CAROLINE ISLANDS AIR, INC.

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

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2013 AND 2012

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

Years Ended September 30, 2013 and 2012
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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 FSM National Government, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and 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, 2013 and 2012, 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 described in Note 2 to the financial statements, during the year ended September 30, 2013, Caroline Islands Air, Inc. implemented Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, and Statement No. 65, *Items Previously Reported as Assets and Liabilities*. 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 basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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 January 2, 2014 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 audit performed in accordance with *Government Auditing Standards* in considering Caroline Islands Air, Inc.'s internal control over financial reporting and compliance.

Deloitte + Touche LLP

Tamuning, Guam
January 2, 2014

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

Management's Discussion and Analysis
Years Ended September 30, 2013 and 2012

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, 2013 and 2012. MD&A is 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 service 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 no 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 2013

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.

Fiscal year 2013 revenue sources of CIA operations are from $171k of passenger airfare, $102k of charter services, $43k of baggage fees, and $21k 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, 2013, 2012 and 2011 are summarized below:

	2013	2012	2011
Assets:			
Current Assets	$ 104,569	$ 60,777	$ 108,230
Noncurrent Assets	10,136	3,740	4,620
Total assets	$ 114,705	$ 64,517	$ 112,850
Liabilities:			
Current Liabilities	$ 9,473	$ 13,924	$ 12,985
Total Liabilities	9,473	13,924	12,985

	2013	2012	2011
Net Position:			
Net investment in capital assets	10,136	3,740	4,620
Unrestricted	95,096	46,853	95,245
Total net position	105,232	50,593	99,865
	$ 114,705	$ 64,517	$ 112,850

Assets: Total assets of $115k comprise $105k or 91% of current assets and $10k or 9% of capital assets.

Current assets: Total current asset of $105k comprised $28k or 27% of cash, $12k or 12% of accounts receivable, $59k or 56% of prepaid inventory and $6k or 5% of inventory.

Noncurrent assets: The noncurrent assets of $10k comprise the Company's property and equipment, net of accumulated depreciation.

Liabilities: CIA's liabilities of $9k are all current consisting of accounts payable and accrued liabilities.

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, 2013, 2012 and 2011.

	2013	2012	2011
Operating revenues	$ 338,026	$ 402,292	$ 407,637
Cost of operating revenues	(243,087)	(395,741)	(411,062)
Gross profit (loss)	94,939	6,551	(3,425)
General and administrative expenses	(38,300)	(55,823)	43,651
Operating income (loss)	56,639	(49,272)	(47,076)
Nonoperating expenses	(2,000)	-	-
Change in net position	54,639	(49,272)	(47,076)
Net position at beginning of year	50,593	99,865	146,941
Net position at end of year	$ 105,232	$ 50,593	$ 99,865

CIA's operating revenues are from $171k of passenger airfare, $102k of charter services, $43k of baggage fees and $21k of freight and others.

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.

Below are the summary statements of cash flows:

	2013	2012	2011
Cash flows provided by (used in) operating activities	$ 23,063	$ (54,327)	$ (36,323)
Cash flows used in noncapital financing activities	(2,000)	-	-
Cash flows used in capital and related financing activities	(7,276)	-	(5,500)
Net change in cash	17,787	(54,327)	(41,823)
Cash at beginning of year	14,071	68,398	110,221
Cash at end of year	$ 31,858	$ 14,071	$ 68,398

4. Debt and Capital Asset Activities

No significant debt or capital asset activities occurred during the year ended September 30, 2013. For additional information on capital assets, please refer to note 3 to the financial statements.

Management's Discussion and Analysis for the year ended September 30, 2012, is set forth in the report on the audit of financial statements, which is dated June 26, 2013. That Discussion and Analysis explains the major factors impacting the 2011 financial statements and can be viewed at the FSM Office of the National Public Auditors' website at www.fsmopa.fm.

Economic Outlook

CIA succeeded in generating a net profit in FY2013 by increasing airfares and reducing fuel costs. However, CIA continues to face challenges during FY2014. 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.

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

Statements of Net Position
September 30, 2013 and 2012

ASSETS	2013	2012
Current assets:		
Cash	$ 27,858	$ 14,071
Trade receivables	12,250	12,886
Prepaid inventory	58,720	-
Inventory	5,741	33,820
Total current assets	104,569	60,777
Property and equipment, net	10,136	3,740
	$ 114,705	$ 64,517
LIABILITIES AND NET POSITION		
Current liabilities:		
Accounts payable	9,291	8,832
Accrued liabilities and others	182	5,092
Total liabilities	9,473	13,924
Commitments		
Net position:		
Net investment in capital assets	10,136	3,740
Unrestricted	95,096	46,853
Total net position	105,232	50,593
	$ 114,705	$ 64,517

See accompanying notes to financial statements.

