

OFFICE OF THE NATIONAL PUBLIC AUDITOR
FEDERATED STATES OF MICRONESIA

**PERFORMANCE AUDIT OF
Caroline Island Airline (CIA)
(FY 2009 through June 2010)**

REPORT NO. 2010-11



**Haser H. Hainrick
National Public Auditor**



FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

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October 27, 2010

His Excellency Manny Mori, President
Honorable Members of the FSM Congress
Federated States of Micronesia

RE: Performance Audit of the Caroline Island Airline (CIA)

We have completed a performance audit of the Caroline Island Airline. The audit was conducted at the request of the Chairman, Committee on Judiciary and Governmental Operations of the FSM Congress who asked the Public Auditor to conduct an audit of the airline's management processes and activities for fiscal year 2009 through June 30, 2010.

As such, the objectives of the audit are to (1) evaluate the effectiveness of current management and oversight systems to determine if it provides adequate assurance that operational goals and objectives are achieved. (2) evaluate the effectiveness and compliance of procurement procedures, (3) evaluate cash handling procedures to ensure cash is adequately secure and (4) determine if assets, equipment, and supplies are properly secured.

The audit was conducted pursuant to Title 55, Chapter 5 of the FSM Code, and in accordance with Generally Accepted Government Auditing Standards issued by the Controller General of the United States.

The audit found that management and oversight systems do not provide adequate assurance that the operational goals and objectives are being achieved. Specifically there is no business plan that maps how the Airline can become a self-sustaining enterprise.

The Airline does not document any plan of business-development, marketing / advertising, or its projected cash flow for any period of time in the future.

The audit found that Management has not implemented necessary internal controls. Specifically, we found that flight Manifests are missing, or were not filled out for approximately 20-25% of flights taken. Additionally, approximately 12% of the existing manifests were incomplete.

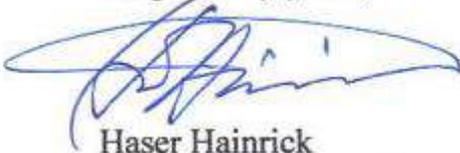
The audit also found that chartering services were provided to the public without documentation that the customer understand and agrees with the key terms and conditions.

Lastly, there is no standard procedure for hiring of employees and other employment practices.

The audit report includes recommendations that will help the airline management to improve, ultimately, the effectiveness of airline management.

A copy of the draft report was provided to the Airline Management, representative of the Executive Branch of the National Government and the Board of Directors for management comments and responses. The airline management and Board of Directors responded and agreed to the findings and recommendations. Their responses are included as attachments to the audit report.

Respectfully yours,



Haser Hainrick
National Public Auditor

XC: Vice President
Chief Executive Officer
All members, Board of Director

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INTRODUCTION

Background

The Caroline Islands Airline, Inc. (Airline) was created on December 27, 1997, by an act of the Congress of the FSM (CFSM), with the passage of Public Law (PL) 10-072. PL 10-072 established the Airline as a fully empowered public corporation with the intent that “at the earliest practical opportunity, following a resolution of Congress ... shares shall be offered to the public” to become an independent private corporation.

The Law established the following purposes:

- Provide air transportation services throughout the Nation;
- Operate domestic air transportation;
- Train citizens in professions related to aeronautics; and,
- Engage in support activities including freight, delivery activities, and passenger services.

PL 10-072 also described the process and procedure for nomination and appointment of members to the Board of Directors (Board). The passage of PL 16-26, effective March 17, 2010 established that when the State representatives on the Board become vacant, replacement members are to be at the recommendation of the particular State Governor and approval of the FSM President with the consent of Congress. Additionally, PL 16-26 states that the representative from the National Government is no longer restricted to be the Secretary of the Department of Transportation, Communication & Infrastructure (TCI), and, as with all the Board members is to be approved by the President with the consent of Congress.

The Board is comprised of 5 regular members, 4 representing the FSM States and 1 representing the National Government. The Airline’s Chief Executive Officer (CEO) is a non-voting, ex-officio member.

