

**AIR MARSHALL ISLANDS, INC.**

**INDEPENDENT AUDITORS' REPORT ON  
INTERNAL CONTROL AND ON COMPLIANCE**

**YEAR ENDED SEPTEMBER 30, 2003**

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Chairman  
Board of Directors  
Air Marshall Islands, Inc.:

We have audited the financial statements of Air Marshall Islands, Inc. (AMI), as of and for the year ended September 30, 2003, and have issued our report thereon dated August 15, 2005, which was qualified due to our inability to obtain all the minutes of Board of Directors' meetings held from October 1, 2002 through August 15, 2005 and our inability to obtain adequate accounting records to support trade receivables, expendable parts, accounts payable and air traffic liability. Except as discussed in the preceding sentence, we conducted our 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**

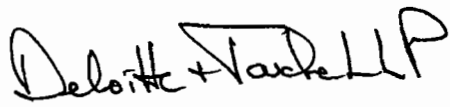
In planning and performing our audit, we considered AMI's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect AMI's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings (pages 3 through 14) as items 2003-1 through 2003-11.

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 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2003-2 through 2003-11 to be material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of AMI in a separate letter dated August 15, 2005.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether AMI's financial statements are free of material misstatement, we 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 our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no 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 Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

August 15, 2005

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Revenue/Receipts

Finding No. 2003-1

Criteria: Ticket stock should be maintained in an orderly and systematic fashion.

Condition: During the year ended September 30, 2003, ticket stock was not issued to and sold by ticketing agents/stations in sequential order and certain auditor and flight coupons were not reported to revenue accounting in a timely manner. In addition, of twenty-five tickets tested, we noted the following exceptions:

- Cash sales made by a ticketing agent at the Airok station on March 28, 2003 were not deposited until April 21, 2003; cash sales made by a ticketing agent at the Ebeye station on November 27, 2002 were not deposited until December 5, 2002; cash sales made by a ticketing agent at the Kili station on March 31, 2003 were not deposited until April 14, 2003; cash sales made by a ticketing agent at the Likiep station on April 12, 2003 and June 7, 2003 were not deposited until April 23, 2003 and June 18, 2003, respectively; cash sales made by ticketing agents at the Majuro station on October 21, 2002, February 20, 2003, May 9, 2003, July 29, 2003 and August 21, 2003 were not deposited until October 24, 2002, February 27, 2003, May 20, 2003, September 9, 2003 and August 28, 2003, respectively.
- Deposits on December 5, 2002 of cash sales by a ticketing agent at the Ebeye station were over by \$108 and deposits on June 23, 2003 of cash sales by a ticketing agent at the Namdrik station were over by \$40. We noted that only the \$108 variance was recorded in the general ledger. Our discussions with accounting personnel indicated that no effort has been made to resolve these variances.
- The flight coupons and associated daily sales reports were not made available for two tickets (ticket #s 4200-261268 and 4200-262126).
- The flight coupons for two tickets (ticket #s 5500-095539 and 5500-095540) were not attached to the associated daily sales report for June 16, 2003 for the Namdrik station.
- The Airok station flight manifest for March 28, 2003 included passengers who were boarded with no tickets. We were informed by revenue accounting personnel that this was due to a shortage of ticket stock and that the tickets were subsequently issued by revenue accounting.
- For two tickets (ticket #s 5500-087466 and 5500-097038), the fares charged of \$108 and \$77 did not agree with the established fares of \$180 and \$153, respectively.
- One charge sale (ticket # 5500-093908) on March 31, 2003 at the Kili station was not invoiced until September 30, 2003, and three charge sales (ticket #s 4400-050335, 5500-093310 and 5500-094933) on July 25, 2003, February 20, 2003 and March 26, 2003 at the Majuro station were not invoiced until January 14, 2004, May 2, 2003 and August 20, 2003, respectively.
- For one ticket (ticket # 5500-100808) issued by a ticketing agent at the Kili station, the associated cash receipts journal was not made available.

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Revenue/Receipts

Finding No. 2003-1, Continued

Cause: The cause of the above conditions is the lack of adherence to established policies and procedures relating to control over and issuance of ticket stock and the depositing of receipts.

Effect: The effect of the above conditions is the possible misstatement of cash, revenues, unearned revenues and expenses.

Prior Year Status: Lack of adherence to established policies and procedures relating to control over and issuance of ticket stock was reported as a finding in the audits of AMI for fiscal years 1999 through 2002.

Recommendation: We recommend that management ensure the revenue accounting department adheres to established policies and procedures relating to control over and issuance of ticket stock and that cash over and short amounts be recorded.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The relevant staff have been instructed to adhere to set policies and procedures for issuing and reporting tickets and recording cash shortages and overages.

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Purchases/Disbursements

Finding No. 2003-2

Criteria: Disbursements should be properly recorded in the general ledger.

Condition: During the year ended September 30, 2003, aircraft rentals totaling \$401,225, a \$66,000 security deposit on the Dash 8 aircraft and leasehold improvements on the Dash 8 aircraft totaling \$269,548 were recorded as maintenance expense. Audit adjustments were proposed to correct these errors.

