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June 26, 2013

The Board of Directors
Caroline Islands Air, Inc.

Dear Members of the Board of Directors:

We have performed an audit of the financial statements of Caroline Islands Air, Inc. (CIA or the Company), a component unit of the FSM National Government, as of and for the year ended September 30, 2012, in accordance with auditing standards generally accepted in the United States of America and ("generally accepted auditing standards") have issued our report thereon dated June 26, 2013.

We have prepared the following comments to assist you in fulfilling your obligation to oversee the financial reporting and disclosure process for which management of the Company is responsible.

OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS AND GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS

Our responsibility under generally accepted auditing standards and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, have been described in our engagement letter dated November 26, 2012. As described in that letter, the objective of a financial statement audit conducted in accordance with the aforementioned standards is:

- To express an opinion on the fairness of the presentation in the Company's basic financial statements and to disclaim an opinion on the required supplementary information for the year ended September 30, 2012 in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"), in all material respects; and

- To report on the Company's internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended September 30, 2012 based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*.

Our responsibilities under generally accepted auditing standards include forming and expressing an opinion about whether the financial statements that have been prepared with the oversight of management and the Board of Directors are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The audit of the financial statements does not relieve management or the Board of Directors of their responsibilities.

We considered the Company's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

ACCOUNTING ESTIMATES

Accounting estimates are an integral part of the financial statements prepared with the oversight of management and are based on management's current judgments. Those judgments are ordinarily based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the Company's 2012 financial statements include management's estimate of the allowance for doubtful accounts, which is determined based upon past collection experience and aging of the accounts and management's estimate of depreciation expense, which is based on estimated useful lives of the respective capital assets. During the year ended September 30, 2012, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

MATERIAL CORRECTED MISSTATEMENTS

Our audit of the financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Material misstatements were brought to the attention of management as a result of our audit procedures and were corrected by management during the current period. We have attached to this letter, as Appendix II, a summary of misstatements corrected by management.

SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are set forth in Note 2 to the Company's 2012 financial statements. During the year ended September 30, 2012, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by the Company:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53)*, which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CIA.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CIA.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CIA.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CIA.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of CIA.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of CIA.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of CIA.

DISAGREEMENTS WITH MANAGEMENT

We have not had any disagreements with management related to matters that are material to the Company's 2012 financial statements.

CONSULTATION WITH OTHER ACCOUNTANTS

We are not aware of any consultations that management may have had with other accountants about auditing and accounting matters during 2012.

SIGNIFICANT ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT PRIOR TO OUR INITIAL ENGAGEMENT

Throughout the year, routine discussions were held, or were the subject of correspondence, with management regarding the application of accounting principles or auditing standards in connection with transactions that have occurred, transactions that are contemplated, or reassessment of current circumstances. In our judgment, such discussions or correspondence were not held in connection with our retention as auditors.

OTHER SIGNIFICANT ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT

Throughout the year, routine discussions were held, or were the subject of correspondence, with management. In our judgment, such discussions or correspondence did not involve significant issues requiring communication to the Board of Directors.

SIGNIFICANT DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

In our judgment, we received the full cooperation of the Company's management and staff and had unrestricted access to the Company's senior management in the performance of our audit.

MANAGEMENT'S REPRESENTATIONS

We have made specific inquiries of the Company's management about the representations embodied in the financial statements. Additionally, we have requested that management provide to us the written representations the Company is required to provide to its independent auditors under generally accepted auditing standards. We have attached to this letter, as Appendix III, a copy of the representation letter we obtained from management.

CONTROL-RELATED MATTERS

We have issued a separate report to you, dated June 26, 2013, wherein no matters involving the Company's internal control over financial reporting that were considered to be material weaknesses under standards established by the American Institute of Certified Public Accountants, and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters were reported.

We have communicated to management, in Appendix I, deficiencies in internal control over financial reporting that we identified during our audit.

* * * * * *

This report is intended solely for the information and use of management, the Board of Directors, others within the Company and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Deloitte & Touche LLP

SECTION I – DEFICIENCIES

We identified, and have included below, a deficiency involving CIA's internal control over financial reporting as of September 30, 2012 that we wish to bring to your attention:

1. Employment Contracts

Comment: We noted that written employment contracts are not utilized for several employees.

Recommendation: We recommend that CIA formalize written employment contracts for all employees.

