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February 14, 2017

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, 2016, in accordance with auditing standards generally accepted in the United States of America and ("generally accepted auditing standards") have issued our report thereon dated February 14, 2017.

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.

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

cc: To Management of Caroline Islands Air, Inc.

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 September 30, 2016. 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 whether the statement of net position of CIA as of September 30, 2016 and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended (the "financial statements"), are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") and perform specified procedures on the required supplementary information for the year ended September 30, 2016.

- To report on CIA'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, 2016 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.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether caused by fraud or error. In making those risk assessments, we considered internal control over financial reporting relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that were 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 was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

SIGNIFICANT ACCOUNTING POLICIES

CIA's significant accounting policies are set forth in Note 2 to CIA's 2016 financial statements. During the year ended September 30, 2016, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by CIA:

- GASB Statement No. 72, *Fair Value Measurement and Application,* which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment.

SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears.

- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, which addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014.

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

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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. During the year ended September 30, 2016, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

UNCORRECTED 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. Included in Attachment II as Appendices A and B are a summaries of uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest and prior periods presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

MATERIAL CORRECTED MISSTATEMENTS

Included in Attachment I is a summary of corrected misstatements which were brought to the attention of management as a result of our audit procedures and were corrected by management during the current period.

OTHER INFORMATION IN THE ANNUAL REPORTS

When audited financial statements are included in documents containing other information such as CIA's 2016 Annual Report, we will read such other information and consider whether it, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements audited by us. In the event that CIA issues an Annual Report or other documentation that includes the audited financial statements, we will read the other information in CIA's 2016 Annual Report and will inquire as to the methods of measurement and presentation of such information. If we note a material inconsistency or if we obtain any knowledge of a material misstatement of fact in the other information, we will discuss this matter with management and, if appropriate, with the Board of Directors.

DISAGREEMENTS WITH MANAGEMENT

We have not had any disagreements with management related to matters that are material to the Company's 2016 financial statements.

OUR VIEWS ABOUT SIGNIFICANT MATTERS THAT WERE SUBJECT OF 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 2016.

SIGNIFICANT FINDINGS OR ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT PRIOR TO OUR RETENTION

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 FINDINGS OR ISSUES ARISING FROM THE AUDIT 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 findings or 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 Attachment II, a copy of the representation letter we obtained from management.

CONTROL-RELATED MATTERS

We have issued a separate report to you, dated February 14, 2017, 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 Attachment III, deficiencies in internal control over financial reporting that we identified during our audit.

The definition of a control deficiency is also set forth in Attachment III.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Attachment IV and should be read in conjunction with this report.

* * * * * *

Attachment I

Journal Entries - AJE

#	Name	Debit	Credit
	1 AJE Unrecorded liability		
5009	AIRPLANE MAINT./OPER EXP.: Repair/Maint. Supplies	916.75	
2101	Accounts Payable		916.75
		916.75	916.75
	Unrecorded liability		
	2 AJE Unrecorded revenue		
1101	Accounts Receivable	53,280.00	
4020	OTHER SERVICES: Charter Services		53,280.00
		53,280.00	53,280.00
	Revenue cut-off error		
	1 CAJE Fuel inventory		
1103	Inventory	29,874.37	
5004	AIRPLANE MAINT./OPER EXP.: Mobil - Avgas		28,664.69
5015	FSM GOV'T TAXES: Docking Fees		267.50
5004	AIRPLANE MAINT./OPER EXP.: Mobil - Avgas		305.00
5015	FSM GOV'T TAXES: Docking Fees		332.18
2108	Payroll Liabilities:2108 FSM 6% Employee Inc. Tax		305.00
		29,874.37	29,874.37
	Adjustment per fuel inventory count at year-end		
	2 CAJE Prepaid insurance premium		
5020	Insurance: Airplane Ins.	941.72	
1104	Prepaid Expenses		941.72
		941.72	941.72
	Prepaid aviation insurance premium for the insurance period ended 02/12/2017		