Cause: The cause of the above condition is the improper recording of disbursements.

Effect: The effect of the above condition is the misstatement of expenses.

Recommendation: We recommend that management ensure that all expenses are properly recorded in the general ledger.

Auditee Response and Corrective Action Plan: We partially agree with the finding and recommendation. There are three basic cost components of the Dash 8 aircraft lease rentals:

- 1) Basic rent – charged to flight operations
- 2) Maintenance reserve – charged to maintenance
- 3) Engine rental – charged to flight operations

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Receivables

Finding No. 2003-3

Criteria: Receivables should be supported by a reconciled subsidiary ledger.

Condition: As of September 30, 2003, AMI recorded trade receivables (A/C # 12701, totaling \$452,116) that did not reconcile to the supporting subsidiary ledger balance of \$616,515. No explanation was made available regarding the unreconciled variance.

Cause: The cause of the above condition is the lack of reconciliation on a monthly basis.

Effect: The effect of the above condition is the misstatement of receivables and revenues.

Prior Year Status: Lack of proper reconciliation of receivables to the supporting subsidiary ledger was reported as a finding in the audits of AMI for fiscal years 2001 and 2002.

Recommendation: We recommend that management ensure that receivables are properly reconciled to the supporting subsidiary ledger on a monthly basis and in a timely manner.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. MAS 90 Aging Report prints Accounts Receivable Transactions and ages them by Due Date or Invoice Date, depending upon what was set up in Accounts Receivable Options. The Trial Balance prints Accounts Receivable by Transaction Date. These two reports may not reflect the same transactions and their totals may not agree because of the difference between the Transaction Dates and Invoice/Due Dates. The Trial Balance is the correct report to use to reconcile with the general ledger.

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Receivables

Finding No. 2003-4

Criteria: Accounts receivable should be recorded at net realizable value.

Condition: As of September 30, 2003, the aged accounts receivable subsidiary ledger, excluding affiliate accounts, indicated that customer accounts with balances greater than 120 days represented seventy-eight (78) percent of the \$616,515 balance. Although many of these balances have not had any recent activity, AMI has not evaluated the ultimate collectibility of these balances. A total allowance of \$457,151 has been recorded to offset this balance.

Cause: The cause of the above condition is the lack of procedures to evaluate the collectibility of recorded receivables.

Effect: The effect of the above condition is the possible misstatement of receivables.

Prior Year Status: Collectibility of receivables was reported as a finding in the audits of AMI for fiscal years 2000 through 2002.

Recommendation: We recommend that management review all outstanding receivables for collectibility.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. All receivable accounts were critically reviewed starting October 12, 2004 to determine if such are valid and collectible. The policy on provisions for bad debts (120 days and over) can be fully implemented once the aging analysis report is reconciled with the General Ledger.

Policy on bad debts provision shall be documented and approved to ensure consistency and uniformity of application.



**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Receivables

Finding No. 2003-5

Criteria: Accounts receivable should be collected in a timely manner.

Condition: As of September 30, 2003, AMI recorded receivable from the government of the Republic of the Marshall Islands (RepMar) amounting to \$984,343, the majority of which are more than eight years old. A summary of these receivables is as follows:

Ministry of Finance	\$ 239,579
Ministry of Health and Environment	163,232
Cabinet	143,101
Ministry of Resources and Development	119,432
Office of the President	83,280
Ministry of Education	61,945
Ministry of Foreign Affairs and Trade	50,286
Nitijela	41,732
Other	<u>81,756</u>
	<u>\$ 984,343</u>

The corresponding payable recorded by RepMar amounted to \$81,570. The variance of \$902,773 relates to services provided by AMI without authorized RepMar purchase orders.

Cause: The cause of the above condition is the lack of response by RepMar to management's efforts to collect the above balances and the lack of concurrence by RepMar with the amount.

Effect: The effect of the above condition is that receivables from related parties are potentially overstated, which resulted in an allowance for doubtful receivables of \$640,146 as of September 30, 2003.

Prior Year Status: Long outstanding receivables from related parties was reported as a finding in the audits of AMI for fiscal years 1998 through 2002.

Recommendation: We recommend that management continue its efforts to reach an agreement on the collection of the receivable balances.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The allowance for doubtful accounts as of this given date (for government accounts) is adequate. Reconciliation of Government Accounts is done with the Office of the Assistant Secretary of Finance on a regular and continuing basis (the latest is August 12, 2005) and as a result accounts were updated (both books of accounts) and some aging accounts were obligated or funded for payment.

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Expendable Parts

Finding No. 2003-6

Criteria: Expendable parts should be supported by a reconciled subsidiary ledger.

Condition: As of September 30, 2003, AMI recorded gross expendable parts totaling \$565,295 that did not reconcile to the supporting subsidiary ledger balance of \$507,373. No explanation was made available regarding the unreconciled variance.

Cause: The cause of the above condition is the lack of monthly reconciliations.

Effect: The effect of the above condition is the misstatement of expendable parts.