SECTION II - DEFINITION

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not always met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

APPENDIX I

Summary of Corrected Misstatements (September 30, 2012)

Description of Misstatement	Assets		Liabilities		Equity		Income		TOTAL
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	
AJE 1									
Dr 1201 Investments	25,000.00								25,000
Dr 3001 Retained Earnings					12,185.53				12,186
Cr 3002 Contributed Capital						25,000.00			(25,000)
Cr 1003 Accounts Receivable		5,097.77							(5,098)
Cr 2000 Accounts Payable				1,174.74					
Cr 2117 Accrued Liabilities				476.02					
Cr 2119 Vacation Leave Payable				5,437.00					(5,437)
									0
AJE 2									0
Dr 5037 Depreciation Expense							880.00		
CR 1207 Accumulated Depreciation		880.00							
									0
AJE 3									0
Dr 1001 Cash	3,511.13								3,511
Cr 2101 Accounts Payable				3,511.13					(3,511)
AJE 4									
Dr 5036 Miscellaneous Expense							1,332.00		1,332
Cr 1001 Cash		1,332.00							(1,332)
AJE 5									
Dr 1103 Inventory	5,936.05								5,936
Cr 5004 Expense Avgas								5,936.05	(5,936)
AJE 6									0
Dr 1101 Accounts Receivable	2,393.00								
Cr 4018 Freight services								2,393.00	
AJE 7									
Dr 1101 Accounts Receivable	1,400.00								
Cr 4020 Charter Services								1,400.00	
									0
AJE 8									0
Dr 5029 Office Administration							141.03		141
Dr 5027 Hanger Space							713.08		713
Dr 5008 PPA Landing Fees							108.12		108
Cr 2101 Accounts Payable		962.23							(962)

The above corrected misstatements do not represent fraud or illegal acts.

Mary Tretnoff
CFO/ CAROLINE ISLANDS AIR

APPENDIX III

Caroline Islands Air Inc

"Wings of the FSM"

P.O. Box 2238, Pohnpei, FM 96941

Tel: (691)-320-8406
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e-mail: cia@mail.fm

June 26, 2013

Deloitte & Touche
P.O. Box 753
Kolonia, Pohnpei 96941

We are providing this letter in connection with your audits of the statements of net assets of Caroline Islands Air, Inc. (CIA or the Company), a component unit of the FSM National Government, as of September 30, 2012 and the related statements of revenues, expenses and changes in net assets and of cash flows for the year then ended, for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the Company in conformity with accounting principles generally accepted in the United States of America (GAAP). We confirm that we are responsible for the following:

a. The fair presentation in the basic financial statements of the Company's net assets, and the related statements of revenues, expenses and changes in net assets, and cash flows in conformity with accounting principles generally accepted in the United States of America.

b. The fair presentation of the information included in supplemental schedules and Management's Discussion and Analysis accompanying the basic financial statements.

c. The design and implementation of programs and controls to prevent and detect fraud.

d. Establishing and maintaining effective internal control over financial reporting.

e. The review and approval of the financial statements and related notes and acknowledge your role in the preparation of this information. Specifically, we acknowledge that your role in the preparation of the financial statements was a matter of convenience rather than one of necessity. We have reviewed the financial statement preparation assistance provided by you and acknowledge that the financial statements are prepared in accordance with GAAP. Our review was based on the use of the financial statement disclosure checklist for stand-alone business-type activities obtained from the Government Finance Officers Association.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audits.

1. The basic financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America. In addition:

    a. Net asset components (invested in capital assets net of related debt, restricted and unrestricted) are properly classified and approved

    b. Revenues and expenses are appropriately classified in the statements of revenues, expenses and changes in net assets within operating and non-operating revenues and expenses

    c. Capital assets are properly capitalized, reported and depreciated

2. CIA has made available to you all:

    a. Financial records and related.

    b. Minutes of the meetings of the Board of Directors or summaries of actions of recent meetings for which minutes have not yet been prepared. The only minutes that we have provided you are for the date of February 7, 2012, April 16, 2012, July 13, 2012, August 30, 2012 and November 20, 2012, and there are no meetings other than those that have occurred from November 20, 2012 through the date of this letter.

3. There have been no:

    a. Action taken by CIA's management that contravenes the provisions of federal and Federated States of Micronesia (FSM) laws and regulations or of contracts and grants applicable to CIA and for all funds administered by the Company.

    b. Communication from other regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices or other matters that could have a material effect on the financial statements.

4. We have no knowledge of any fraud or suspected fraud affecting the Company involving (a) management, (b) employees who have significant roles in internal control over financial reporting, or (c) others if the fraud could have a material effect on the financial statements.

