Financial Statements, Required Supplementary Information and Internal Control and Compliance

Caroline Islands Air, Inc.

(A Component Unit of the Federated States of Micronesia National Government)

Year ended September 30, 2024
with Report of Independent Auditors

Shape the future
with confidence

Caroline Islands Air, Inc.
(A Component Unit of the Federated States of Micronesia National Government)

Financial Statements and Required Supplementary Information

Year ended September 30, 2024

Contents

Shape the future
with confidence

Ernst & Young LLP
P.O. Box 753
Kolonia Pohnpei, FSM 96941

Tel: 691 320 2781/5206
Fax: 691 320 5402
ey.com

Report of Independent Auditors

The Board of Directors
Caroline Islands Air, Inc.

Report on the Audit of the Financial Statements

Disclaimer of Opinion

We were engaged to audit the financial statements of Caroline Islands Air, Inc. (the Company), which comprise the statement of net position as of September 30, 2024 and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements (collectively referred to as the “financial statements”).

We do not express an opinion on the accompanying financial statements of the Company. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

The Company was unable to provide a substantial portion of the documentation, schedules, and other supporting evidence requested by us to verify significant recorded transactions and account balances included in the accompanying financial statements. Because the requested information was not available, we were unable to perform audit procedures that we considered necessary to substantiate the occurrence, completeness, accuracy, valuation, and presentation of significant transactions and balances. As a result, we were unable to determine whether material adjustments may be necessary with respect to the amounts reported in the accompanying financial statements, and the possible effects of these matters are material and pervasive to the financial statements as a whole. Accordingly, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of the Company's financial statements 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, and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 5 be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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 July 31, 2026, on our consideration of the Company'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 the effectiveness of the Company's 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 the Company's internal control over financial reporting and compliance.

Ernst + Young LLP

July 31, 2026

Management’s Discussion and Analysis

Years ended September 30, 2024

The following Management’s Discussion & Analysis (MD&A) provides an overview of the financial activities of Caroline Islands Air, Inc. (CIA) for the fiscal year ended September 30, 2024. This discussion is intended to assist readers in understanding the financial statements and the significant changes in financial position and operations during the year. CIA is a legally separate entity that is included as a discretely presented component unit in the financial statements of the Federated States of Micronesia (FSM) National Government in accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, as amended. This MD&A should be read in conjunction with the accompanying financial statements and related notes.

Background

CIA is a component unit of the FSM National Government and was created under Public Law No. 10-72 by the Congress of the Federated States of Micronesia (FSM). The primary objectives of CIA are to: (1) provide air transportation services across the Federated States of Micronesia (FSM); (2) contract with domestic and international entities for aircraft procurement and service provision; (3) operate domestic air routes; (4) train FSM citizens in aeronautical professions; (5) serve as a 'Freely Associated State Air Carrier' as defined in the Federal Programs and Services Agreement pursuant to the Compact of Free Association; (6) conduct support activities such as freight terminal operations, delivery services, and passenger assistance; and (7) engage in joint ventures with other organizations to further its operational goals.

Overview of Fiscal Year 2024

Restatement of Prior Year Financial Information. Following the issuance of CIA’s September 30, 2023 financial statements, management identified reporting errors that affected the presentation of assets, liabilities, beginning net position, and the change in net position for the year then ended. As a result, the September 30, 2023 financial statements have been restated to reflect corrected amounts. Comparative data included in this MD&A for fiscal year 2023 reflects these restated balances to ensure consistency and transparency across reporting periods.

CIA's accounts are structured as a proprietary fund, a classification used by governmental entities that operate similarly to private-sector businesses.

For the current year 2024, CIA’s operations include regular/charter flight services and cargo.

In fiscal year 2024, CIA’s operating revenues comprised $80,141 from charter services, $54,556 from passenger airfare, $6,600 from service fees, $3,424 from baggage fees, and $565 from miscellaneous sources.

Financial Highlights

1. Comparative Statements of Net Position

The following table presents a summarized comparison of CIA's Statements of Net Position as of September 30, 2024 and 2023. This summary highlights key financial indicators and reflects the impact of prior year adjustments where applicable:

	2024	(As Restated) 2023
Assets:		
Current assets	$292,957	$119,821
Liabilities:		
Current liabilities	$245,993	$130,451
Net position:		
Unrestricted	46,964	(10,630)
	$292,957	$119,821

As of September 30, 2024 and 2023, CIA reported total current assets of $292,957 and $119,822, respectively. These amounts comprised cash of $251,375 and $26,764, inventory of $16,044 and $0, and prepaid expenses of $25,538 and $93,058.