Attachment I, Continued

	3 CAJE Subsidy from FSMNG		
5003	AIRPLANE MAINT./OPER EXP.:Aircraft repair parts	103,307.00	
6001	Subsidies from FSM National Government		103,307.00
		103,307.00	103,307.00
	Subsidy from FSM National Government		
	4 CAJE Depreciation expense		
5037	Depreciation Expense	6,081.00	
1208	Computer Equipment: Accum. Depreciation		3,000.00
1207	Company Vehicles: Accum. Depreciation		3,081.00
		6,081.00	6,081.00
	Depreciation expense		
	5 CAJE Withholding Tax		
2108	Payroll Liabilities:2108 FSM 6% Employee Inc. Tax	4,045.33	
5029	Supplies: Office Administration		3,834.58
5022	Payroll Expenses		210.75
		4,045.33	4,045.33
	Withholding tax posting error		
	6 CAJE Unrecorded space rent		
5027	Rental Expenses: Hanger Space	1,200.00	
2101	Accounts Payable		1,200.00
		1,200.00	1,200.00
	Unrecorded space rent in Chuuk for April - September 2016		

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

Mary Tretnoff
CFO, CAROLINE ISLANDS AIR

ATTACHMENT II

Caroline Islands Air Inc

"Wings of the FSM"

P.O. Box 2238, Pohnpei, FM 96941

Tel: (691)-320-8406
Fax: (691)-320-8530
e-mail: cia@mail.fm

February 14, 2017

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

We are providing this letter in connection with your audits of the statements of net position of the Caroline Islands Air, Inc. ("CIA" or the "Company"), a component unit of the FSM National Government, as of September 30, 2016 and 2015 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, 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 preparation and fair presentation in the basic financial statements of the Company's net position, and the related statements of revenues, expenses and changes in net position, and cash flows in conformity with GAAP.

b. 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

   - To prevent and detect fraud

c. 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 GAAP. In addition:

    a. The financial statements include all component units as well as joint ventures with an equity interest, and properly disclose all other joint ventures and other related organizations.

    b. Net position components (net investment in capital assets, restricted and unrestricted) are properly classified and approved.

    c. Deposits and investment securities are properly classified in the category of custodial credit risk.

    d. Required supplementary information is measured and presented within prescribed guidelines.

    e. Applicable laws and regulations are followed in adopting, approving, and amending budgets.

    f. Capital assets are properly capitalized, reported and depreciated

2. The Company has provided to you all relevant information and access as agreed in the terms of the audit engagement letter.

3. The Company has made available to you:

    a. All minutes of the meetings of the Board of Directors or summaries of actions of recent meetings for which minutes have not yet been prepared.

    b. All financial records and related data for all financial transactions of the Company and for all funds administered by the Company. The records, books, and accounts, as provided to you, record the financial and fiscal operations of all funds administered by the Company and provide the audit trail to be used in a review of accountability. Information presented in financial reports is supported by the books and records from which the financial statements have been prepared.

    c. Contracts and grant agreements (including amendments, if any) and any other correspondence that has taken place with federal agencies.

4. There have been no:

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

    b. Communications with 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.

5. 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 for each opinion unit. A summary of such uncorrected misstatements has been attached as Appendix A.

6. We believe the effects of the uncorrected financial statement misstatements detected in the current year that relate to the prior year presented, when combined with those misstatements aggregated by you during the prior-year audit engagement and pertaining to the prior year presented, are immaterial, both individually and in the aggregate, to the financial statements for the year ended September 30, 2014 taken as a whole. A summary of such uncorrected misstatements has been attached as Appendix B.

7. The Company 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.

8. 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 where the fraud could have a material effect on the financial statements.

9. We have no knowledge of any allegations of fraud or suspected fraud affecting the Company's financial statements communicated by from employees, former employees, analysts, regulators, or others.

10. There are no unasserted claims or assessments that we are aware of or that legal counsel has advised us are probable of assertion and must be disclosed in accordance with GASB Codification of Governmental Accounting and Financial Reporting Standards ("GASB Codification") Section C50, *Claims and Judgments.*

11. 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.

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

13. 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.