**Table 1
Board of Directors,
At June 30, 2010**

Representative	Function
State of Pohnpei	Acting Chairman
State of Yap	Secretary of the Board
FSM Secretary, TCI	Member
State of Kosrae	Member
State of Chuuk	Member
CEO of the Airline	Non-voting member

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The Airline operates 3 aircrafts owned by the National Government.

**Table 2
Aircraft**

Model Year	Aircraft Company	Model	Engines	Load	Fuel Type
1961	Beech	BE65	2 x 400 HP	9	Low Lead
1972	Britten-Norman	Islander	2 x 300 HP	9	Low Lead
1979	Britten-Norman	Islander	2 x 260 HP	9	Low Lead

The Airline employs the following positions:

**Table 3
Summary of Employee Positions**

Position	Count	Location
CEO / Pilot / Mechanic	1	Pohnpei
Administrative Officer	1	Pohnpei
Assistant Mechanics (Part Time)	3	Pohnpei
Agents	7	Outer Islands
Assistant Agent	2	Weno
Ground's Helper	1	Weno
Total	15	

The audit was performed at the request of the Chairman of the Committee on Judiciary and Governmental Operations a Senator from the outer islands.

Objectives, Scope and Methodology

Objectives – The objectives of this audit were to determine whether:

1. Management and oversight systems provide adequate assurance that operational goals and objectives are achieved.
2. Cash is adequately secured.
3. Assets, equipment, and supplies are properly secured.
4. Procurement procedures are adequate.

This audit was conducted pursuant to Title 55 of the FSM Code, Chapter 5, which states in part:

“The Public Auditor shall inspect and audit transactions, accounts, books, and other financial records of every branch, department, office, agency, board, commission, bureau, and statutory authority of the National Government and of other public legal entities, including, but not limited to, States, subdivisions thereof, and nonprofit organizations receiving public funds from the National Government.”

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Scope: The scope of our audit includes all activities and internal controls relevant to the objectives for the time period of fiscal year 2009 through June 30, 2010. Transactions representative of the relevant activities were primarily selected from fiscal year 2009 through December 31, 2009 time period while processes and activities were generally reviewed through June 30, 2010.

Methodology – The audit fieldwork was conducted at the Airline’s office and aircraft hanger located at the Pohnpei International Airport.

To determine whether management and oversight systems provide adequate assurance that operational goals and objectives are achieved, the audit team:

- Reviewed CFSM’s intents and purposes for the Airline as stated in PL 10-072;
- Reviewed minutes of Board meetings;
- Interviewed Board members;
- Reviewed policies and procedures;
- Reviewed financial and operational reports;
- Obtained, summarized, and analyzed various operating data including cost structures; and,
- Obtained and summarized flight manifests.

The audit team interviewed the President’s Chief of Staff to determine the process and procedure of appointing persons to the Airline’s Board and other Boards, and the system, if any, to hold Boards accountable.

To determine if cash is adequately secured, the audit team selected a judgmental sample of flight manifests and examined the passenger airfare from payment to bank deposit.

To determine if assets, equipment, and supplies are properly secured, the audit team obtained the asset listing from Department of Finance & Administration and confirmed existence, also observing the physical security of the assets. Additionally, since fuel is the Airline’s largest cost of operation, we observed the security over fuel storage and the records for accountability of usage.

To determine if procurement procedures are adequate, the audit team reviewed the procedures used to purchase its primary operating expense, which is the purchase of fuel.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States. These standards required that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

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Prior Audit Coverage

This is the first audit by the ONPA of the Airline. External financial audits were conducted by Fortenberry & Ballard, PC, Certified Public Accountants, of which the most recent was completed on December 18, 2009 for Fiscal Years 2008 and 2009. The audit team reviewed the external financial audit reports. The December 18, 2009 report found expenses were not accrued and recommended that a system be established to facilitate journal entries to the general ledger accounts.

