

CAROLINE ISLANDS AIR, INC.

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

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 2021

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

Year Ended September 30, 2021
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Caroline Islands Air, Inc.:

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Caroline Islands Air, Inc., (the "Company") a component unit of the Federated States of Micronesia National Government), which comprise the statement of net position as of September 30, 2021 and the related statement 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.

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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the 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. Because of the matters described in the "Basis for Disclaimer of Opinion" paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

Due to inadequacies in the Company's books of original entry, the general and subsidiary ledgers and substantially all corroborating evidence in support of the financial statements, we were not able to apply audit procedures concerning recorded balances in the financial statements that would be adequate for us to express an opinion on the financial statements.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Emphasis of Matter

Reporting Entity

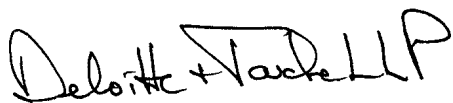
As discussed in Note 7 to the financial statements, COVID-19 has resulted in immediate adverse impact to the Company's operations. However, the length of time such conditions will continue to exist are not estimable at present. Our opinion is not modified with respect to this matter.

Other Matters

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 April 6, 2023, 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 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 internal control over financial reporting or on compliance. That report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* and should be considered in assessing the results of our engagement to audit.

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

April 6, 2023

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

Management's Discussion and Analysis
Year Ended September 30, 2021

This section of the Caroline Islands Air, Inc. (CIA) annual audit report presents the Management's Discussion and Analysis (MD&A) for the fiscal year ended September 30, 2021. MD&A is supplementary information required by the Governmental Accounting Standards Board Statement No. 34 (GASB 34) on the 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 FSM, (2) contract with domestic and foreign persons and corporations for the provision 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 2021

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 2021, operating revenue sources of CIA's operations are from \$480k of passenger airfare, \$148k of charter services, \$9k of baggage fees, and \$9k of freight and others.

Financial Highlights

1. Statement of Net Position

The 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, 2021 and 2020 are summarized below:

	<u>2021</u>	<u>2020</u>
Assets:		
Current assets	\$ 269,932	\$ 235,598
Capital assets	<u>17,694</u>	<u>17,694</u>
Total assets	\$ <u>287,626</u>	\$ <u>253,292</u>
Liabilities:		
Current liabilities	\$ <u>78,281</u>	\$ <u>32,401</u>
Total liabilities	<u>78,281</u>	<u>32,401</u>

CAROLINE ISLANDS AIR, INC.
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Management's Discussion and Analysis
Year Ended September 30, 2021

Comparative Statements of Net Position at September 30, 2021 and 2020 are summarized below, continued:

	<u>2021</u>	<u>2020</u>
Net position:		
Net investment in capital assets	\$ 17,694	\$ 17,694
Unrestricted	<u>191,651</u>	<u>203,197</u>
Total net position	209,345	220,891
	<u>\$ 287,626</u>	<u>\$ 253,292</u>

Assets: As of September 30, 2021, total assets of \$287k comprise \$269k or 94% of current assets and \$18k or 6% of capital assets.

Current assets: Total current assets of \$269k comprised \$81k or 30% of cash, \$130k or 48.5% of prepaid expense, \$59k or 22% 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 \$78k 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, 2021 and 2020.

	<u>2021</u>	<u>2020</u>
Operating revenues	\$ 647,024	\$ 225,552
Cost of operating revenues	<u>(804,873)</u>	<u>(812,669)</u>
Gross loss	(157,849)	(587,117)
General and administrative expenses	<u>122,304</u>	<u>89,828</u>
Operating loss	(280,153)	(676,945)
Non-operating income	<u>268,607</u>	<u>326,992</u>
Change in net position	(11,546)	(349,953)
Net position at beginning of year	<u>220,891</u>	<u>570,844</u>
Net position at end of year	<u>\$ 209,345</u>	<u>\$ 220,891</u>

Fiscal year 2021 operating revenue sources of CIA operations are from \$479k of passenger airfare, \$148k of charter services, \$9k of baggage fees, and \$9k of freight and others.

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Management's Discussion and Analysis
Year Ended September 30, 2021

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 outflows at gross amounts, differentiating the activities into cash flows arising from operating activities, noncapital financing and capital and related financing.

