

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, 2014 AND 2013

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

Years Ended September 30, 2014 and 2013
Table of Contents

	<u>Page No.</u>
I. Independent Auditors' Report	1
II. Management's Discussion and Analysis	3
III. Basic Financial Statements:	
Statements of Net Position	6
Statements of Revenues, Expenses and Changes in Net Position	7
Statements of Cash Flows	8
Notes to Financial Statements	9
IV. Independent Auditors' Report on Compliance with Laws and Regulations:	
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 <i>Government Auditing Standards</i>	14
Unresolved Prior Year Findings	16



Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

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, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Caroline Islands Air, Inc. as of September 30, 2014 and 2013, 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.

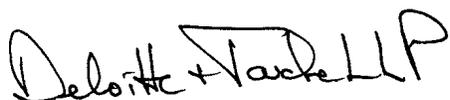
Other Matters

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 Governmental Accounting Standards Board 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 May 8, 2015 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.

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

May 8, 2015

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

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

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, 2014 and 2013. 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 2014

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 2014 revenue sources of CIA operations are from \$225k of passenger airfare, \$135k of charter services, \$50k of baggage fees, and \$20k, net 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, 2014, 2013 and 2012 are summarized below:

Assets:	<u>2014</u>	<u>2013</u>	<u>2012</u>
Current assets	\$ 224,716	\$ 104,569	\$ 60,777
Noncurrent assets	<u>10,136</u>	<u>10,136</u>	<u>3,740</u>
Total assets	\$ <u>234,852</u>	\$ <u>114,705</u>	\$ <u>64,517</u>
Liabilities:			
Current liabilities	\$ <u>14,768</u>	\$ <u>9,473</u>	\$ <u>13,924</u>
Total Liabilities	<u>14,768</u>	<u>9,473</u>	<u>13,924</u>

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

Management's Discussion and Analysis
September 30, 2014 and 2013

Comparative Statements of Net Position at September 30, 2014, 2013 and 2012 are summarized below, Continued

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Net position:			
Net investment in capital assets	10,136	10,136	3,740
Unrestricted	<u>209,948</u>	<u>95,096</u>	<u>46,853</u>
Total net position	<u>220,084</u>	<u>105,232</u>	<u>50,593</u>
	\$ <u>234,852</u>	\$ <u>114,705</u>	\$ <u>64,517</u>

Assets: Total assets of \$235k comprise \$225k or 96% of current assets and \$10k or 4% of capital assets.

Current assets: Total current assets of \$225k comprised \$134k or 60% of cash, \$47k or 21% of prepaid inventory, \$38k or 17% of prepaid expense and \$6k or 2% 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 \$15k 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, 2014, 2013 and 2012.

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Operating revenues	\$ 430,312	\$ 338,026	\$ 402,292
Cost of operating revenues	<u>(365,184)</u>	<u>(243,087)</u>	<u>(395,741)</u>
Gross profit	65,128	94,939	6,551
General and administrative expenses	<u>(25,552)</u>	<u>(38,300)</u>	<u>(55,823)</u>
Operating income (loss)	39,576	56,639	(49,272)
Nonoperating income	75,276	-	-
Nonoperating expenses	<u>-</u>	<u>(2,000)</u>	<u>-</u>
Change in net position	114,852	54,639	(49,272)
Net position at beginning of year	<u>105,232</u>	<u>50,593</u>	<u>99,865</u>
Net position at end of year	\$ <u>220,084</u>	\$ <u>105,232</u>	\$ <u>50,593</u>

CIA's operating revenues are from \$225k of passenger airfare, \$135k of charter services, \$50k of baggage fees and \$20k of freight and others.

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

Management's Discussion and Analysis
September 30, 2014 and 2013

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:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Cash flows provided by (used for) operating activities	\$ 30,999	\$ 23,063	\$ (54,327)
Cash flows provided by (used for) noncapital financing activities	75,276	(2,000)	-
Cash flows used for capital and related financing activities	<u>-</u>	<u>(7,276)</u>	<u>-</u>
Net change in cash	106,275	13,787	(54,327)
Cash at beginning of year	<u>27,858</u>	<u>14,071</u>	<u>68,398</u>
Cash at end of year	\$ <u>134,133</u>	\$ <u>27,858</u>	\$ <u>14,071</u>

4. Debt and Capital Asset Activities

No significant debt or capital asset activities occurred during the year ended September 30, 2014. 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, 2013, is set forth in the report on the audit of financial statements, which is dated January 2, 2014. That Discussion and Analysis explains the major factors impacting the 2013 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 FY2014 by operating fully throughout the year. However, CIA continues to face challenges during FY2015. 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.

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 2238, Kolonia Pohnpei, FM96941.

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

Statements of Net Position
September 30, 2014 and 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Current assets:		
Cash	\$ 134,133	\$ 27,858
Trade receivables	-	12,250
Prepaid inventory	47,220	49,154
Prepaid expense	37,622	9,566
Inventory	<u>5,741</u>	<u>5,741</u>
Total current assets	224,716	104,569
Property and equipment, net	<u>10,136</u>	<u>10,136</u>
	<u>\$ 234,852</u>	<u>\$ 114,705</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable	9,980	9,291
Accrued liabilities and others	<u>4,788</u>	<u>182</u>
Total liabilities	<u>14,768</u>	<u>9,473</u>
Commitments		
Net position:		
Net investment in capital assets	10,136	10,136
Unrestricted	<u>209,948</u>	<u>95,096</u>
Total net position	<u>220,084</u>	<u>105,232</u>
	<u>\$ 234,852</u>	<u>\$ 114,705</u>

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses, and Changes in Net Position
Years Ended September 30, 2014 and 2013