As of September 30, 2024 and 2023, CIA reported total liabilities of $245,993 and $130,451, respectively. All liabilities were classified as current and consisted of accounts payable, accrued liabilities, and other obligations.

2. Comparative Statements of Revenues, Expenses and Changes in Net Position

The following table summarizes the financial performance for the fiscal years ended September 30, 2024 and 2023, presenting comparative data on revenues and expenses. It includes operating revenues and expenses, the resulting net operating position, and non-operating revenues and expenses, highlighting changes in CIA's net position across both fiscal periods.

	2024	(As Restated) 2023
Operating revenues	$ 145,286	$ 169,655
Cost of operating revenues	(576,472)	(609,542)
Gross loss	(431,186)	(439,887)
General and administrative expenses	96,128	83,761
Operating loss	(527,314)	(523,648)
Non-operating income	584,908	563,150
Change in net position	57,594	39,502
Net position at beginning of year	(10,630)	(50,132)
Net position at end of year	$ 46,964	$(10,630)

Economic Outlook

CIA incurred an operating loss of $(527,314) for the fiscal year 2024. It continues to face operational challenges, primarily due to reliance on a single aircraft experiencing ongoing mechanical issues. These challenges have contributed to persistent revenue shortfalls, making it difficult to adequately cover essential operating costs, including fuel expenditure and the periodic overhaul of aircraft components. Notwithstanding the operating loss, nonoperating income of $584,908, consisting of insurance recoveries of $345,000 and subsidies from the FSM National Government of $239,908, resulted in an increase in net position of $57,594 and a positive net position of $46,964 as of September 30, 2024. Addressing these operational issues remains a top priority. CIA's action plan is strategically focused on improving aircraft reliability, optimizing resource allocation, and enhancing overall operational efficiency.

Financial Management Contact

This audit report is designed to provide all interested users with a general overview of CIA's financial condition. Inquiries concerning this report, if any, may be directed to Caroline Islands Air, Inc., P.O. Box 510, Kolonia Pohnpei, FM 96941, or visit the FSM Office of the National Public Auditors' website at www.fsmopa.fm.

Management's Discussion and Analysis for the year ended September 30, 2023, is set forth in the report on the audit of financial statements, which is dated August 8, 2025. That Discussion and Analysis explains the major factors impacting the 2023 financial statements and can be viewed at the FSM Office of the National Public Auditors' website at www.fsmopa.fm.

Statement of Net Position

September 30, 2024

Assets	
Current assets:	
Cash	$251,375
Inventory	16,044
Prepaid expense	25,538
Total assets	$292,957
Liabilities and Net Position	
Current liabilities:	
Accounts payable	$ 36
Accrued liabilities and others	245,957
Total liabilities	245,993
Commitments and contingencies	
Net position:	
Unrestricted	46,964
Total liabilities and net position	$292,957

See accompanying notes.

Caroline Islands Air, Inc.

(A Component Unit of The Federated States of Micronesia National Government)

Statement of Revenues, Expenses, and Changes in Net Position

Year ended September 30, 2024

Operating revenues:	
Charter services	$ 80,141
Passenger airfare	54,556
Service fees	6,600
Baggage fees	3,424
Drums	565
Total operating revenues	145,286
Operating costs:	
Salaries and employee housing	320,988
Insurance	74,917
Maintenance and operation	49,088
Rent	78,019
Contract labor	31,825
Taxes	21,635
Total operating cost	576,472
Gross loss	(431,186)
General and administrative expenses:	
Travel	69,910
Professional fees	9,887
Communications	5,993
Utilities	5,547
Supplies	1,406
Bank service fees	3,207
Miscellaneous	178
Total general and administrative expenses	96,128
Operating loss	(527,314)
Nonoperating income:	
Insurance recoveries	345,000
Subsidies from the FSM National Government	239,908
Total nonoperating income	584,908
Change in net position	57,594
Net position at beginning of year, as restated	(10,630)
Net position at end of year	$ 46,964

See accompanying notes.

Caroline Islands Air, Inc.
(A Component Unit of The Federated States of Micronesia National Government)

Statement of Cash Flows

Year ended September 30, 2024

Cash flows from operating activities:	
Cash received from customers	$ 145,286
Cash paid to suppliers for goods and services	(184,595)
Cash paid to employees for services	(320,988)
Net cash used in operating activities	(360,297)
Cash flows from noncapital financing activities:	
Proceeds from insurance claims	345,000
Subsidies from the FSM National Government	239,908
Cash provided by noncapital financing activities	584,908
Net change in cash	224,611
Cash at beginning of year	26,764
Cash at end of year	$ 251,375
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	$(527,314)
(Increase) decrease in assets:	
Prepaid expense	67,519
Inventory	(16,044)
Increase (decrease) in liabilities:	
Accrued liabilities and others	115,542
Net cash used in operating activities	$(360,297)

See accompanying notes.

