

*Financial Statements, Required Supplementary
Information and Compliance and Internal Control*

Caroline Islands Air, Inc.

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

*Year ended September 30, 2022
with Report of Independent Auditors*



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, 2022

Contents

Report of Independent Auditors	1
Management’s Discussion and Analysis	3
Basic Financial Statements	
Statement of Net Position	7
Statement of Revenues, Expenses and Changes in Net Position	8
Statement of Cash Flows	9
Notes to Financial Statements	10
Compliance and Internal Control	
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 <i>Government Auditing Standards</i>	18
Schedule of Findings and Responses	20



Ernst & Young LLP
231 Ypao Road
Suite 201 Ernst & Young Building
Tamuning, Guam 96913

Tel: +1 671 649 3700
Fax: +1 671 649 3920
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 the Caroline Islands Air, Inc. (the Company), which comprise the statement of net position as of September 30, 2022 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 has not performed reconciliations or maintained subsidiary ledgers for a significant portion of account balances on its September 30, 2022 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, 2022. We were unable to confirm or verify by alternative means the recorded balances in the financial statements. As a result of these matters, we were unable to determine the extent of adjustments that are necessary in respect of recorded or unrecorded balances in 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 Statement

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 6 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 June 28, 2024, 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

June 28, 2024

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

Management's Discussion and Analysis

Year ended September 30, 2022

This section of the Caroline Islands Air, Inc. (CIA) annual audit report presents the Management's Discussion and Analysis (MD&A) for the fiscal year ended September 30, 2022. MD&A is supplementary information required by the Governmental Accounting Standards Board Statement No. 34 (GASB 34) on the 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 services throughout the FSM, (2) contract with domestic and foreign persons and corporations for the provision 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 not 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 2022

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.

In fiscal year 2022, operating revenue sources of CIA's operations are from \$586k of passenger airfare, \$151k of charter services, \$64k of service fees, \$12k of baggage fees, and \$5k of freight and others.

Financial Highlights

1. Statement of Net Position

The 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.

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

Management's Discussion and Analysis, continued

Comparative Statements of Net Position at September 30, 2022 and 2021 are summarized below:

	<u>2022</u>	<u>2021</u>
Assets:		
Current assets	\$218,199	\$269,932
Capital assets	<u>17,694</u>	<u>17,694</u>
Total assets	<u>\$235,893</u>	<u>\$287,626</u>
Liabilities:		
Current liabilities	<u>181,455</u>	<u>78,281</u>
Net position:		
Net investment in capital assets	17,694	17,694
Unrestricted	<u>36,744</u>	<u>191,651</u>
Total net position	<u>54,438</u>	<u>209,345</u>
	<u>\$235,893</u>	<u>\$287,626</u>

Assets: As of September 30, 2022, total assets of \$236k comprise \$218k (or 92%) of current assets and \$18k (or 6%) of capital assets.

Current assets: Total current assets of \$236k comprise \$30k (or 14%) of cash, \$130k (or 60%) of prepaid expense, \$59k (or 26%) of inventory.

Noncurrent assets: The noncurrent assets of \$18k comprise CIA's property and equipment, net of accumulated depreciation.

Liabilities: CIA's liabilities of \$181k are all current consisting of accounts payable, accrued liabilities and others.

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.

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

Management's Discussion and Analysis, continued

Below is the comparative summary of Statement of Revenues, Expenses and Changes in Net Position for the fiscal years ended September 30, 2022 and 2021.

	<u>2022</u>	<u>2021</u>
Operating revenues	\$818,406	\$647,024
Cost of operating revenues	<u>(956,466)</u>	<u>(804,873)</u>
Gross loss	(138,060)	(157,849)
General and administrative expenses	<u>166,215</u>	<u>122,304</u>
Operating loss	(304,275)	(280,153)
Non-operating income	<u>149,368</u>	<u>268,607</u>
Change in net position	(154,907)	(11,546)
Net position at beginning of year	<u>209,345</u>	<u>220,891</u>
Net position at end of year	<u>\$ 54,438</u>	<u>\$209,345</u>

Fiscal year 2022 operating revenue sources of CIA's operations are from \$586k of passenger airfare, \$151k of charter services, \$64k of service fees, \$12k of baggage fees, and \$5k of freight and others.