CONCLUSION

Based on our audit, we conclude that:

1. Management and oversight systems do not provide adequate assurance that the operational goals and objectives are being achieved.
2. Cash receipts not fully accounted due to some missing flight manifests.
3. Although most assets and equipment are adequately secured, we found that fuel, which is the Airline's largest expense, is not adequately secured.
4. Procurement procedures were adequate.

The detail discussions of our findings supporting the conclusions are on the following pages.

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FINDINGS AND RECOMMENDATIONS

- 1. More than a decade subsequent to its creation, the Airline remains a government owned corporation lacking the strategic and tactical capacity to operate as a self-sustaining enterprise.**

Public Law 10-072 states that the Airline as soon as practical is to become a private corporation.

To attract private investment, the investor must believe that a return on investment in the Airline is achievable. To achieve a return on investment, the Airline must align its operation with good management practices starting with the development of basic business strategic and tactical planning.

The audit team observed that business planning, strategic and tactical, is lacking:

- A. Strategic, long term plan: There is no business plan that maps how the Airline can become a self-sustaining enterprise. A strategic plan would illustrate how outer island people and other users could best be served by islander aircraft operating reliably and economically. The strategic plan should address key elements, for example:
 1. *Marketing Plan / Services Provided*: There is no plan of how best to serve the air transportation needs of island people. A marketing plan should illustrate how the services provided by the Airline are needed by the various demographic groups of the island people. The marketing plan is then put into practical application through promotions and local advertising on all the islands.
 2. *Financial Projections and Analyses*: The absence of long term planning reflects the social acceptance of the Airline being dependent on Congress for cash subsidies to operate.
 3. *Aircraft Life Cycle Planning*: Aircraft life cycle planning has not been formalized, but has simply been to maintain the current aircraft. There is no documented management analysis of the advantages or disadvantages of alternative or replacement aircraft, or upgrades to current aircraft deployed. For example, the current aircraft require leaded fuel that is harmful to the environment and the fuel is in limited production and the Airline pays nearly double the price compared to other aviation fuels.

Alternative fuels, engines and / or aircraft should be analyzed relative to the cost / benefit of each. The analyses should be documented with the advantages and disadvantages of

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each clearly indicated, have a recommended course of action, and include replacement of engine or aircraft at the most advantageous time of the life cycle.

- B. Tactical Plan (Short Term): The Airline does not document any plan of business-development, marketing / advertising, or its projected cash flow for any period of time in the future.
1. Flight schedules are not advertised or posted for the public to view, as required by Public Law 10-92 signed June 6, 1998. (See FSM Code, Title 20, Section 418).
 2. Airline services are not advertised.
 3. Financial budgets are not developed, not implemented, and there is no indication of any financial analysis or financial projections. For example:
 - a. management has not implemented a budget process, there is no comparative analyses of budgeted income and expenses versus actual income and expense performed monthly, quarterly or annually; and,
 - b. management has not performed a cost analyses to determine how many passengers or how much cargo sales income is needed to make a flight pay for itself.

Financial Analyses Cost Principle: A management accounting cost principle is that all flights for which income is greater than the variable cost of making the flight, (from a cost/profit concern) should be flown since all income remaining after subtracting the variable cost will contribute to paying fixed cost. On a periodic basis (monthly, quarterly and annually) all fixed cost must be paid from income in order to have a positive net operating income. In summary, income that exceeds variable costs will pay for fixed costs, and income that exceeds both variable costs and fixed costs, will become a positive operating income. The income remaining after variable cost is called the “contribution margin” (CM). Contribution margin pays for fixed cost, plus if there is any remaining amount it becomes operating income.

Illustrative Use of Financial Analyses for Passenger Flights: During the course of the audit, the audit team analyzed the Airline’s cost structures to assist management with “fly or no fly” analyses. The Operations Manual states on page 32 that all flights with fewer than 5 passengers, or a full load of cargo should be cancelled. Table 5 illustrates why specific financial analyses is needed for each route, for example:

- a minimum of *only* 3 (not 5) passengers is needed for a one way flight from Pohnpei to Mokil for airfare (3 x \$90) since \$270 is greater than the variable cost of \$268, and
- a minimum of 7 (not 5) passengers is needed for a one way flight from Pohnpei to Ta (7 x \$130=\$910) for airfare to be greater than the variable cost of \$804.