1. Reporting Entity

Caroline Islands Air, Inc. ("CIA" or the "Company") is a component unit of the Federated States of Micronesia (FSM) National Government. CIA was created under Public Law 10-72, as passed by the FSM Congress and was signed into law on December 27, 1997, for the purpose of providing the following services:

- Provide air transportation service throughout FSM;
- Contract with domestic and foreign persons and corporations for the provisions of aircraft and services;
- Operate domestic air transportation;
- Train citizens in professions related to aeronautics;
- Act as a "Freely Associated State Air Carrier" within the meaning of the Federal Program and Services Agreement concluded pursuant to the Compact of Free Association;
- Engage in support activities, included but not limited to, freight terminal and delivery activities and passenger services; and
- Enter into joint ventures with other entities in order to effectuate its operation.

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 discretely presented component unit.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accounting policies of the Company conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by GASB Statement No. 37, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

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 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.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as non-operating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. Expenses not meeting this definition are reported as non-operating 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.

The Company's equity is presented in the following net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation, plus construction or improvement of those assets, net of related debts.

- Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

2. Summary of Significant Accounting Policies, continued

Accounting 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.

Cash

For the purposes of the statements of net position and cash flows, cash are defined as cash in bank checking and savings accounts.

Trade Receivables

CIA's trade receivables are with businesses and governments that relate to passenger, cargo and charter charges. An allowance for uncollectible accounts is stated at an amount which management believes to 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. CIA did not record any trade receivables or an allowance for uncollectible accounts as of September 30, 2024.

Prepaid Expense

Prepaid expense mainly consists of insurance premiums paid for the unelapsed policy period or other goods and services to be consumed in future periods. At September 30, 2024, recorded prepaid expense represents prepayment of fuel purchase and prepaid insurance.

Inventory

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

Capital Assets

CIA capitalizes individual items with estimated useful lives of more than five years and the purchase cost of more than $1,000. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets, which is 5 years for all existing asset categories.

2. Summary of Significant Accounting Policies, continued

Taxes

The Company exists and operates solely for the benefit of the public and is exempted from any State or Municipal taxes or assessments on any of its property, operations or activities. The Company is liable for employees' contributions to the National Social Security System or other employees benefits of the State of FSM National Government, if any, in such manner as provide by law.

Deferred Outflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. The Company has no items that qualify for reporting in this category.

Deferred Inflows of Resources

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (addition of net position) until then. The Company has no items that qualify for reporting in this category.

Recently Adopted Accounting Pronouncements

In June 2022, GASB issued Statement No. 100, *Accounting Changes and Error Corrections – An Amendment of GASB Statement No. 62*. The primary objective of this Statement is to enhance accounting and financial reporting requirements for accounting changes and error corrections to provide more understandable, reliable, relevant, consistent, and comparable information for making decisions or assessing accountability. The requirements of this Statement will improve the clarity of the accounting and financial reporting requirements for accounting changes and error corrections, which will result in greater consistency in application in practice. In turn, more understandable, reliable, relevant, consistent, and comparable information will be provided to financial statement users for making decisions or assessing accountability. In addition, the display and note disclosure requirements will result in more consistent, decision useful, understandable, and comprehensive information for users about accounting changes and error corrections. The implementation of GASB Statement No. 100 during the year ended September 30, 2024 did not have a material effect on the accompanying financial statements.

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements

In June 2022, GASB issued Statement No. 101, *Compensated Absences*. The objective of this Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures. The unified recognition and measurement model in this Statement will result in a liability for compensated absences that more appropriately reflects when a government incurs an obligation. In addition, the model can be applied consistently to any type of compensated absence and will eliminate potential comparability issues between governments that offer different types of leave. The model also will result in a more robust estimate of the amount of compensated absences that a government will pay or settle, which will enhance the relevance and reliability of information about the liability for compensated absences. GASB Statement No. 101 will be effective for fiscal year ending September 30, 2025.

In December 2023, GASB issued Statement No. 102, *Certain Risk Disclosures*. The primary objective of this Statement is to provide users of the government financial statements with essential information about risks related to a government's vulnerabilities due to ascertain concentrations or constraints. This Statement requires a government to assess whether a concentration or constraint makes the primary government reporting unit or other reporting units that report a liability for revenue debt vulnerable to the risk of a substantial impact. Additionally, this Statement requires a government to assess whether an event or events associated with a concentration or constraint that could cause the substantial impact have occurred, have begun to occur, or are more likely than not to begin to occur within 12 months of the date the financial statements are issued. GASB Statement No. 102 will be effective for fiscal year ending September 30, 2025.