3. Summary Statement of Cash Flows

The following table presents information about changes in the cash position using the direct method of reporting sources and uses of cash. The direct method reports all major cash inflows and outflows at gross amounts, differentiating the activities into cash flows arising from operating activities, noncapital financing and capital and related financing.

	<u>2022</u>	<u>2021</u>
Cash flows used in operating activities	\$(201,101)	\$(234,272)
Cash flows provided by noncapital financing activities	<u>149,368</u>	<u>268,607</u>
Net change in cash	(51,733)	34,335
Cash at beginning of year	<u>81,354</u>	<u>47,019</u>
Cash at end of year	<u>\$ 29,621</u>	<u>\$ 81,354</u>

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

Management's Discussion and Analysis, continued

Economic Outlook

CIA incurred an operating loss in the amount of \$(304,275) during fiscal year 2022. CIA continues to face challenges especially because CIA operates with one plane with continuous mechanical challenges. 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.

Management's Discussion and Analysis for the year ended September 30, 2021, is set forth in the report on the audit of financial statements, which is dated April 6, 2023. That Discussion and Analysis explains the major factors impacting the 2021 financial statements and can be viewed at the FSM Office of the National Public Auditors' website at www.fsmopa.fm.

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 510, Kolonia Pohnpei, FM 96941.

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

Statement of Net Position

September 30, 2022

Assets

Current assets:

Cash	\$ 29,621
Prepaid expense	129,968
Inventory	<u>58,610</u>

Total current assets 218,199

Capital assets, net 17,694

\$235,893

Liabilities and Net Position

Current liabilities:

Accounts payable	\$ 5,949
Accrued liabilities and others	<u>175,506</u>

Total liabilities 181,455

Commitments and contingencies

Net position:

Net investment in capital assets	17,694
Unrestricted	<u>36,744</u>

Total net position 54,438

Total liabilities and net position \$235,893

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, 2022

Operating revenues:	
Passenger airfare	\$586,493
Charter services	150,966
Service fees	64,127
Baggage fees	12,011
Freight	4,469
Drums	<u>340</u>
Total operating revenues	<u>818,406</u>
Operating costs:	
Salaries and housing	451,458
Maintenance and operation	295,577
Insurance	101,237
Rent	62,841
Taxes	25,059
Contract labor	<u>20,294</u>
Total operating costs	<u>956,466</u>
Gross loss	<u>(138,060)</u>
General and administrative expenses:	
Travel	117,069
Utilities	9,600
Communications	8,572
Supplies	8,254
Professional fees	3,788
Bank service fees	2,411
Miscellaneous	<u>16,521</u>
Total general and administrative expenses	<u>166,215</u>
Operating loss	<u>(304,275)</u>
Nonoperating income (expense):	
Subsidies from the FSM National Government	<u>149,368</u>
Change in net position	<u>(154,907)</u>
Net position at beginning of year	<u>209,345</u>
Net position at end of year	<u>\$ 54,438</u>

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, 2022

Cash flows from operating activities:	
Cash received from customers	\$ 818,406
Cash paid to suppliers for goods and services	(568,049)
Cash paid to employees for services	<u>(451,458)</u>
Net cash used in operating activities	(201,101)
Cash flows from noncapital financing activities:	
Subsidies from the FSM National Government	<u>149,368</u>
Net change in cash	(51,733)
Cash at beginning of year	<u>81,354</u>
Cash at end of year	\$ <u>29,621</u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$(304,275)
Increase in liabilities:	
Accrued liabilities and others	<u>103,174</u>
Net cash used in operating activities	\$(<u>201,101</u>)

See accompanying notes.

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

Notes to Financial Statements

Year ended September 30, 2022

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.

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

Notes to Financial Statements, continued

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.

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

Notes to Financial Statements, continued

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. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of allowance for uncollectible receivables.

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 has not recorded any trade receivables or an allowance for uncollectible accounts as of September 30, 2022.

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.

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.

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

Notes to Financial Statements, continued

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 2017, GASB issued Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. The Company has not completed its adoption and as such, GASB Statement No. 87 did not result in a material effect on the accompanying financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. The adoption of GASB Statement No. 89 did not result in a material effect on the accompanying financial statements.

