

Caroline Islands Air, Inc.

Financial Statements and
Independent Auditor's Reports
as of and for the Years Ended
September 30, 2004 and 2005

J.E. Fortenberry, III, PC
Certified Public Accountant

Caroline Islands Air, Inc.
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J.E. FORTENBERRY, III, P.C.
CERTIFIED PUBLIC ACCOUNTANT

INDEPENDENT AUDITOR'S REPORT
ON BASIC FINANCIAL STATEMENTS

Board of Directors
Caroline Islands Air, Inc.
Pohnpei, Micronesia

I have audited the accompanying financial statements of the Caroline Islands Air, Inc., a component unit of the Federated States of Micronesia, as of and for the years ended September 30, 2004 and 2005. These financial statements are the responsibility of the Caroline Islands Air, Inc.'s management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my 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. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinions.

In my opinion the financial statements referred to above present fairly, in all material respects, the financial position of the Caroline Islands Air, Inc. at September 30, 2004 and 2005, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued my report dated November 27, 2007 on my consideration of the Caroline Islands Air, Inc.'s internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audit.



J.E. Fortenberry, III, PC
November 27, 2007

Certified Public Accountant

FINANCIAL STATEMENTS

Caroline Islands Air, Inc.
Kolonias, Pohnpei
Statement of Net Assets
September 30

Assets

	<u>2004</u>	<u>2005</u>
Current Assets:		
Cash and Cash Equivalents	\$91,149	\$37,902
Total Accounts Receivable, Net of Allowance for Doubtful Accounts	<u>1,153</u>	<u>0</u>
Total Current Assets	<u>92,302</u>	<u>37,902</u>
Non-Current Assets:		
Property and Equipment:		
Vehicles	3,000	3,000
Furniture & Equipment	<u>7,738</u>	<u>7,738</u>
Total Capital Assets	10,738	10,738
Less: Accumulated Depreciation	<u>(5,651)</u>	<u>(7,807)</u>
Net Capital Assets	<u>5,087</u>	<u>2,931</u>
Total Assets	<u>\$97,389</u>	<u>\$40,833</u>

Liabilities and Net Assets

Current Liabilities:		
Accounts Payable	\$20,084	20,084
Accrued Payroll Related Liabilities	<u>3,521</u>	<u>3,840</u>
Total Current Liabilities	23,605	23,924
Non-Current Liabilities:	<u>0</u>	<u>0</u>
Total Non-Current Liabilities	0	0
Total Liabilities	<u>23,605</u>	<u>23,924</u>
Net Assets:		
Invested in Capital Assets, Net of Related Debt	\$5,087	2,931
Unrestricted	<u>68,697</u>	<u>13,978</u>
Total Net Assets	<u>\$73,785</u>	<u>\$16,910</u>

The accompanying notes are an integral part of this statement.

Caroline Islands Air, Inc.
 Kolonia, Pohnpei
Statement of Revenue, Expenses and Change in Net Assets
 Fiscal Years ended September 30, 2004 and 2005

	<u>2004</u>	<u>2005</u>
Operating Revenues:		
Passenger Airfare	\$233,278	\$241,473
Baggage Fees	53,101	49,117
Charter Services	48,883	55,548
Drums	12,691	6,327
Freight	<u>4,659</u>	<u>1,700</u>
Total Operating Revenue	352,612	354,165
Operating Expenses:		
Salaries and Benefits	73,295	92,820
Rent	11,714	10,197
Utilities	4,068	5,040
Ordinary Maintenance & Operations	190,733	222,407
Depreciation	2,956	2,156
Insurance	18,778	41,747
Communication	9,298	13,132
Taxes	8,437	7,801
Administrative Repairs	987	1,412
Supplies	2,363	3,447
Professional Fees	4,383	5,261
Travel	13,130	3,610
Miscellaneous	<u>1,616</u>	<u>2,256</u>
Total Operating Expenses	341,758	411,286
Earnings (Loss) from Operations	10,854	(57,121)
Nonoperating Revenues (Expenses)		
Interest Income	<u>443</u>	<u>244</u>
	<u>11,297</u>	<u>(56,877)</u>
Net Assets - Beginning	<u>62,488</u>	<u>73,785</u>
Net Assets - Ending	<u>\$73,785</u>	<u>\$16,910</u>

The accompanying notes are an integral part of this statement.

