

**CAROLINE ISLANDS AIR, INC.**

**(A COMPONENT UNIT OF THE FEDERATED STATES OF  
MICRONESIA NATIONAL GOVERNMENT)**

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**FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2020 AND 2019**

**CAROLINE ISLANDS AIR, INC.**  
**(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Years Ended September 30, 2020 and 2019  
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## **INDEPENDENT AUDITORS' REPORT**

Board of Directors  
Caroline Islands Air, Inc.:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Caroline Islands Air, Inc., a component unit of the Federated States of Micronesia National Government, which comprise the statements of net position as of September 30, 2020 and 2019, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

#### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Caroline Islands Air, Inc. as of September 30, 2020 and 2019, and the changes in its financial position and its cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## ***Emphasis of Matter***

As discussed in Note 7 to the financial statements, COVID-19 has resulted in immediate adverse impact to the Company's operations. However, the length of time such conditions will continue to exist are not estimable at present. Our opinion is not modified with respect to this matter.

## ***Other Matters***

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 to 5 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated February 11, 2022, on our consideration of Caroline Islands Air, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely 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 effectiveness of Caroline Islands Air, Inc.'s internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Caroline Islands Air, Inc.'s internal control over financial reporting and compliance.

*Deloitte & Touche LLP*

February 11, 2022

**CAROLINE ISLANDS AIR, INC.**  
**(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Management's Discussion and Analysis  
Years Ended September 30, 2020 and 2019

This section of the Caroline Islands Air, Inc. (CIA) annual audit report presents the Management's Discussion and Analysis (MD&A) for the fiscal years ended September 30, 2020 and 2019. MD&A is a supplementary information required by the Governmental Accounting Standards Board Statement No. 34 (GASB 34) on reporting model. The preparation of MD&A is the responsibility of the management of CIA, and it is designed to help the reader in understanding the accompanying financial statements and notes to the financial statements.

Background

Caroline Islands Air, Inc. is a government owned corporation, created under Public Law No. 10-72 by the Congress of the Federated States of Micronesia (FSM). The main purpose of CIA is to (1) provide air transportation services throughout the Nation, (2) contract with domestic and foreign persons and corporations for the provisions of aircraft and services, (3) operate domestic air transportation, (4) train citizens in professions related to aeronautics, (5) act as a "Freely Associated State Air Carrier" within the meaning of the Federal Program and Services Agreement concluded pursuant to the Compact of Free Association, (6) engage in support activities, included but not limited to, freight terminal and delivery activities and passenger services, and (7) enter into joint ventures with other entities in order to effectuate its operation.

Overview of Fiscal Year 2020

The accounts of CIA are organized as a proprietary fund. Proprietary funds are used by governmental units that are operated in a manner similar to private business enterprises.

For the current year, CIA's operations include regular/charter flight services and cargo.

In fiscal year 2020, operating revenue sources of CIA's operations are from \$147k of passenger airfare, \$51k of charter services, \$16k of baggage fees, and \$11k of freight and others.

Financial Highlights

1. Statement of Net Position

Statement of Net Position presents what CIA owns (assets), owes (liabilities) and the net position (the difference between total assets and total liabilities) at the end of the fiscal year. The "net position" is one indicator of whether the current financial condition has improved or worsened during the year.

Comparative Statements of Net Position at September 30, 2020, 2019 and 2018 are summarized below:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Assets:			
Current assets	\$ 235,598	\$ 595,161	\$ 417,726
Capital assets	<u>17,694</u>	<u>25,097</u>	<u>32,499</u>
Total assets	<u>\$ 253,292</u>	<u>\$ 620,258</u>	<u>\$ 450,225</u>
Liabilities:			
Current liabilities	\$ <u>32,401</u>	\$ <u>49,414</u>	\$ <u>42,590</u>
Total liabilities	<u>32,401</u>	<u>49,414</u>	<u>42,590</u>

**CAROLINE ISLANDS AIR, INC.**  
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Management's Discussion and Analysis  
Years Ended September 30, 2020 and 2019

Comparative Statements of Net Position at September 30, 2020, 2019 and 2018 are summarized below, continued:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Net position:			
Net investment in capital assets	\$ 17,694	\$ 25,097	\$ 232,499
Unrestricted	<u>203,197</u>	<u>545,747</u>	<u>375,136</u>
	<u>220,891</u>	<u>570,844</u>	<u>407,635</u>
Total net position	\$ <u>253,292</u>	\$ <u>620,258</u>	\$ <u>450,225</u>

Assets: Total assets of \$253k comprise \$235k or 93% of current assets and \$18k or 7% of capital assets.