	<u>2021</u>	<u>2020</u>
Cash flows used in operating activities	\$ (234,272)	\$ (748,907)
Cash flows provided by noncapital financing activities	268,607	498,429
Cash flows used in capital and related financing activities	<u>-</u>	<u>-</u>
Net change in cash	34,335	(250,478)
Cash at beginning of year	<u>47,019</u>	<u>297,497</u>
Cash at end of year	\$ <u>81,354</u>	\$ <u>47,019</u>

During the year ended September 30, 2021, the Company received \$175K of December 2020 insurance claims for a CIA aircraft. For additional information on non-operating income and contributions, please refer to note 3 to the financial statements.

Economic Outlook

CIA generated an operating loss in FY2021 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 years subsequent to 2021, Executive boards and management already identify a suitable aircraft and are looking into purchasing it to service the outer islands of Chuuk and Pohnpei.

Management's Discussion and Analysis for the year ended September 30, 2020, is set forth in the report on the audit of financial statements, which is dated February 11, 2022. That Discussion and Analysis explains the major factors impacting the 2020 financial statements and can be viewed at the FSM Office of the National Public Auditors' website at 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.

CAROLINE ISLANDS AIR, INC.
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Statement of Net Position
September 30, 2021

ASSETS

Current assets:		
Cash	\$	81,354
Prepaid expense		129,968
Inventory		<u>58,610</u>
Total current assets		269,932
Capital assets, net		<u>17,694</u>
	\$	<u><u>287,626</u></u>

LIABILITIES AND NET POSITION

Current liabilities:		
Accounts payable	\$	5,949
Accrued liabilities and others		<u>72,332</u>
Total liabilities		<u>78,281</u>
Commitments		
Net position:		
Net investment in capital assets		17,694
Unrestricted		<u>191,651</u>
Total net position		<u>209,345</u>
	\$	<u><u>287,626</u></u>

See accompanying notes to financial statements.

CAROLINE ISLANDS AIR, INC.
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Statement of Revenues, Expenses, and Changes in Net Position
Year Ended September 30, 2021

Operating revenues:	
Passenger airfare	\$ 479,528
Charter services	148,293
Baggage fees	9,907
Freight	3,124
Service fees	734
Drums	5,438
Total operating revenues	647,024
Operating costs:	
Maintenance and operation	311,782
Salaries and housing	309,608
Insurance	57,692
Contract labor	56,568
Rent	53,348
Taxes	15,875
Total operating costs	804,873
Gross loss	(157,849)
General and administrative expenses:	
Travel	59,788
Supplies	24,925
Utilities	10,178
Communications	8,952
Professional fees	8,788
Bank service fees	1,818
Miscellaneous	7,855
Total general and administrative expenses	122,304
Operating loss	(280,153)
Nonoperating income (expense):	
Subsidies from the FSM National Government	93,607
Insurance recoveries	175,000
Nonoperating income	268,607
Change in net position	(11,546)
Net position at beginning of year	220,891
Net position at end of year	\$ 209,345

See accompanying notes to financial statements.

CAROLINE ISLANDS AIR, INC.
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Statement of Cash Flows
Year Ended September 30, 2021

Cash flows from operating activities:	
Cash received from customers	\$ 529,716
Cash paid to suppliers for goods and services	(454,380)
Cash paid to employees for services	<u>(309,608)</u>
Net cash used in operating activities	<u>(234,272)</u>
Cash flows from noncapital financing activities:	
Subsidies from the FSM National Government	93,607
Proceeds from insurance claim	<u>175,000</u>
Net cash provided by noncapital financing activities	<u>268,607</u>
Net change in cash	34,335
Cash at beginning of year	<u>47,019</u>
Cash at end of year	<u><u>\$ 81,354</u></u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (280,153)
Increase in assets:	
Prepaid expense	1
Increase in liabilities:	
Accrued liabilities and others	<u>45,880</u>
Net cash used in operating activities	<u><u>\$ (234,272)</u></u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2021

(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, 2021 and 2020, CIA has operated in the states of Pohnpei and Chuuk. Additionally, it began operations in Yap and the 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, 2021

(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, 2021, the carrying amount of CIA's total cash was \$81,354 and the corresponding bank balances were \$142,661, all of which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2021, bank deposits in the amount of \$142,661 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, 2021.

