees, constituting the majority of the Company's senior management, resigned from their positions for unrelated reasons. Among the resignations were the Executive Director, Finance Director, Asia-Pacific Operations Director, and Philippines Country Director. The effect of the resignations is uncertain, but there exists a possibility that they may adversely affect the Company's future operating continuity. The Board of Directors is appointing interim management and intends to permanently replace necessary vacancies.