Current assets: Total current asset of \$235k comprised \$47k or 20% of cash, \$130k or 55% of prepaid expense, \$59k or 25% of inventory and others.

Noncurrent assets: The noncurrent assets of \$17k comprise the Company's property and equipment, net of accumulated depreciation.

Liabilities: CIA's liabilities of \$32k are all current consisting of accounts payable, accrued liabilities and others.

## 2. Summary Statement of Revenues, Expenses and Changes in Net Position

The following table provides information on the financial performance of the current year in terms of revenues and expenses. It presents the operating revenues and expenses and the corresponding net operating results, as well as non-operating revenues and expenses.

Below is the comparative summary of Statement of Revenues, Expenses and Changes in Net Position for the fiscal years ended September 30, 2020, 2019 and 2018.

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Operating revenues	\$ 225,552	\$ 1,051,923	\$ 813,435
Cost of operating revenues	<u>(812,669)</u>	<u>(1,190,724)</u>	<u>(1,065,651)</u>
Gross loss	(587,117)	(138,801)	(252,216)
General and administrative expenses	<u>89,828</u>	<u>117,427</u>	<u>(168,360)</u>
Operating loss	(676,945)	(256,228)	(420,576)
Non-operating income	<u>326,992</u>	<u>419,437</u>	<u>187,007</u>
Change in net position	(349,953)	163,209	(233,569)
Net position at beginning of year	<u>570,844</u>	<u>407,635</u>	<u>641,204</u>
Net position at end of year	\$ <u>220,891</u>	\$ <u>570,844</u>	\$ <u>407,635</u>

Fiscal year 2020 operating revenue sources of CIA operations are from \$147k of passenger airfare, \$51k of charter services, \$16k of baggage fees, and \$11k of freight and others.

During the year ended September 30, 2019, the Company recorded \$175K as insurance receivable for an incident involving one of the Company's aircrafts. This amount is collected in 2020.

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Management's Discussion and Analysis  
Years Ended September 30, 2020 and 2019

3. Summary Statement of Cash Flows

The following table 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 out flows at gross amounts, differentiating the activities into cash flows arising from operating activities, noncapital financing and capital and related financing.

Below are the summary of Statements of Cash Flows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
Cash flows used in operating activities	\$ (748,907)	\$ (185,235)	\$ (506,603)
Cash flows provided by noncapital financing activities	498,429	253,300	187,007
Cash flows used in capital and related financing activities	<u>-</u>	<u>-</u>	<u>(8,892)</u>
Net change in cash	(250,478)	68,065	(328,488)
Cash at beginning of year	<u>297,497</u>	<u>229,432</u>	<u>557,920</u>
Cash at end of year	\$ <u>47,019</u>	\$ <u>297,497</u>	\$ <u>229,432</u>

4. Debt and Capital Asset Activities

For additional information on capital assets, please refer to note 3 to the financial statements.

Economic Outlook

CIA generated an operating loss in FY2020 and CIA continues to face challenges especially because CIA operates with one plane with continuous mechanical challenges. These operating issues are the continued revenue shortfalls to adequately cover operating costs, fuel for airplanes and periodic overhaul of airplane parts. These continue to be the main priorities for the operation and plan of action are focused toward improving these operating issues.

In the subsequent year, FY2021, CIA continues to pay for its non-operating activities without generating any revenues due to continuing effect COVID-19 related issues resulting in continuous decline in operation.