	2014	2013
Operating revenues:		
Passenger airfare	\$ 224,951	\$ 171,383
Charter services	135,352	102,120
Baggage fees	50,180	43,467
Freight	31,549	19,801
Service fees	400	1,205
Drums	125	50
Bad debts	(12,245)	-
Total operating revenues	430,312	338,026
Cost of operating revenues:		
Maintenance and operation	204,387	96,677
Salaries and housing	115,975	110,526
Insurance	27,010	15,943
Taxes	9,675	4,102
Rent	8,137	14,959
Depreciation	-	880
Total cost of operating revenues	365,184	243,087
Gross profit	65,128	94,939
General and administrative expenses:		
Utilities	6,720	7,470
Communications	6,107	11,098
Supplies	5,633	3,744
Travel	2,333	10,144
Contract labor	1,800	2,556
Bank service fees	711	1,541
Professional fees	219	-
Janitorial	65	15
Miscellaneous	1,964	1,732
Total general and administrative expenses	25,552	38,300
Operating income	39,576	56,639
Nonoperating income (expense), net:		
Subsidies from the FSM National Government	75,276	-
Interest expense	-	(2,000)
Nonoperating income (expense), net	75,276	(2,000)
Change in net position	114,852	54,639
Net position at beginning of year	105,232	50,593
Net position at end of year	\$ 220,084	\$ 105,232

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, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Cash received from customers	\$ 442,562	\$ 338,662
Cash paid to suppliers for goods and services	(295,588)	(200,163)
Cash paid to employees for services	(115,975)	(115,436)
Net cash provided by operating activities	<u>30,999</u>	<u>23,063</u>
Cash flows from noncapital financing activities:		
Subsidies from the FSM National Government	75,276	-
Interest paid to related party	-	(2,000)
Net cash provided by (used for) noncapital financing activities	<u>75,276</u>	<u>(2,000)</u>
Cash flows from capital and related financing activities:		
Acquisition of capital assets	-	(7,276)
Net cash used for capital and related financing activities	<u>-</u>	<u>(7,276)</u>
Net change in cash	106,275	13,787
Cash at beginning of year	<u>27,858</u>	<u>14,071</u>
Cash at end of year	<u>\$ 134,133</u>	<u>\$ 27,858</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 39,576	\$ 56,639
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	-	880
Bad debts	12,245	-
(Increase) decrease in assets:		
Trade receivables	5	636
Prepaid inventory	1,934	(49,154)
Prepaid expense	(28,056)	(9,566)
Inventory	-	28,079
Increase (decrease) in liabilities:		
Accounts payable	689	459
Accrued liabilities and others	4,606	(4,910)
Net cash provided by operating activities	<u>\$ 30,999</u>	<u>\$ 23,063</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, 2014 and 2013

(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.

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

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

- 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.

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 position. Proprietary fund operating statements present increases and decreases in net total position. 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, 2014 and 2013, the carrying amounts of CIA's total cash was \$134,133 and \$27,858, respectively, and the corresponding bank balances were \$135,365 and \$36,373, respectively, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2014 and 2013, 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 adequate to absorb losses that may become uncollectible. The allowance is established through a provision for bad debts expense and is netted with the accounts receivable for reporting purposes. Bad debts are written-off against the allowance on the specific identification method.

Prepaid Inventory

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

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

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

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.

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, 2014, CIA implemented the following pronouncements:

- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

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

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2012, GASB issued 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 68 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect 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 this statement on the financial statements of CIA.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect on the financial statements of CIA.

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.

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

Notes to Financial Statements
September 30, 2014 and 2013

(3) Property, Plant and Equipment

Capital asset activities for the years ended September 30, 2014 and 2013 are as follows:

	Balance at October <u>1, 2013</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at September <u>30, 2014</u>
Motor vehicles	\$ 19,776	\$ -	\$ -	\$ 19,776
Equipment	10,300	-	-	10,300
Furniture and fixtures	<u>1,638</u>	<u>-</u>	<u>-</u>	<u>1,638</u>
	31,714	-	-	31,714
Less accumulated depreciation	<u>(21,578)</u>	<u>-</u>	<u>-</u>	<u>(21,578)</u>
	<u>\$ 10,136</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,136</u>
	Balance at October <u>1, 2012</u>	Transfers and <u>Additions</u>	Transfers and <u>Deletions</u>	Balance at September <u>30, 2013</u>
Motor vehicles	\$ 15,500	\$ 4,276	\$ -	\$ 19,776
Equipment	7,300	3,000	-	10,300
Furniture and fixtures	<u>1,638</u>	<u>-</u>	<u>-</u>	<u>1,638</u>
	24,438	7,276	-	31,714
Less accumulated depreciation	<u>(20,698)</u>	<u>(880)</u>	<u>-</u>	<u>(21,578)</u>
	<u>\$ 3,740</u>	<u>\$ 6,396</u>	<u>\$ -</u>	<u>\$ 10,136</u>

(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 2015. The approximate future minimum lease payments through the date of lease expiration are \$7,130.

(5) Related Party Transactions

CIA is a component unit of the FSM National Government. As of September 30, 2014 and 2013, \$47,549 and \$34,901, respectively, of operating revenues were earned from the FSM National Government.

CIA received \$75,276 of subsidies from FSM National Government during the year ended September 30, 2014.

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

**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, 2014, 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 May 8, 2015.

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.

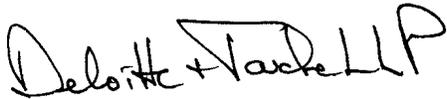
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not 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.

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

May 8, 2015

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

Unresolved Prior Year Findings
Year Ended September 30, 2014

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