In April 2024, GASB issued Statement No. 103, *Financial Reporting Model Improvements*. The objective of this Statement is to improve key components of the financial reporting model to enhance the effectiveness of the financial reporting model in providing information that is essential for decision making and assessing a government's accountability and address certain application issues identified through pre-agenda research conducted by the GASB. This Statement establishes new accounting and financial reporting requirements or modifies existing requirements related to management's discussion and analysis (MD&A), unusual or infrequent items, presentation of the proprietary fund statement of revenues, expenses, and changes in fund net position, information about major component units in basic financial statements, budgetary comparison information and financial trends information in the statistical section. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 103 will be effective for fiscal year ending September 30, 2026.

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In September 2024, GASB issued Statement No. 104, *Disclosure of Certain Capital Assets*. The objective of this Statement is to provide users of government financial statements with essential information about certain types of capital assets. This Statement requires certain types of capital assets to be disclosed separately in the capital assets note disclosures required by Statement 34. Lease assets recognized in accordance with Statement No. 87, Leases, and intangible right-to-use assets recognized in accordance with Statement No. 94, Public-Private and Public-Public Partnerships and Availability Payment Arrangements, should be disclosed separately by major class of underlying asset in the capital as-sets note disclosures. Subscription assets recognized in accordance with Statement No. 96, Subscription-Based Information Technology Arrangements, also should be separately disclosed. In addition, this Statement requires intangible assets other than those three types to be disclosed separately by major class. GASB Statement No. 104 will be effective for fiscal year ending September 30, 2026.

In December 2025, GASB issued Statement No. 105, *Subsequent Events*. The objective of this Statement is to improve the financial reporting requirements for subsequent events, thereby enhancing consistency in their application and better meeting the information needs of financial statement users. This Statement defines subsequent events as transactions or other events that occur after the date of the financial statements but before the date the financial statements are available to be issued. This Statement describes the date the financial statements are available to be issued as the date at which (1) the financial statements are complete in a form and format that complies with generally accepted accounting principles and (2) approvals necessary for issuance have been obtained.

That definition modifies the subsequent events time frame throughout the GASB literature. This Statement also requires the date through which subsequent events have been evaluated to be disclosed. This Statement clarifies the subsequent events that constitute recognized and nonrecognized events and establishes specific note disclosure requirements for nonrecognized events. GASB Statement No. 105 will be effective for fiscal year ending September 30, 2027.

The management is currently evaluating the effects the above upcoming accounting pronouncements might have on its financial statements.

3. Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Company'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. The Company does not have a deposit policy for custodial credit risk.

As of September 30, 2024, the carrying amount of the Company's total cash was $251,375 and the corresponding bank balance was $251,730, which is primarily maintained in financial institutions subject to insurance by Federal Deposit Insurance Corporation (FDIC). As of September 30, 2024, bank deposits in the amount of $251,730 are subject to the limits of FDIC insurance coverage. The Company does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, deposits in excess of the limits are exposed to custodial credit risk.

4. Capital Assets

Capital asset activities for the year ended September 30, 2024 are as follows:

	Balance at October 1, 2023	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2024
Motor vehicles	$56,790	$ ---	$ ---	$56,790
Equipment	10,300	---	---	10,300
Furniture and fixtures	1,638	---	---	1,638
	68,728	---	---	68,728
Less accumulated depreciation	(68,728)	---	---	(68,728)
	$ ---	$ ---	$ ---	$ ---

5. Related Party Transactions

During the year ended September 30, 2024, CIA received $239,908 of subsidies from the FSM National Government for its operating costs.

At September 30, 2024, accrued liabilities include a total of approximately $186,000 of FSM employee income tax withholdings and social security taxes employee withholdings and employer contributions unpaid from the quarter ended June 30, 2022 to September 30, 2024.

CIA utilizes airplanes owned by the FSM National Government at no cost. Although there is no written agreement governing the use, CIA is responsible for the servicing and repairs of the airplanes.

6. Commitments and Contingencies

Leases

CIA operates a hangar through an annual lease with the Pohnpei Port Authority, a component unit of the State of Pohnpei. Annual rent is $10,562, and the current lease term expired in October 2023 and is under a year-to-year agreement.

CIA also leases office space in Pohnpei, a storage space in Chuuk and apartments in Pohnpei, Yap and Palau under month-to-month agreements.