Management's Discussion and Analysis for the year ended September 30, 2019, is set forth in the report on the audit of financial statements, which is dated February 25, 2021. That Discussion and Analysis explains the major factors impacting the 2018 financial statements and can be viewed at the FSM Office of the National Public Auditors' website at [www.fsmopa.fm](http://www.fsmopa.fm).

Financial Management Contact

This financial report is designed to provide all interested users with a general overview of the Company's finances. Inquiries concerning this report, if any, may be directed to Caroline Islands Air, Inc., P.O. Box 510, Kolonia Pohnpei, FM 96941.

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Statements of Net Position  
September 30, 2020 and 2019

<u>ASSETS</u>	<u>2020</u>	<u>2019</u>
Current assets:		
Cash	\$ 47,019	\$ 297,497
Insurance claims receivable	-	175,000
Prepaid expense	129,969	53,720
Inventory	<u>58,610</u>	<u>68,944</u>
Total current assets	235,598	595,161
Capital assets, net	<u>17,694</u>	<u>25,097</u>
	<u>\$ 253,292</u>	<u>\$ 620,258</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable	\$ 5,949	\$ 29,961
Accrued liabilities and others	<u>26,452</u>	<u>19,453</u>
Total liabilities	<u>32,401</u>	<u>49,414</u>
Commitments		
Net position:		
Net investment in capital assets	17,694	25,097
Unrestricted	<u>203,197</u>	<u>545,747</u>
Total net position	<u>220,891</u>	<u>570,844</u>
	<u>\$ 253,292</u>	<u>\$ 620,258</u>

See accompanying notes to financial statements.

**CAROLINE ISLANDS AIR, INC.**  
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Statements of Revenues, Expenses, and Changes in Net Position  
Years Ended September 30, 2020 and 2019

	2020	2019
Operating revenues:		
Passenger airfare	\$ 146,875	\$ 513,054
Charter services	50,658	376,738
Baggage fees	16,027	128,575
Freight	11,357	30,806
Service fees	-	2,585
Drums	635	165
Total operating revenues	225,552	1,051,923
Operating costs:		
Insurance	281,926	215,156
Salaries and housing	226,861	301,900
Maintenance and operation	163,265	480,995
Contract labor	55,073	96,347
Rent	48,749	54,611
Taxes	29,392	34,313
Depreciation	7,403	7,402
Total operating costs	812,669	1,190,724
Gross loss	(587,117)	(138,801)
General and administrative expenses:		
Travel	47,332	58,419
Supplies	13,625	24,345
Utilities	12,547	19,224
Communications	6,153	10,116
Professional fees	4,988	2,975
Bank service fees	184	1,165
Miscellaneous	4,999	1,183
Total general and administrative expenses	89,828	117,427
Operating loss	(676,945)	(256,228)
Nonoperating income (expense):		
Subsidies from the FSM National Government	323,429	253,300
Extraordinary item - insurance recoveries	-	175,000
Other income (expense)	3,563	(8,863)
Nonoperating income	326,992	419,437
Change in net position	(349,953)	163,209
Net position at beginning of year	570,844	407,635
Net position at end of year	\$ 220,891	\$ 570,844

See accompanying notes to financial statements.

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Statements of Cash Flows  
Years Ended September 30, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Cash flows from operating activities:		
Cash received from customers	\$ 225,552	\$ 1,055,298
Cash paid to suppliers for goods and services	(747,599)	(938,633)
Cash paid to employees for services	(226,860)	(301,900)
Net cash used in operating activities	<u>(748,907)</u>	<u>(185,235)</u>
Cash flows from noncapital financing activities:		
Subsidies from the FSM National Government	323,429	253,300
Proceeds from insurance claim	175,000	-
Net cash provided by noncapital financing activities	<u>498,429</u>	<u>253,300</u>
Net change in cash	(250,478)	68,065
Cash at beginning of year	<u>297,497</u>	<u>229,432</u>
Cash at end of year	<u>\$ 47,019</u>	<u>\$ 297,497</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (676,945)	\$ (256,228)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Other expense	3,563	(8,863)
Depreciation	7,403	7,402
(Increase) decrease in assets:		
Trade receivables	-	3,375
Prepaid inventory	-	120,044
Prepaid expense	(76,249)	(18,538)
Inventory	10,334	(39,251)
Increase (decrease) in liabilities:		
Accounts payable	(24,012)	7,001
Accrued liabilities and others	6,999	(177)
Net cash used in operating activities	<u>\$ (748,907)</u>	<u>\$ (185,235)</u>

See accompanying notes to financial statements.