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**Table 5
Example Cost Analyses
One Way Trips**

Example Flight	Typical Flight Time (Hour)	Estimated Variable Cost (VC) Per Hour	Estimated Total VC	One Way Fare	Minimum Passengers Needed To Cover VC	Total Fare Needed	Contribution Margin (Airfare-VC)
PNI-MOK	0.8	\$335	\$268	\$90	3	\$270	\$2
PNI-TA	2.4	\$335	\$804	\$130	7	\$910	\$106
TA-WENO	1.4	\$335	\$469	\$95	5	\$475	\$6
WENO -HOUK	1.3	\$335	\$436	\$85	6	\$510	\$74
PNI-PLP	1.4	\$335	\$469	\$95	5	\$475	\$6
WENO-ONOUN	1.3	\$335	\$436	\$80	6	\$480	\$44

Source: The estimated variable cost per hour rate was determined by obtaining from management the approximate current cost of fuel, plus the current cost to repair/replace/service aircraft components including engine parts, wheel and landing gear.

A complete detail of the computation of variable cost for each aircraft is attached on page 13.

Illustrative Use of Financial Analyses for Charter Flights: Charter Services, which are priced at \$700 per hour, are *very profitable*, as shown in Table 6 below.

**Table 6
Example of Financial Analyses Regarding Charter Flights
Summary Table of Charter Activity
Calendar Year 2009**

Type of Customer	Percent By Customer Type	Charter Sales Income	Estimated Variable Cost	Estimated Contribution Margin	Round Trips	Average Sale Per Charter
Individuals	35%	\$47,643	\$23,351	\$24,292	20	\$2,382
States & Agencies	35%	\$47,669	\$22,937	\$24,732	13	\$3,667
FSM & Agencies	14%	\$18,630	\$7,341	\$11,289	8	\$2,329
RMI ¹ : Enwetak Local Gov't	12%	\$16,120	\$10,193	\$5,927	5	\$3,224
Other	4%	\$4,306	\$1,871	\$2,435	4	\$1,077
Total	100%	\$134,368	\$65,693	\$68,675	50	N/A

Source: The data for this table were assembled by the auditors using cost analysis techniques. Information was assembled from flight manifest documents, receipts, e-mail communications and interviews with the Airline management. The estimated variable cost was calculated using the variable cost per hour of flight, as shown in the attachment on page 13, multiplied by the hours of flight to the particular destination, plus the return trip.

¹ RMI refers to the Republic of the Marshall Islands.

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Table 7 lists the amounts of cash subsidies requested by the Airline and received from the FSM National Government, by fiscal year for 2006-2009:

**Table 7
List of Government Subsidy Amounts for Fiscal Years 2006-2009**

Fiscal Year	Amount
2009	\$147,421
2008	-0-
2007	\$22,573
2006	\$109,337

Source: Audited Financial Statements by Fortenberry

Summary and Result: The financial analyses shown and discussed above illustrate how the proper managing of passenger flights when combined with the highly profitable charter service will result in the Airline being operated profitably with a positive return on investment.

Ultimately, the lack of business and financial planning resulted in the Airline not being operated profitably and today still being dependant on government subsidies until such corrective action is accomplished.

Cause and Recommendations

- *The Board of Directors was not held accountable.* Public Law 10-072 requires that the audited, annual financial statements along with other relevant information (Annual Performance Report) to be submitted to the President's Office and to Congress within 90 days following the close of its fiscal year end, or September 30. The 2008 Annual Performance Report was not completed until December, 2009 one year past its due date. The performance of the Board was not monitored nor reviewed by anyone.
- *The Board has not built the necessary management capacities to perform business planning.* For example, the Airline does not have a Budget and Finance officer, a key requirement of PL 10-072. As a result, there is no employee trained in financial planning, financial analysis, or in the Generally Accepted Accounting Principles (GAAP). There is no employee with the knowledge to build and implement a budget process, to perform financial analyses or to provide insight regarding cost structures, financial projections, and other information necessary for intelligent management decision making.