Caroline Islands Air, Inc.
 Kolonia, Pohnpei
Statement of Cash Flows
 Fiscal Years ended September 30, 2004 and 2005

	<u>2004</u>	<u>2005</u>
Cash flows from operating activities:		
Operating receipts	\$355,125	\$356,436
Cash paid for goods and services	(249,947)	(317,107)
Payment to employees for services	<u>(73,295)</u>	<u>(92,820)</u>
Net provided (used) by operating activities	31,883	(53,491)
Cash flows from noncapital financing activities:		
Appropriated grants	<u>0</u>	<u>0</u>
Net provided (used) by noncapital financing activities	0	0
Cash flows from capital activities:		
Acquisition of capital assets	0	0
Proceeds from capital grants	<u>0</u>	<u>0</u>
Net provided (used) by capital and related financing activities	0	0
Cash flows from investing activities:		
Interest on Investments	<u>443</u>	<u>244</u>
Net provided (used) by investing activities	443	244
Net increase/decrease in cash	32,326	(53,247)
Cash and cash equivalents, beginning	<u>58,823</u>	<u>91,149</u>
Cash and cash equivalents, ending	<u><u>\$91,149</u></u>	<u><u>\$37,902</u></u>
Cash flows from operating activities:		
Increase in Net Assets Before Depreciation	14,253	(54,721)
Adjustments to reconcile decrease/increase in net assets to net cash provided by operating activities -		
Interest on Investments	(\$443)	(\$244)
Capital grants	0	0
Operating grants	0	0
Changes in assets and liabilities:		
Receivables	7,887	1,153
Accounts payable	<u>10,186</u>	<u>321</u>
Total Adjustments	<u>17,630</u>	<u>1,230</u>
Net cash used in operating activities	<u><u>\$31,883</u></u>	<u><u>(\$53,491)</u></u>

The accompanying notes are an integral part of this statement.

Caroline Islands Air, Inc.

Notes to the Financial Statements
September 30, 2004 and 2005

Caroline Islands Air, Inc.

Notes to the Financial Statements

For the year ended September 30, 2004 and 2005

(1) Summary of Significant Accounting Policies.

A. Nature of Organization and Operations.

Caroline Islands Air, Inc. (CIA) is a public corporation established under the laws of the Federated States of Micronesia (FSM). On December 27, 1997, Public Law No. 10-72 established the public corporation to manage the operation and maintenance of the aircraft already purchased, as well as any other aircraft that may subsequently be purchased to operate out of Pohnpei State in the FSM. CIA is managed by a Board of Directors composed of 5 members: the Secretary of the FSM Department of Transportation, Communication and Infrastructure, or his designee; one member from Chuuk, one member from Kosrae, one member from Yap, one member from Pohnpei and the chief executive officer of CIA.

The public corporation is charged by the Congress of the Federated States of Micronesia with the following duties:

- 1) provide air transportation service throughout the Nation;
- 2) contract with domestic and foreign persons and corporations for the provisions of aircraft and services;
- 3) operate domestic air transportation;
- 4) train citizens in professions related to aeronautics;
- 5) act as a "Freely Associated State Air Carrier" with in 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;
- 7) enter into joint ventures with other entities in order to effectuate its operations.

B. Enterprise Fund Accounting.

The Airline is organized, operated and financed in a manner similar to a private business enterprise, where (a) the intent of the governing body is that the cost (expense, including depreciation) of providing services on a continuing basis be financed or recovered primarily through user charges, or (b) where the governing body has decided the periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

C. Basis of Accounting.

Caroline Islands Air, Inc.

Notes to the Financial Statements

For the year ended September 30, 2004 and 2005

The financial statements of the Caroline Islands Air, Inc. have been prepared in conformity with accounting principles generally accepted in the United States of America and, as a governmental entity provides certain disclosures required by the Governmental Accounting Standard Board (GASB). The GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Pursuant to Governmental Accounting Standard Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, the Airline has elected to apply all applicable Financial Accounting Standard Board (FASB) pronouncements issued on or before November 30, 1989 in preparing financial statements and related disclosures unless those pronouncements conflict or contradict Governmental Accounting Standard Board (GASB) pronouncements.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The Enterprise Fund is accounted for on a flow of economic resources measurement focus and a determination of net income and capital maintenance. With this measurement focus, all assets and all liabilities associated with the operation of this fund are included on the balance sheet. The Enterprise Fund uses the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized at the time liabilities are incurred, regardless of the timing of the related cash flows.

D. Receivables

The Airline's accounts receivable are with businesses and individuals that relate to passenger and freight tickets. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on receivables that may become un-collectable based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense.

E. Net Asset Categories

Resources are classified into the following net assets categories:

Invested in capital assets, net of related debt whereas capital assets, net of accumulated depreciation and outstanding principal balances of debt attributed to the acquisition, construction or improvement of those assets.

Caroline Islands Air, Inc.

Notes to the Financial Statements

For the year ended September 30, 2004 and 2005

Restricted, either Nonexpendable where net assets subject to externally imposed stipulations require permanent maintenance or Expendable where external stipulations exist which may be fulfilled by the Airline.

There was no restricted net assets at September 30, 2004 or 2005.