5. We have no knowledge of any allegations of fraud or suspected fraud affecting the Company received in communications from employees, former employees, analysts, regulators, or others.

6. We believe the effects of any uncorrected financial statement misstatements aggregated by you during the current audit engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

7. There are no unasserted claims or assessments that legal counsel has advised us are probable of assertion and must be disclosed in accordance with Financial

Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 450, *Contingencies* (formerly FASB Statement No. 5, *Accounting for Contingencies*).

8. We are responsible for compliance with local and state laws, rules and regulations, including compliance with the provisions of grants and contracts relating to the Company's operations. We are responsible for establishing and maintaining the components of internal control relating to our activities in order to achieve the objectives of providing reliable financial reports, effective and efficient operations, and compliance with laws and regulations. The Company is responsible for maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.

9. There are no reportable conditions, including significant deficiencies and material weaknesses, in the design or operation of internal control that could adversely affect CIA's ability to initiate, record, process, and report financial information.

10. Management has identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts.

11. CIA has not performed a formal risk assessment, including the assessment of the risk that the financial statements may be materially misstated as a result of fraud. However, management has made available to you their understanding about the risks of fraud in the Company and do not believe that the financial statements are materially misstated as a result of fraud.

Except where otherwise stated below, matters less than $4,000 collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to or disclosure in the financial statements.

12. The Company has no plans or intentions that may affect the carrying value or classification of assets and liabilities.

13. The following, to the extent applicable, have been appropriately identified and properly recorded and disclosed in the financial statements:

    a. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.

    b. Related-party transactions and associated amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral).

14. In preparing the financial statements in conformity with GAAP, management uses estimates. All estimates have been disclosed in the financial statements for which known information available prior to the issuance of the financial statements indicates that both of the following criteria are met:

    a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.

b. The effect of the change would be material to the financial statements.

We are not aware of any estimates at September 30, 2012 that may change and that the effect of the change would be material to the financial statements.

15. Risks associated with concentrations, based on information known to management, that meet all of the following criteria have been disclosed in the financial statements:

    a. The concentration exists at the date of the financial statements;

    b. The concentration makes the enterprise vulnerable to the risk of a near-term severe impact; and

    c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

16. There are no:

    a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.

    b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450, *Contingencies* (formerly FASB Statement No. 5, *Accounting for Contingencies*) other than that disclosed in the financial statements.

17. The Company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral.

18. The Company has complied with all aspects of contractual agreements that would have an effect on the financial statements in the event of noncompliance.

19. No events have occurred subsequent to September 30, 2012 to the date of this letter that require consideration as adjustments to or disclosures in the financial statements.

20. We have disclosed to you that no change in the Company's internal control over financial reporting has occurred during the Company's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

21. Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.

22. Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value. All inventories are the property of the Company and do not include any items consigned to it or any items billed to customers.

23. We believe that all expenditures that have been deferred to future periods are recoverable.

24. No corporation or agency of the Federal Government or the FSM National

Government has reported a material instance of noncompliance to us.

25. There have been no actions taken by management, which contravene the provisions of local laws or regulations or of contracts applicable to the Company.

26. The Company is responsible for determining and maintaining the adequacy of the allowance for doubtful accounts receivable, as well as estimates used to determine such amounts. Management believes the allowances are adequate to absorb currently estimated bad debts in the account balances.

27. We have advised you that we have not received any awards provided by federal agencies in the form of grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, or direct appropriations.

28. The Company has obligated, expended, received, and used public funds of the Company in accordance with the purpose for which such funds have been appropriated or otherwise authorized by federal or local law. Such obligation, expenditure, receipt, or use of public funds was in accordance with any limitations, conditions, or mandatory directions imposed by federal or local law.

29. Money or similar assets handled by the Company on the local governments have been properly and legally administered and the accounting and recordkeeping related thereto is proper, accurate, and in accordance with law.

30. No evidence of fraud or dishonesty in fiscal operations of programs administered by the Company has been discovered.

31. During fiscal year 2012, CIA implemented the following pronouncements

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

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The implementation of these pronouncements did not have a material effect on CIA's financial statements.

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32. The Company 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. The Company has not experienced any losses on such accounts and management believes it is not exposed to any significant credit risk on its deposits.

33. We have disclosed to you all conditions that we are undertaking to resolve the current uncertainty relative to our ability to continue as a going concern. Additionally, we confirm that any airplane utilized by the Authority is owned by the FSM National Government.

Alex Tretnoff
Chief Executive Officer

Mary Tretnoff
Chief Financial Officer