One person serves as the CEO / Pilot / Mechanic, and with 3 aircrafts to maintain and operate, there is little time for the CEO to oversee the development of business planning.

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- *The Board does not hold management accountable.* The Board does not evaluate management's performance.
- *The Board seldom meets.* To date, the Board has met only once in 2010 even though PL-10-072 Section 12 states, "Regular meetings shall be held not less than one per calendar quarter". Our review of the Board minutes indicates that some Board members declined to attend meetings because they did not have the time.

We recommend:

- FSM President's Office:
 - Communicate and document the responsibilities and key elements of governance expected of the Boards;
 - Require reports and copies of minutes following each Board meeting; and,
 - Require Board members to receive training in Board responsibilities, including the principles, tools and techniques of Enterprise Risk Management.²
- Congress, Committee on Transportation, Communication and Infrastructure: Follow-up on the timely filing of each year's Annual Performance Report as required by PL 10-072.
- Board of Directors:
 - Meet regularly: The Airline has a long history of being under-managed and generally unmanaged. It is the Board's function to establish policies and oversee the management of the Airline. The Board should consider meeting monthly until the Airline develops and implements the basic tools of managing the business. The Board should agree to a 12 month calendar of meetings at its first meeting, including the specific date and place of meeting.
 - Oversee the CEO to hire the appropriate staff: Oversee the hiring of the necessary functions / skill-sets including a Budget and Finance Officer educated and trained in financial planning and analysis and in generally accepted accounting principles.
 - Oversee the CEO to Perform the Appropriate Business Planning: Ensure the CEO directs the development and implementation of:
 - ✓ A budget process, including financial reporting and analyses including comparison of budget to actual on a regular basis: annually, quarterly and monthly;
 - ✓ A plan of marketing and promoting airline services;
 - ✓ A plan of advertising of services including pricing; and,

² *Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.* Quoted from: www.coso.org

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- ✓ Public posting and advertising of flight schedules (required by law).

- Oversee the CEO to Develop A Strategic Plan: Work with the CEO to develop a Strategic Plan as to how the Airline can become self sustainable. The Strategic Plan should be a long term plan that illustrates over the course of time, perhaps 5 years, how the marketing plan and advertising of services can produce a return on expenditures by increased revenues and project the resulting increased airline activities, flights and charters into a profitable business model.

- Conduct a performance evaluation of the CEO.

- Use the Strategic Plan To Obtain Additional Funding From Congress: The development of a formalized, documented plan to become self-sustainable will illustrate to Congress, or other investors and sponsors, that investing in the Airline can have a positive return on investment.

2. Management has not implemented the necessary internal controls.

The audit team reviewed the controls³ pertaining to the documentation of flight manifests, charter services, usage of fuel, and employment practices.

Regarding these controls, the Airlines Operations Manual requires:

- Flight manifests be completed and signed (page 39, section D.2),
- Personnel files to be maintained and shall include for each employee: physical description, date of hire, duties of employee, place of birth, resume, plus other requirements (page 1).
- Charter Services: Various terms and conditions as listed (page 40), including the acceptance passengers.

Principles of accountability require fuel expenditures, the Airline's largest expense of operating, to be supported by records establishing that the fuel was used only for authorized purposes.

Generally accepted business principles require key agreements, such as Charter Service Agreements, terms and conditions to be documented and should be agreed with customers at the time of payment, or sooner.

Details of the findings are described below:

³ COSO defines internal control as a process, effected by an entity's board of directors, management and other personnel that is designed to provide reasonable assurance regarding the achievement of objectives in effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. See www.coso.org.