**CAROLINE ISLANDS AIR, INC.**  
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Notes to Financial Statements  
September 30, 2020 and 2019

(1) Organization

Caroline Islands Air, Inc. (“CIA” or the “Company”) is a component unit of the Federated States of Micronesia (FSM) National Government. CIA was created under Public Law 10-72, as passed by the FSM Congress and was signed into law on December 27, 1997, for the purpose of providing the following services:

- Provide air transportation service throughout FSM;
- Contract with domestic and foreign persons and corporations for the provisions of aircraft and services;
- Operate domestic air transportation;
- Train citizens in professions related to aeronautics;
- Act as a “Freely Associated State Air Carrier” within the meaning of the Federal Program and Services Agreement concluded pursuant to the Compact of Free Association;
- Engage in support activities, included but not limited to, freight terminal and delivery activities and passenger services; and
- Enter into joint ventures with other entities in order to effectuate its operation.

For the years ended September 30, 2020 and 2019, CIA has operated in the states of Pohnpei and Chuuk. Additionally, it began operation in Yap and Republic of Palau in January 2018.

CIA is governed by a six-member Board of Directors appointed as follows:

- 1 member appointed by the President with the advice and consent of the FSM Congress to represent the FSM National Government;
- 4 State representatives appointed by the President with the advice and consent of the FSM Congress upon the recommendation to the President by the Governor of the pertinent State; and
- The Chief Executive Officer of CIA as ex officio but without rights to vote.

CIA’s financial statements are incorporated into the financial statements of the FSM National Government as a component unit.

(2) Summary of Significant Accounting Policies

Basis of Accounting

CIA utilizes the flow of economic resources measurement focus. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Net Position

Net position represents the residual interest in CIA’s assets after liabilities are deducted and consists of the following categories:

Net investment in capital assets - include capital assets, net of accumulated depreciation, reduced by outstanding debt, net of debt service reserve.

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Notes to Financial Statements  
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

Net Position, Continued

Restricted nonexpendable - net position subject to externally imposed stipulations that require CIA to maintain them permanently.

Restricted expendable - net position whose use is subject to externally imposed stipulations that can be fulfilled by actions of CIA pursuant to those stipulations or that expire with the passage of time.

Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position 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.

Operating and Non-Operating Revenue and Expenses

CIA considers passenger and related charter and cargo revenues and costs directly related to such revenues to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

Cash

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

As of September 30, 2020 and 2019, the carrying amount of CIA's total cash was \$47,019 and \$297,497, respectively, and the corresponding bank balances were \$52,288 and \$333,815, respectively, all of which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2020 and 2019, bank deposits in the amount of \$52,288 and \$323,514, respectively, were FDIC insured. CIA 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. CIA has not experienced any losses in such accounts and management believes it is not exposed to any significant custodial credit risk on its deposits.

Trade Receivables

CIA's trade receivables are with businesses and governments that relate to passenger, cargo and charter charges. The allowance for uncollectible accounts is stated at an amount which management believes is adequate to absorb losses that may become uncollectible. The allowance is established through a provision for bad debts expense and netted with the accounts receivable for reporting purposes. There are no outstanding trade receivables or allowance for doubtful accounts as of September 30, 2020 and 2019.

Prepaid Expense

Prepaid expense consists of insurance premiums paid for the unelapsed policy period.

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Notes to Financial Statements  
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

Inventory

CIA's inventory consists of Avgas and jet fuel in drums. Inventory is substantially carried at the lower of cost (first-in, first-out) or market.