14. Significant assumptions used by us in making accounting estimates are reasonable.

Except where otherwise stated below, matters less than $5,200 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.

15. Except as listed in Appendices A and B, there are no transactions that have not been properly recorded in the accounting records underlying the financial statements.

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

17. Regarding related parties:

    a. We have disclosed to you the identity of the Company's related parties and all the related party relationships and transactions of which we are aware.

    b. To the extent applicable, related parties and all the related-party relationships and transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral) have been appropriately identified, properly accounted for, and disclosed in the financial statements.

    c. CIA is a component unit of the FSM National Government. For the years ended September 30, 2016 and 2015, $60,084 and $20,474, respectively, of revenue was from the FSM National Government.

    d. During the years ended September 30, 2016 and 2015, CIA received $103,307 and $10,000, respectively, of subsidies from FSM National Government.

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

18. 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 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, 2016 that may change and that the effect of the change would be material to the financial statements.

19. There are no:

    a. Instances of identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing the financial statements

    b. Known actual or possible litigation and claims whose effects should be considered when preparing the financial statements that have not been disclosed to you and accounted for and disclosed in accordance with GAAP

    c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by GASB Codification Section C50, *Claims and Judgments*.

20. Regarding required supplementary information:

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the

a. We confirm that we are responsible for the required supplementary information.

b. The required supplementary information is measured and presented in accordance with GASB Codification Section 2200, *Comprehensive Annual Financial Report*

c. The methods of measurement and presentation of the supplementary information have not changed from those used in the prior period.

21. 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.

22. The Company has complied with all aspects of contractual agreements that may affect the financial statements.

23. No department or agency of the Federal Government or the FSM National Government has reported a material instance of noncompliance to us.

24. During fiscal year 2016, CIA implemented the following pronouncements

- GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The implementation of this statement did not have a material effect on the financial statements.

- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The implementation of this statement did not have a material effect on the financial statements.

- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, which addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014. The implementation of this statement did not have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

25. 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.

26. 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.

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

28. No events have occurred after September 30, 2016, but before February 14, 2017, the date the financial statements were available to be issued that require consideration as adjustments to or disclosures in the financial statements.

Alex Tretnoff
Chief Executive Officer

Mary Tretnoff
Chief Financial Officer

Appendix A

Uncorrected Misstatements - PAJE

Name	Debit	Credit
1 PAJE Unrecorded liability		
Accounts Payable	9,267.00	
Other Income		9,267.00
	9,267.00	9,267.00

Unreconciled accounts payable balance

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

Mary Tretnoff
CFO, CAROLINE ISLANDS AIR

Appendix B

Uncorrected Misstatements (Prior Period) - PAJE

Name	Debit	Credit
2 PAJE Unrecorded liability		
Accounts Payable	9,267.00	
Other Income		9,267.00
	9,267.00	9,267.00
Unreconciled accounts payable balance		
3 PAJE Unrecorded receivable		
Accounts Receivable	3,900.00	
Charter Services		3,900.00
	3,900.00	3,900.00
Unrecorded accounts receivable		

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

Mary Tretnoff
CFO, CAROLINE ISLANDS AIR

SECTION I – DEFICIENCIES

We identified, and have included below, deficiencies involving CIA's internal control over financial reporting as of September 30, 2016 that we wish to bring to your attention:

1. Employment Contracts

Comment: Written employment contracts are not utilized for several employees.

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

2. Bookkeeping

Comment: There were numerous audit adjustments which impacted a significant number of accounts. Many of the adjustments relate to the lack of year-end closing entries.

Recommendation: We recommend that management record year-end closing entries, such as prepaid expenses, prepaid fuel, and accrued salaries expense. Procedures should be formalized to require periodic bookkeeping.

3. Board meetings

Comment: Board meetings have not been held since October 2015 because the members' term has expired. Board members are still involved with CIA's operation since new members have not been appointed.

Recommendation: We recommend that management request that FSM National Government follow the FSM Public Laws and appoint Board members.

SECTION II - DEFINITION

The definition of a deficiency 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.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

The Company's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.