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A. Flight Manifests are missing, or were not filled out for approximately 20-25% of flights taken. Additionally, approximately 12% of the existing manifests were incomplete. The flight manifest is a key control because:

1. For safety since it documents the key calculations used to determine compliance with weight limits and the plane's center of gravity;
2. For safety since it becomes an authoritative list of all passengers by name; and,
3. For income since it documents that all passengers paid, or did not pay.

Flight manifest forms are pre-numbered, however, numeric control sequence was not enforced.

As a result, it could not be determined whether all flights complied with weight limitations, or whether all income from flight activity was properly recorded and deposited.

B. Charter Services: Chartering of aircraft provided sales revenue of \$103,900 in FY2009. Charter services are provided to the public, to the State and local governments, to the National Government and Agencies, and to the Enwetak local government in the Republic of the Marshall Islands.

The Airline Operations Manual, Section VII, Sections E and F lists multiple terms, conditions and policies directly governing the chartering of planes.

Standard business practice is for the terms and conditions of key agreements to be documented and for the customer to read and sign a standard form acknowledging agreement.

This significant and profitable service is provided without documentation that the customer understands and agrees with the key terms and conditions.

As a result, in the absence of formal documentation of Charter activity:

1. There is inadequate assurance that all Charter income is properly recorded especially if a flight manifest (see above) was not prepared.
2. Customer disputes may result in liability and / or diminished good-will due to misunderstandings since key terms and conditions are not all documented.

C. Fuel usage: The largest single expense to operate the Airline is the cost of aviation fuel. Fuel is purchased in 55 gallon drums.

Standard business practice requires expenditures, especially of this amount, to be fully accounted for including the keeping of records documenting its legitimate use.

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While refueling of aircraft is noted on the maintenance logs, *the quantity of fuel disbursed is not recorded.*

As a result, the audit team could not determine if all fuel purchased was used only for authorized purposes. It was noted by management that the 100LL fuel could also be used for boat engines.

- D. Employment Records: The Airline employs 15 or more, however, there is no documentation of job performance expectations, no job descriptions, no documentation of employee policy regarding sick or annual leave, and no employment documents signed by the employee or the employer. Individuals were hired and reported to work without approved personnel actions and/or employment contracts.

Standard business practice is for all phases of the employment process to be documented and formalized to help ensure the hiring of the right people for the job, to promote fairness, mutual expectations between the employee and employer. The employment process in general, the doctrine of fairness, and holding employees accountable are all key areas requiring formalized review and the keeping of documentation.

There is no standard procedure being followed for hiring of employees or other employment practices.

As a result, overall employee performance is diminished and in the event of legal action, the Airline is potentially liable.

Cause and Recommendations

- A. Flight Manifests: Management indicates that flight manifests are sometimes lost before they are filed, while at other times if the return flight has no passengers then manifests are not prepared. Also, sequential accountability is difficult for management since forms from the same sequence are kept on each of the islands.
- B. Charter Services: Management indicates that a standard form has not been developed and that they rely on emails and verbal communication as to what is expected regarding the terms and conditions of charter service.
- C. Fuel Usage: Management indicates that a physical inventory is sometimes performed of fuel on hand, and that there are records of refueling the planes (but quantity of fuel is not recorded). However, no procedure has been established to log the quantity of fuel used, and therefore there is no reconciliation of quantity purchased, to quantity used.
- D. Employment Records: Management has limited time and standard employment records were not implemented.

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We recommend:

A. Flight Manifests: That the pilot should:

- Verify and ensure that flights are documented with a flight manifest and that all key information is entered and verified for accuracy; and,
- Sign-off on all flight manifests.

B. Charter Services: That management should prepare a standard form that includes all the terms and conditions specific to charter services in accordance with the terms and conditions listed in the Operations Manual Section VII, Sections E and F.

C. Fuel Usage: That management should implement a procedure that documents fuel usage adequate to show date, time, quantity, and purpose and can be used in summary to reconcile to the amount purchased, and the amount presently available. A single manual log if properly maintained will be adequate for this purpose. The reconciliation of fuel purchased, less fuel used, to the quantity presently-on-hand must also be performed.