Prepaid Expense

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

CAROLINE ISLANDS AIR, INC.
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Notes to Financial Statements
September 30, 2021

(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 additional insurance proceeds of \$175,000 during the year ended September 30, 2021. As the plane was owned by the FSM National Government, no losses were recorded by CIA and the initial settlement was recorded as other income from insurance recovery as of September 30, 2019.

New Accounting Standards

During the year ended September 30, 2021, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 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.

During the year ended September 30, 2021, CIA implemented the following pronouncements:

- GASB Statement No. 84, *Fiduciary Activities*, which improves guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

CAROLINE ISLANDS AIR, INC.
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Notes to Financial Statements
September 30, 2021

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 90, *Majority Equity Interests - An Amendment of GASB Statements No. 14 and 61*, which improves 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.
- GASB Statement No. 93, *Replacement of Interbank Offered Rates*, which establishes accounting and reporting requirements related to the replacement of Interbank Offered Rates such as the London Interbank Offered Rate (LIBOR) for hedging derivative instruments. The provision removing LIBOR as an appropriate benchmark interest rate for the evaluation of the effectiveness of derivative instruments is effective for the year ending September 30, 2022.

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

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 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, 2021

(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. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. 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. In accordance with GASB Statement No. 95, 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. 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 definition of a pension plan and for benefits provided through those plans. GASB Statement No. 97 will be effective for fiscal year ending September 30, 2022.

CAROLINE ISLANDS AIR, INC.
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Notes to Financial Statements
September 30, 2021

(2) Summary of Significant Accounting Policies, Continued

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 year ended September 30, 2021 are as follows:

	Balance at October <u>1, 2020</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at September <u>30, 2021</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>(51,034)</u>	<u>-</u>	<u>-</u>	<u>(51,034)</u>
	<u>\$ 17,694</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17,694</u>

(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 \$10,562, 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 year ended September 30, 2021 are as follows:

Overtime in Palau	\$ -
Ground handling in Palau	-
Contract employee	40,901
Overtime in the FSM	-
Airport cleaning and maintenance	1,145
Other contract cost	<u>14,522</u>
	<u>\$ 56,568</u>

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

Notes to Financial Statements
September 30, 2021

(6) Related Party Transactions

For the year ended September 30, 2021, \$19,092 of operating revenues were earned from the FSM National Government.

During the year ended September 30, 2021, CIA received \$93,607 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 travel beginning in March 2020. Such restrictions have resulted in significant negative impact on the CIA's operations for the year ended September 30, 2021, including decreased revenues due to limited flights. As a result, the FSM National Government has continued to provide 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, 2021, 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 April 6, 2023. Our report stated that we were unable to apply audit procedures that would be adequate for us to express an opinion on the financial statements due to inadequacies in the Company's accounting records.

Internal Control Over Financial Reporting

In planning of the engagement to 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 2021-001 that we consider as significant deficiencies.

Compliance and Other Matters

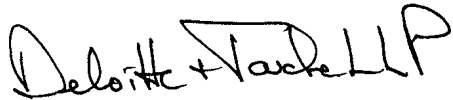
As part of obtaining reasonable assurance about whether the Company's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material 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.

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

April 6, 2023

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

Schedule of Findings and Responses
Year Ended September 30, 2021

Finding No. : 2021-001

Timely Record Keeping and Preparation of Financial Statements

Criteria: An effective control includes policies and procedures requiring reconciliation and preparation of financial statements on a monthly basis.

Condition: The general ledger was not reconciled on a monthly basis and underlying source documentation and other pertinent documents supporting recorded transactions were not available for inspection. A FY2021 final Trial Balance was only provided in November 2022. However, underlying account analysis and other supporting source documentation were not provided.

Cause: The cause of the above the condition is lack of periodic reconciliation of the general ledger.

Effect: The effect of the above condition is the potential for material 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: We do not agree with the findings because we do reconcile our QuickBooks every month.

Auditor Response: On December 6, 2022, a trial balance and general ledger were provided fifteen months after fiscal year end without attendant detail account analyses and schedules, subsidiary ledgers, and account reconciliations.

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

Unresolved Prior Year Findings
Year Ended September 30, 2021

Summary Schedule of Prior Audit Findings:

Finding Number	Finding Title	Status
2020-001	Proper Safekeeping of Source Documentation	Not Corrected or Resolved.