Self-Insurance

CIA purchases insurance to cover accidental damage or loss to aircraft hulls. Additionally, liability insurance is obtained against CIA's legal liability to third parties and passengers for accidental bodily injury and accidental damage to property including cargo, freight and mail. CIA is substantially self-insured for all other risks. Management is of the opinion that no material loss has been sustained as a result of this practice for the past three years.

In March 2024, a plane owned by the FSM National Government (see note 5) and operated by CIA had an accident. CIA, as the insured party, claimed and received insurance proceeds of $345,000 during the year ended September 30, 2024. As the plane was owned by the FSM National Government, no losses were recorded by CIA and the settlement was recorded as other income from insurance recovery as of September 30, 2024.

7. Restatement

Subsequent to the issuance of CIA's 2023 financial statements, CIA changed the reported September 30, 2023 assets and change in net position for the year ended September 30, 2023 to correct errors. As a result of this determination, September 30, 2023 financial statements have been restated from the amounts previously reported as follows:

	As previously Reported	As Restated	Increase
Total assets	$87,884	$ 119,821	$31,937
Change in net position	$39,502	$ 71,439	$31,937
Ending net position	$42,567	$(10,630)	$31,937
Liabilities and net position	$87,884	$ 119,821	$31,937

Ernst & Young LLP
P.O. Box 753
Kolonia Pohnpei, FSM 96941

Tel: 691 320 2781/5206
Fax: 691 320 5402
ey.com

Report of Independent Auditors 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 were engaged to audit, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States (Government Auditing Standards), the financial statements of business-type activities of Caroline Islands Air, Inc. (the Company), as of and for the year ended September 30, 2024, and the related notes to the financial statements, which collectively comprise the Company's basic financial statements and have issued our report thereon dated July 31, 2026. Our report disclaims an opinion on such financial statements because the Company has not performed reconciliation or maintained subsidiary ledgers for a significant portion of account balances on its September 30, 2024 statement of net position. As of the date of our audit report, management was still in the process of performing such procedures to determine adjustments that are necessary to correct the financial statements as of and for the year ended September 30, 2024.

Report on Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements of the Company, we considered the Company's internal control over financial reporting (internal control) as a basis for designing 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. We did identify a certain deficiency in internal control, described in the accompanying Schedule of Findings and Responses as item 2024-001 that we consider to be a material weakness.

Report on 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 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*. However, if the scope of our work had been sufficient to enable us to express an opinion on the basic financial statements, instances of noncompliance or other matters may have been identified and reported herein.

The Company's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the Company's response to the findings identified in our audit and described in the accompanying schedule of findings and questioned costs. The Company's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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.

Ernst + Young LLP

July 31, 2026

Schedule of Findings and Responses

Year ended September 30, 2024

Finding No.: 2024-001

Timely Record Keeping and Preparation of Financial Statements

Criteria: An effective control includes policies and procedures requiring reconciliation and preparation of financial statements on a monthly basis and effective document filing and retrieval system to allow timely retrieval of supporting documents supporting recorded transactions.

Condition: The Company's general ledger was not reconciled periodically or at the year-end. Additionally, a significant portion of underlying source documentation and other pertinent documents supporting recorded transactions were not available for inspection. A preliminary trial balance for the year ended September 30, 2024 was provided on January 14, 2026 and was returned as it contained obvious errors deemed pervasive to the financial statements. A revised trial balance was provided on March 26, 2026 with some supporting schedules and reconciliations provided in April to May 2026. As of July 15, 2026, the Company was unable to provide all required supporting documents or further detailed reconciliations to support significant portion of audit request in areas of accrued liabilities, revenues and expenses.

Cause: The cause of the above the condition is lack of periodic reconciliation of the general ledger, as well as the timely and the proper analysis of all pertinent balance sheet accounts, other than the cash-in-bank accounts. Additionally, due to the small operation size, there is a lack of regular review control for a second person to verify the financial transactions recorded against supporting documents such as cash receipts, billing invoices, vendor invoices, receiving reports, payment vouchers, payroll disbursement records or journal vouchers on a regular basis to allow for easy identification and retrieval of such documents to support recorded transactions.

Effect: The effect of the above condition is the potential material misstatements of financial statements, including the potential disbursements of Company funds for unsupported transactions or unidentified revenue transactions that may not have been timely invoiced or collected.

Recommendation: Management should establish policies and procedures for the proper safekeeping, filing and retention of source documents that support the validity and occurrence of transactions.

Auditee Response and Corrective Action Plan: We agree with the finding. We will design and implement internal financial policies and procedures to strengthen internal control over timely reconciliation of accounts.