Capital Assets

CIA capitalizes individual items with estimated useful lives of more than five years and the purchase cost of more than \$1,000. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Estimated useful lives of property and equipment are as follows:

Motor vehicles	5 years
Equipment	5 years
Furniture and fixtures	5 years

Risk Management

CIA purchases insurance to cover accidental damage or loss to aircraft hulls. Additionally, liability insurance is obtained against CIA's legal liability to third parties and passengers for accidental bodily injury and accidental damage to property including cargo, freight and mail. CIA is substantially self-insured for all other risks. Management is of the opinion that no material loss has been sustained as a result of this practice for the past three years.

In September 2019, a plane owned by the FSM National Government (see note 6) and operated by CIA had an accident. CIA, as the insured party, claimed and received insurance proceeds of \$175,000 during the year ended September 30, 2020. As the plane was owned by the FSM National Government, no losses were recorded by CIA and the settlement was recorded as an extraordinary item from insurance recovery as of September 30, 2019 in the accompanying financial statements.

New Accounting Standards

During the year ended September 30, 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement Nos. 84, 89, 90, 91, 92 and 93 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. In accordance with GASB Statement No. 95, management has elected to postpone implementation of these statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 84 will be effective for fiscal year ending September 30, 2021.

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Notes to Financial Statements  
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. Management believes that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 87 will be effective for fiscal year ending September 30, 2022.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 89 will be effective for fiscal year ending September 30, 2022.

In March 2018, GASB issued Statement No. 90, *Majority Equity Interests - An Amendment of GASB Statements No. 14 and 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 90 will be effective for fiscal year ending September 30, 2021.

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.

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Notes to Financial Statements  
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In January 2020, GASB issued Statement No. 92, *Omnibus 2020*. The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about the effective date of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, for interim financial reports, the terminology used to refer to derivative instruments and the applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefits. The requirements related to the effective date of GASB Statement No. 87 and Implementation Guide 2019-3, reissuance recoveries and terminology used to refer to derivative instruments are effective upon issuance. The remaining requirements of GASB Statement No. 92 are effective for the fiscal year ending September 30, 2022.

In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. The primary objective of this Statement is to address those and other accounting and financial reporting implications of the replacement of an IBOR. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 93 will be effective for fiscal year ending September 30, 2022.

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. This Statement also provides guidance for accounting and financial reporting for availability payment arrangements. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

In June 2020, GASB issued Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans - an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the

**CAROLINE ISLANDS AIR, INC.**  
**(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Notes to Financial Statements  
September 30, 2020 and 2019

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

definition of a pension plan and for benefits provided through those plans. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 97 will be effective for fiscal year ending September 30, 2022.

Management Estimates

The preparation of financial statements in conformity with GAAP 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.

(3) Capital Assets

Capital asset activities for the years ended September 30, 2020 and 2019 are as follows:

	Balance at October <u>1, 2019</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at September <u>30, 2020</u>
Motor vehicles	\$ 56,790	\$ -	\$ -	\$ 56,790
Equipment	10,300	-	-	10,300
Furniture and fixtures	<u>1,638</u>	<u>-</u>	<u>-</u>	<u>1,638</u>
	68,728	-	-	68,728
Less accumulated depreciation	<u>(43,631)</u>	<u>(7,403)</u>	<u>-</u>	<u>(51,034)</u>
	<u>\$ 25,097</u>	<u>\$ (7,403)</u>	<u>\$ -</u>	<u>\$ 17,694</u>
	Balance at October <u>1, 2018</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at September <u>30, 2019</u>
Motor vehicles	\$ 56,790	\$ -	\$ -	\$ 56,790
Equipment	10,300	-	-	10,300
Furniture and fixtures	<u>1,638</u>	<u>-</u>	<u>-</u>	<u>1,638</u>
	68,728	-	-	68,728
Less accumulated depreciation	<u>(36,229)</u>	<u>(7,402)</u>	<u>-</u>	<u>(43,631)</u>
	<u>\$ 32,499</u>	<u>\$ (7,402)</u>	<u>\$ -</u>	<u>\$ 25,097</u>

**CAROLINE ISLANDS AIR, INC.**  
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Notes to Financial Statements  
September 30, 2020 and 2019

**(4) Commitments**

**Leases**

CIA operates a hangar through an annual lease with the Pohnpei Port Authority, a component unit of the State of Pohnpei. Annual rent is \$8,556, and the current lease term expiration is in October 2021.