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

Statements of Revenue, Expenses, and Changes in Net Position
Years Ended September 30, 2013 and 2012

	2013	2012
Operating revenues:		
Passenger airfare	$ 171,383	$ 185,547
Charter services	102,120	123,970
Baggage fees	43,467	49,778
Freight	19,801	18,610
Service fees	1,205	3,133
Drums	50	2,145
Sales of Avgas	-	19,109
Total operating revenues	338,026	402,292
Cost of operating revenues:		
Salaries and housing	110,526	105,728
Maintenance and operation	96,677	252,445
Insurance	15,943	17,700
Rent	14,959	11,859
Taxes	4,102	7,129
Depreciation	880	880
Total cost of operating revenues	243,087	395,741
Gross profit	94,939	6,551
General and administrative expenses:		
Communications	11,098	26,849
Travel	10,144	6,488
Utilities	7,470	8,100
Supplies	3,744	4,980
Contract labor	2,556	2,961
Bank service fees	1,541	3,125
Janitorial	15	462
Professional fees	-	219
Miscellaneous	1,732	2,639
Total general and administrative expenses	38,300	55,823
Operating income (loss)	56,639	(49,272)
Nonoperating expenses:		
Interest expense	(2,000)	-
Change in net position	54,639	(49,272)
Net position at beginning of year	50,593	99,865
Net position at end of year	$ 105,232	$ 50,593

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	$ 338,662	$ 401,353
Cash paid to suppliers for goods and services	(200,163)	(346,418)
Cash paid to employees for services	(115,436)	(109,262)
Net cash provided by (used for) operating activities	23,063	(54,327)
Cash flows from noncapital financing activities:		
Interest paid to related party	(2,000)	-
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(7,276)	-
Net change in cash	13,787	(54,327)
Cash at beginning of year	14,071	68,398
Cash at end of year	$ 27,858	$ 14,071
Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:		
Operating income (loss)	$ 56,639	$ (49,272)
Adjustments to reconcile operating income (loss) to net cash provided by (used for) operating activities:		
Depreciation	880	880
(Increase) decrease in assets:		
Trade receivables	636	(939)
Prepaid inventory	(58,720)	-
Inventory	28,079	(5,935)
Increase (decrease) in liabilities:		
Accounts payable	459	4,473
Accrued liabilities and others	(4,910)	(3,534)
Net cash provided by (used for) operating activities	$ 23,063	$ (54,327)

See accompanying notes to financial statements.

(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 which was signed into law on December 27, 1997, for the purpose of providing the following services:

- Provide air transportation service throughout the Nation;
- 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.

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

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, establish standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following three net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

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

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

(2) Summary of Significant Accounting Policies, Continued

Basis of Accounting

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

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, 2013 and 2012, the carrying amounts of CIA's total cash was $27,858 and $14,071, respectively, and the corresponding bank balances were $36,373 and $15,764, respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2013 and 2012, all bank deposits were FDIC insured.

Accounts Receivable

CIA's accounts receivable 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 be 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.

Prepaid Inventory

Prepaid inventory consists of Avgas fuel inventory-in-transit.

Inventory

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

(2) Summary of Significant Accounting Policies, Continued

Property, Plant and Equipment

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 vehicle	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.

New Accounting Standards

During the year ended September 30, 2013, CIA implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which improved 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which enhanced 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 issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement No. 62 superseded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB 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. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

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 *N*o. 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.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of CIA.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 69 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of CIA.

(2) Summary of Significant Accounting Policies, Continued

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to the 2012 financial statements to correspond to the 2013 presentation.

(3) Property, Plant and Equipment

Capital asset activities for the years ended September 30, 2013 and 2012 are as follows:

	Balance at October 1, 2012	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2013
Motor vehicles	$ 15,500	$ 4,276	$ -	$ 19,776
Equipment	7,300	3,000	-	10,300
Furniture and fixtures	1,638	-	-	1,638
	24,438	7,276	-	31,714
Less accumulated depreciation	(20,698)	(880)	-	(21,578)
	$ 3,740	$ 6,396	$ -	$ 10,136

	Balance at October 1, 2011	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2012
Motor vehicles	$ 15,500	$ -	$ -	$ 15,500
Equipment	7,300	-	-	7,300
Furniture and fixtures	1,638	-	-	1,638
	24,438	-	-	24,438
Less accumulated depreciation	(19,818)	(880)	-	(20,698)
	$ 4,620	$ (880)	$ -	$ 3,740

(4) Commitments

Leases

CIA leases a hangar underlying its operations from the Pohnpei Port Authority, a component unit of the State of Pohnpei. CIA is to pay $8,556 per year and the lease expires in July 2014. The approximate future minimum lease payments through the date of lease expiration are $7,130.

(5) Related Party Transactions

CIA borrowed $10,000 from its CEO in April 2013 to fund immediate fuel needs and repaid principal and $2,000 of interest in September 2013.

CIA is a component unit of the FSM National Government. As of September 30, 2013 and 2012, $34,901 and $20,340, respectively, of revenue was from the FSM National Government.

Additionally, CIA utilizes an airplane owned by the FSM National Government at no cost.

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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, 2013, 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 January 2, 2014.

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 that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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.

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*.

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

Tamuning, Guam
January 2, 2014

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

Unresolved Prior Year Findings
Year Ended September 30, 2013

There were no unresolved audit findings from the prior year audits of the Company.