D. Employment and Payroll Records: That Management should;

- Document the hiring process, including the checking of references;
- Use personnel action forms for hiring and promotions; and,
- Use job descriptions that document what is expected of the employee,
- Follow the requirements listed in the Airline's Operation Manual, for personnel files (page 1).

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ATTACHMENT: Variable Cost Detail Per Hour, By Aircraft

Variable Cost Factor	Freq Per 'X' Hours	Islander 2x260 HP				Islander 2X300 HP				Queen 2x400 HP			
		Qty	Sum	\$Per Hour	*Cost	Qty	Sum	\$Per Hour	*Cost	Qty	Sum	\$Per Hour	
1. Fuel: Gal Per Hour													
Low		26				28				38			
High		28				30				40			
Average		27		\$215.2	\$0	29		\$231.2		39			\$310.9
Current Cost Per Gal	\$7.97												
Price Per Drum	422.5												
2. Engine Maintenance:													
A. Rebuild	2000	38000	2	76000	\$38.0	45000	2	90000	\$45.0	52000	2	104000	\$52.0
B. Mags	400	1500	4	6000	\$15.0	1500	4	6000	\$15.0	1500	4	6000	\$15.0
C. Exhaust	600	1350	16	21600	\$36.0	1350	16	21600	\$36.0	1350	16	21600	\$36.0
D. Alternator	2000	600	2	1200	\$0.6	600	2	1200	\$0.6	600	2	1200	\$0.6
E. Air Intake Tubes	300	100	2	200	\$0.7	100	2	200	\$0.7	100	2	200	\$0.7
F. Oil Filter	50	25	2	50	\$1.0	25	2	50	\$1.0	25	2	50	\$1.0
G. Oil (to change)	50	6	26	144	\$2.9	6	26	144	\$2.9	6	36	200	\$4.0
H. Oil (to add)	2	6	2	11	\$5.6	6	2	11	\$5.6	6	2	11	\$5.6
I. Air Filter	300	60	2	120	\$0.4	60	2	120	\$0.4	60	2	120	\$0.4
J. Spark Plugs	300	22	24	528	\$1.8	22	24	528	\$1.8	22	36	792	\$2.6
K. Vacuum Pump	200	350	2	700	\$3.5	350	2	700	\$3.5	0	0	0	\$0.0
L. Engine Cyl Rebuild	2000	1500	2	3000	\$1.5	1500	2	3000	\$1.5	1500	3	4500	\$2.3
3. Propeller Maintenance													
A. Propeller Overhaul	2000	10000	2	20000	\$10.0	10000	2	20000	\$10.0	18000	2	36000	\$18.0
B. Prop Governor	2000	600	2	1200	\$0.6	600	2	1200	\$0.6	600	2	1200	\$0.6
4. Other Maintenance													
A. Brake Pads	200		16				16				8		
B. Wheel Bearings	600	50	5	250	\$0.4	50	5	250	\$0.4	50	3	150	\$0.3
C. Tires	600	170	5	850	\$1.4	170	5	850	\$1.4	220	3	660	\$1.1
Total VC Per Hour					\$334.5				\$357.5				\$450.9

The data in this table was assembled by the audit team based on cost data provided by the CEO. The Table calculates the cost of repairs and maintenance for individual components of the aircraft, per hour of flight. *The cost of each component when added together becomes the total variable cost per hour of flight.*

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MANAGEMENT RESPONSE

CAROLINE ISLANDS AIR, INC
A PUBLIC CORPORATION (P.L., NO. 10-72)
P.O BOX 2238
KOLONIA, POHNPEI FM 96941

October 22, 2010

Mr. Haser H. Hainrick
National Public Auditor
Office of the National Public Auditor
FSM National Government
Palikir, Pohnpei FM 96941

Haser
10.26.2010

Dear Mr. Hainrick:

Submitted herewith are Board's collective comments and responses to the findings according to the draft Performance Audit of the Caroline Islands Airline Report No. 2010-11.