CIA also leases office space in Pohnpei, a storage space in Chuuk and apartments in Pohnpei, Yap and Palau under month-to-month agreements.

**(5) Contract Labor**

Details of contract labor for the years ended September 30, 2020 and 2019 are as follows:

	<u>2020</u>	<u>2019</u>
Overtime in Palau	\$ 20,177	\$ 20,735
Ground handling in Palau	15,146	64,000
Contract employee	5,496	-
Overtime in the FSM	5,377	8,612
Airport cleaning and maintenance	2,333	-
Other contract cost	<u>6,544</u>	<u>3,000</u>
	\$ <u>55,073</u>	\$ <u>96,347</u>

**(6) Related Party Transactions**

For the years ended September 30, 2020 and 2019, \$11,357 and \$72,776, respectively, of operating revenues were earned from the FSM National Government.

During the years ended September 30, 2020 and 2019, CIA received \$323,429 and \$253,300, respectively, of subsidies from the FSM National Government.

CIA utilizes airplanes owned by the FSM National Government at no cost.

**(7) Risks and Uncertainties**

As a result of the spread of COVID-19 coronavirus, governments worldwide, including FSM, Guam and Republic of Palau implemented actions to restrict travels beginning in March 2020. Such restrictions have resulted in significant negative impact on the CIA's operations for the year ended September 30, 2020, including decreased revenues due to limited flights. As a result, the FSM National Government has increased operating subsidies and such would be expected to continue until CIA can return to normal operations, the timing of which cannot be estimated at this time.

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

Board of Directors  
Caroline Islands Air, Inc.:

We have audited, in accordance with the 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, the financial statements of Caroline Islands Air, Inc. (the Company), which comprise the statement of net position as of September 30, 2020, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated February 11, 2022.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

*A deficiency in internal control* 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 and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control over financial reporting, that is less severe than a material weakness yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as item 2020-001 that we consider as significant deficiencies.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free from 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*.

## The Company's Response to Findings

The Company's responses to findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The Company's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

## Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Deloitte & Touche LLP*

February 11, 2022

**CAROLINE ISLANDS AIR, INC.**  
**(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Schedule of Findings and Responses  
Year Ended September 30, 2020

Finding No. : 2020-001

Proper Safekeeping of Source Documentation

Criteria: An effective control includes policies and procedures requiring source documentation such as flight manifest, invoice, receipts and other pertinent documents for all recorded transactions be adequately safeguarded and filed.

Condition: During the course of audit we have noted the following exceptions:

- a) Of 7 charter services revenue (totaling \$39, 500) tested, the supporting flight or cargo manifest was not made available for one cash receipt (10/09/2019, \$3,800).
- b) Of 27 passenger airfare revenue (totaling \$60,832) tested, the supporting flight manifest was not made available for one item (03/02/2020, \$3,040).
- c) Of 24 administrative expenses (totaling \$80,153) tested, the supporting boarding passes, approved travel authorization, invoices and other supporting documents were not provided for the following:

<u>GL Name/no.</u>	<u>Date</u>	<u>Amount</u>
Supplies: Y12 Office Admin	01/15/2020	\$ 459
Travel & Ent: Airline Ticket	12/20/2019	3,150
Travel & Ent: Airline Ticket	02/17/2020	1,788
Travel & Ent: Meals	12/06/2019	<u>3,450</u>
Total		\$ <u>8,847</u>

In addition, 4 of the administrative expenses totaling \$6,780 were reimbursed to the former CEO with additional 16% charge as compensation of use of personal credit card, with no corresponding Board approval.