Unrestricted, in which case assets may be designated for purposes designated by the Committee, or Management.

F. Use of Estimates.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. In the case of Caroline Islands Air, Inc. depreciation was used with the estimates as described in note G.

G. Capital Assets and Depreciation

Property and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful life of the assets. The Airline has a policy in place which requires the capitalization of all asset purchases of \$1,000 or greater and with a useful life of five years or more.

Depreciation of all exhaustible capital assets used by enterprise funds is charged as an expense against operations; and accumulated depreciation is reported on the balance sheet. Depreciation has been provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Vehicles	5 years
Furniture and equipment	5 years

H. Compensated Absences

Accumulated leave for contracted employees is recorded as an expense as the benefit is used by the employees. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits. The related sick pay expense is recorded when the benefit is actually taken.

I. Cash Equivalents.

Cash includes amounts in demand deposits and interest bearing demand deposits. Cash equivalents include amounts in time deposits having a maturity of three month or less when purchased.

Caroline Islands Air, Inc.

Notes to the Financial Statements

For the year ended September 30, 2004 and 2005

(2) Cash and Certificates of Deposit

The Airline may deposit funds within a fiscal agent bank organized under the laws of the Federated States of Micronesia. At September 30, 2004 and 2005 the Airline had cash and savings (book balances) totaling \$91,149 and \$37,903, respectively. These deposits are stated at cost, which approximates market.

These deposits are subjected to custodial credit risk when deposits exceed \$100,000 because they are maintained at financial institutions subject to Federal Deposit Insurance Corporation (FDIC). All of the reported book balances at September 30, 2004 and 2005 were insured.

(3) Property and Equipment

A summary of property and equipment at September 30, 2004 and 2005 follows:

	10.1.2003	added	9.30.2004	added	9.30.2005
Vehicles	3,000	0	3,000	0	3,000
Equipment	6,100	0	6,100	0	6,100
Furniture	<u>1,638</u>	<u>0</u>	<u>1,638</u>	<u>0</u>	<u>1,638</u>
Total	10,738	0	10,738	0	10,738
Accumulated Depreciation	3,495	2,156	5,651	2,156	7,807
Net Assets	7,243		5,087		2,931

Public Law 10-72 Section 3 paragraph 4 allows Caroline Islands Air, Inc. to operate aircraft owned by the Federated States of Micronesia. The Airline operates three aircraft, a 1979 Britten Norman Islander, a 1960 Beech Queenair, and a 1971 Britten Norman Islander.

(4) Risk Management

Caroline Islands Airline purchases insurance to cover accidental damage or loss to aircraft owned by the Federated States of Micronesia. Additionally liability insurance is obtained against the Airline's legal liability to third parties and passengers for accidental bodily injury and accidental damage to property including cargo, freight, and mail. Caroline Islands Airline is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

(5) Receivables

The Airline's accounts receivable are with businesses and governments that relate to passenger, cargo and charter charges. The allowance for uncollectible accounts is stated at an amount which management believes will 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.

Caroline Islands Air, Inc.

Notes to the Financial Statements
For the year ended September 30, 2004 and 2005

	<u>Accounts Receivable</u>	<u>Allowance for Doubtful Accounts</u>
2004	\$37,204	\$36,051
2005	\$33,564	\$33,564

J.E. FORTENBERRY, III, P.C.
CERTIFIED PUBLIC ACCOUNTANT

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

Board of Directors
Caroline Islands Air, Inc.
Pohnpei, Micronesia

I have audited the financial statements of the Caroline Islands Air, Inc. as of and for the years ended September 30, 2004 and 2005, and have issued my report thereon dated November 27, 2007. I conducted my 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.

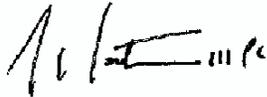
Internal Control over Financial Reporting

In planning and performing my audit, I considered the Corporation's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I did not note any matters involving internal control over financial reporting and its operation that I consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. The results of my tests did not disclose any instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the legislature, board and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



J.E. Fortenberry, III, PC
November 27, 2007

Certified Public Accountant

FINDINGS, CORRECTIVE ACTION PLAN AND AUDIT FOLLOW-UP

Caroline Islands Air, Inc.
Schedule of Findings and Questioned Costs
For the Years Ended September 30, 2004 and 2005

Section 1: Summary Schedule of Auditor's Results:

Financial Statements:

1. Type of auditor's report issued on the financial statements: Unqualified.
2. Material noncompliance relating to the financial statements? No.
3. Internal control over financial reporting:
 - a. Material weaknesses identified? No.
 - b. Reportable conditions identified that are not considered to be material weaknesses? No.

Section 2: Findings Relating to the Financial Statements

The results of my tests did not disclose any findings related to the financial statements that are required to be reported by *Government Auditing Standards*.