Condition 1- More than a decade subsequent to its creation, the Airline remains a government owned corporation lacking the strategic and tactical capacity to operate as a self-sustaining enterprise.

Response: The Board submitted budget request in the past for a Chief Budget and Financial Officer, but was deleted by either the Executive Branch Review Committee or the Congress. The Board will do everything necessary to ensure the process of hiring of the Chief Budget and Financial Officer start as soon as possible with approved budget.

Condition 2- The Annual Report to the President and Congress was late.

Response: Public Law 10- 72 Section 23 paragraph 2 requires the Board to present an Annual Report to the President and Congress within (90) days after the fiscal year. The Board will closely monitor the progress of the report to ensure timely submission.

As of date, no Annual Report prepared by the management submitted to the Board for our review and comment.

Condition 3: The Board seldom meets.

Response: There should be an absenteeism policy in place to monitor the Board members meeting attendance. We recommend at least two annual Board meetings to be held in one of Pohnpei or Chuuk's outer islands with airport to ensure reliable information for better service from the stakeholders. The management should remind the board members of upcoming meetings and circulate a proposed agenda weeks in

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advance. The CEO must be present at every Board with the Management Report to provide the current financial and performance activities.

Condition 4: Board does not evaluate the performance of the management.

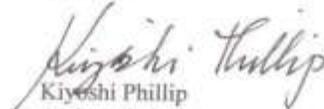
Response: We truly agree that the re-structure of the management team of the Airline be the first order of the new Board with some funds approved to bring necessary and qualified management to provide new vision of moving the Airline forward to better serve the people who need air service. One person serves as CEO/Pilot/ Mechanic with 3 aircrafts to maintain and operate has no time or little time to oversee the business development of the Airline. Hiring of a new CEO and another pilot is necessary.

Condition 5: No necessary Internal Control.

Response: The Board agrees with this finding. The Board will ensure that internal controls be established and implemented as soon as possible by the management. The use of necessary forms and contracts will be implemented to ensure proper documentation of all financial and administrative activities.

On behalf of the Board and Management I would like to thank you and your audit staff for the good spirit of cooperation extended to us during the course of this audit.

Sincerely,



Kiyoshi Phillip

Acting Chairman, Caroline Islands Air, Board of Directors

Xc: Board members
CIA CEO

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NATIONAL PUBLIC AUDITOR'S COMMENTS

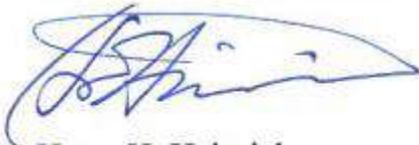
We wish to thank management and staff of the Caroline Island Airline for their assistance and cooperation during the course of our audit.

The ONPA may perform a follow-up review within the next 9-12 months to ensure that the CIA management has taken corrective measures to address the findings and recommendations provided in this report.

In conformity with government auditing standards, we provided a copy of the draft report to Management and Members of the Board of Directors for comments. Their written comments to the draft report are attached to this report.

We have provided copies of this report to the President and Members of Congress for their use and information. We will make copies available to other interested parties upon request.

If there are any questions or concerns regarding this report, please do not hesitate in contacting our Office. Contact information for the Office can be found on the last page of this report, along with the ONPA staff that made major contributions to this report.



Haser H. Hainrick
National Public Auditor

October 27, 2010

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ONPA CONTACT AND STAFF ACKNOWLEDGEMENT

ONPA CONTACT

Haser H. Hainrick, National Public Auditor
Email: hhainrick@fsmopa.fm

ACKNOWLEDGEMENTS

In addition to the contact named above, the following staff made key contributions to this report:

Ron Sufficool, CPA, CISA, CIA, CFE, CMA Audit Manager
Erwihne David, Auditor-In-Charge
Cherisse Irons, Staff Auditor

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