- d) Of 19 repairs and maintenance expenses (totaling \$148,440) tested, the vendor invoices were not provided for the following two items for which check disbursements were made to the former CEO:

<u>GL Name/no.</u>	<u>Date</u>	<u>Amount</u>
AIRPLANE MAINT./OPER EXP.	11/20/2019	\$ 4,412
AIRPLANE MAINT./OPER EXP	01/15/2020	<u>3,509</u>
Total		\$ <u>7,921</u>

- e) Of 31 payroll transactions (totaling \$16,003) tested, the source employment contact/PAF, check voucher, basis of hours and hourly rate were not made available or was incomplete for the following 19 items to determine the basis of gross pay and the validity or accuracy of the payroll expense:

**CAROLINE ISLANDS AIR, INC.**  
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Schedule of Findings and Responses  
Year Ended September 30, 2020

Finding No. : 2020-001, Continued

<u>Check no.</u>	<u>Date</u>	<u>Amount</u>
12608	10/09/2019	\$ 159
12606	10/09/2019	100
12622	10/09/2019	200
12694	11/06/2019	50
12696	11/06/2019	400
12711	11/06/2019	81
12768	11/20/2019	66
12851	12/30/2019	140
12816	12/18/2019	73
12899	01/15/2020	200
12935	01/29/2020	174
12945	02/12/2020	73
13120	05/20/2020	42
13136	06/03/2020	73
13141	06/3/2020	155
13227	07/10/2020	140
13247	07/15/2020	200
13329	08/26/2020	40
13352	09/9/2020	<u>240</u>
Total		\$ <u>2,606</u>

Cause: The cause of the above the condition is lack of periodic monitoring of proper safekeeping of pertinent documents such as invoices, employee contract, approved journal entries, related supporting check disbursement/payroll vouchers and manifests/receipts.

Effect: The effect of the above condition is the potential misstatements of financial statements, including the potential disbursements of Company funds for unsupported transactions.

Recommendation: Management should establish policies and procedures for the proper safekeeping, filing and retention of source documents that support the validity and occurrence of transactions.

Auditee Response and Corrective Action Plan: The Company agrees with the finding and describes corrective action in the Corrective Action Plan.

**CAROLINE ISLANDS AIR, INC.  
(A COMPONENT UNIT OF THE FSM NATIONAL GOVERNMENT)**

Unresolved Prior Year Findings  
Year Ended September 30, 2020

Summary Schedule of Prior Audit Findings:

Finding Number	Finding Title	Status
2019-001	Proper Safekeeping of Source Documentation	Not Corrected or Resolved.



# Caroline Islands Air,

*"Wings of the FSM"*

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Corrective Action Plan  
2 CFR§200.511©  
Year Ended September 30, 2020

Finding No.2020-001	Corrective Action Plan	Anticipated Date	Responsible Person
Of seven charter services revenue items tested (totaling \$39,500), the supporting flight or cargo manifest was not made for one invoice	We agree to these findings.	March 31, 2022	Management, CIA
Of twenty four administrative expenses (totaling \$80,153) the supporting boarding passes, approval travel authorization, invoices and other supporting documents were not provided.	With the new management on board, there is already a system in place to address this finding. CFO and CEO reviewed and ensure that these documents are filed.		
Of twenty seven passengers airfare (totaling \$60,832 and four baggage fees (totaling \$2,756) revenue tested, the supporting flight manifest and related baggage receipts were not made available.	With the new management on board, there is already a system in place to address this finding. CFO and CEO reviewed and ensure that these documents are filed.	March 31, 2022	Management, CIA
Of nineteen repairs and maintenance expenses the vendors invoices and other supporting documents were not provided.			
Of thirty one payroll transactions (totaling \$16,003), the source employment contact/PAF check voucher, basis of hours and hourly rate were not made available and are incomplete. Thus, we were not able to determine the basis of gross pay and the validity or accuracy of the payroll expense.	We agree to this finding.  Management will ensure that all permanent employees have a personnel action indicating pay rate, effective date of employment and all other required information upon hiring. For all re-classification of employees, management will ensure that a PA shall be prepared indicating increase in pay rate and shall be adequately supported and approved.	March 31, 2022	Management, CIA