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

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, continued

In January 2020, GASB issued Statement No. 92, *Omnibus 2020*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature. More comparable reporting will improve the usefulness of information for users of state and local government financial statements. This Statement addresses a variety of topics and includes specific provisions about leases; reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan; applicability of Statement no. 73 and 84 for postemployment benefits, measurement of liabilities (and assets, if any) related to asset retirement obligations (AROs) in a government acquisition; reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers; reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature and terminology used to refer to derivative instruments. The adoption of GASB Statement No. 92 did not have an effect on the accompanying financial statements.

In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. Some governments have entered into agreements in which variable payments made or received depend on an interbank offered rate (IBOR) – most notably, the London Interbank Offered Rate (LIBOR). As a result of global reference rate reform, LIBOR is expected to cease to exist in its current form, prompting governments to amend or replace financial instruments for the purpose of replacing LIBOR with other reference rates by either (a) changing the reference rate or (b) adding or changing fallback provisions related to the reference rate. The objective of this Statement is to address the accounting and financial reporting effects that result from the replacement of IBORs with other reference rates in order to preserve the reliability, consistency, and comparability of reported information. The adoption of GASB Statement No. 93 did not have an effect on the accompanying financial statements.

Upcoming Accounting Pronouncements

In May 2019, GASB issued Statement No. 91, *Conduit debt obligations*. The primary objectives of this statement are to provide a single method reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.

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

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). As used in this Statement, a PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement (SCA), which the Board defines in this Statement as a PPP in which (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

In April 2022, GASB issued Statement No. 99, *Omnibus 2022*. The requirements of this Statement will enhance comparability in the application of accounting and financial reporting requirements and will improve the consistency of authoritative literature. Consistent authoritative literature enables governments and other stakeholders to locate and apply the correct accounting and financial reporting provisions, which improves the consistency with which such provisions are applied more easily. The comparability of financial statements also will improve as a result of this Statement. Better consistency and comparability improve the usefulness of information for users of local government financial statements. GASB Statement No. 99 will be effective for fiscal year ending September 30, 2023.

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

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In June 2022, GASB issues 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. GASB Statement No. 100 will be effective for fiscal year ending September 30, 2024.

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 years ending September 30, 2025.

CIA 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, 2022, the carrying amount of the Company's total cash was \$29,621 and the corresponding bank balance was \$30,051, which is primarily maintained in financial institutions subject to Federal Deposit Insurance the Plan (FDIC) insurance. As of September 30, 2022, bank deposits in the amount of \$30,051 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, these deposits are exposed to custodial credit risk.

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

Notes to Financial Statements, continued

4. Capital Assets

Capital asset activities for the year ended September 30, 2022 are as follows:

	Balance at October 1, 2021	Transfers and Additions	Transfers and Deletions	Balance at September 30, 2022
Motor vehicles	\$56,790	\$ ---	\$ ---	\$56,790
Equipment	10,300	---	---	10,300
Furniture and fixtures	<u>1,638</u>	<u>---</u>	<u>---</u>	<u>1,638</u>
	68,728	---	---	68,728
Less accumulated depreciation	<u>(51,034)</u>	<u>---</u>	<u>---</u>	<u>(51,034)</u>
	<u>\$17,694</u>	<u>\$ ---</u>	<u>\$ --</u>	<u>\$17,694</u>

5. Related Party Transactions

During the year ended September 30, 2022, CIA received \$149,368 of subsidies from the FSM National Government.

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 October 2022.

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.



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, 2022, and the related notes to the financial statements, which collectively comprise the Company's basic financial statements and have issued our report thereon dated June 28, 2024. 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, 2022 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, 2022.

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 2022-001 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.

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

June 28, 2024

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

Schedule of Findings and Responses

Year ended September 30, 2022

Finding No.: 2022-001

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.

Condition: The Company's general ledger was not reconciled periodically or at the year-end, and 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, 2022 was provided in January 2024 and subsequently a revised reversion was provided in March 2024. However, the updated trial balance does not reflect any transactions or adjustments in several key accounts such as prepaid expenses, inventory, capital assets, and accounts payable as such these balances remained the same as of the September 30, 2021 closing balances. The Company was unable to provide supporting subsidiary ledgers to allow auditors to perform sufficient alternative procedures to determine the extent of misstatements on these accounts.

Cause: The cause of the above the condition is lack of periodic reconciliation of the general ledger, as well as the proper analysis of all pertinent balance sheet accounts, other than the cash-in-bank accounts.

Effect: The effect of the above condition is the material misstatements of financial statements, including the potential disbursements of Company funds for unsupported transactions.

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.