Recommendation: We recommend that management ensure that expendable parts are properly reconciled to the supporting subsidiary ledger on a monthly basis and in a timely manner.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Monthly reconciliation of the general ledger versus subledger on balances and review of movements (receipts, issuances and adjustments) during the month may not be practical, however, quarterly reconciliation and the procedure in taking up the discrepancy (if any) is being done starting April 2005.

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Expendable Parts

Finding No. 2003-7

Criteria: Expendable parts cost should be supported by vendor invoices.

Condition: Of thirty-one expendable parts items tested, totaling \$120,124, the vendor invoices for twenty-six items were not made available.

Cause: The cause of the above condition is the lack of retention of appropriate documentation.

Effect: The effect of the above condition is the misstatement of expendable parts.

Prior Year Status: Errors in expendable parts valuation were reported as a finding in the audits of AMI for fiscal years 1992 through 2002.

Recommendation: We recommend that management ensure that supporting invoices to substantiate expendable parts cost be retained.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Most of the vendors of AMI are paid in advance (CIA) before delivery or shipment is made. Payment to such vendor cannot be initiated unless a Pro-forma Invoice is received and attached to the Purchase Order and Request for Check Payment or Wire Transfer. The vendor invoices that were not made available the time of audit might have been misplaced.

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Accounts Payable

Finding No. 2003-8

Criteria: Accounts payable should be supported by a reconciled subsidiary ledger.

Condition: As of September 30, 2003, AMI recorded trade payables (A/c # 20210, totaling \$282,287) that did not reconcile to the supporting subsidiary ledger balance of \$443,238. No explanation was made available regarding the unreconciled variance.

Cause: The cause of the above condition is the lack of monthly reconciliations.

Effect: The effect of the above condition is the misstatement of payables and expenses.

Prior Year Status: Lack of proper reconciliation of payables to the supporting subsidiary ledger was reported as a finding in the audit of AMI for fiscal year 2002.

Recommendation: We recommend that management ensure that payables are properly reconciled to the supporting subsidiary ledger on a monthly basis and in a timely manner.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Aged Invoice Report under MAS90 uses the invoice date or due date for its calculations; the general ledger posting uses the system date or as it is sometimes called the transaction date. What has caused the discrepancy between the general ledger and the Aged Invoice Report is that an invoice has an invoice date which falls in one accounting period and a system date which falls in another accounting period.

## AIR MARSHALL ISLANDS, INC.

Schedule of Findings  
Year Ended September 30, 2003

### Air Traffic Liability

#### Finding No. 2003-9

Criteria: Air traffic liabilities should represent the value of unused transportation sold by the air carrier.

Condition: As of September 30, 2003, AMI recorded an air traffic liability of \$309,713 that did not reconcile to the supporting subsidiary ledger balance of \$378,455. No explanation was made available regarding the unreconciled variance.

Cause: The cause of the above condition is the lack of reconciliation by the revenue accounting department of unused tickets sold by AMI.

Effect: The effect of the above condition is the possible misstatement of unearned and earned passenger revenues.

Prior Year Status: Lack of a reconciled supporting subsidiary ledger for air traffic liability was reported as a finding in the audit of AMI for fiscal year 2002.

Recommendation: We recommend that management ensure the revenue accounting department adheres to established policies and procedures relating to the reconciliation of unused tickets sold by AMI.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Unearned revenue based on the subsidiary records is generated the Dash Revenue Accounting System. This system is not in sync with MAS90, the general ledger system that generates the balance sheet account. Monthly reconciliation and update (considering the existing manning complement for both revenue and accounts receivable) may not be practical unless a new Accounting System Platform (Oracle Financials) specifically designed for Airline Accounting is adopted.

Moreover, the unearned traffic tickets indicated in the Trial Balance is a conservative figure and this is a potential adjustment (earned income) within the next twelve months. One year is the cut-off period in treating traffic liability as earned for international tickets and six months for domestic tickets. This policy is a must consistent with Airline Accounting Practices.

All of the above are corrective measures taken or to be taken by management to ensure that earned and unearned revenues are accurately captured by the system.

**AIR MARSHALL ISLANDS, INC.**

Schedule of Findings  
Year Ended September 30, 2003

Related Party Disclosure

Finding No. 2003-10

Criteria: In accordance with Statement of Financial Accounting Standards No. 57, *Related Party Disclosures*, material related party transactions are required to be disclosed.

Condition: A schedule of revenues earned from related parties during the fiscal year was not made available.

Cause: The cause of the above condition is the lack of policies and procedures for maintaining related party information.

Effect: The effect of the above condition is noncompliance with Statement of Financial Accounting Standards No. 57, *Related Party Disclosures*.

Prior Year Status: Noncompliance with Statement of Financial Accounting Standards No. 57, *Related Party Disclosures* was reported as a finding in the audits of AMI for fiscal years 1999 through 2002.

Recommendation: We recommend that management establish policies and procedures for maintaining related party information during the year.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. All related party transactions are fully disclosed in the subsidiary records and these are included in the list of earned and unearned revenues. The auditee(s) may not be informed or aware of the format of the schedule acceptable to the auditor(s) during the audit engagement period or fieldwork. We will ensure that the required information is made available in future audits.

# AIR MARSHALL ISLANDS, INC.

Schedule of Findings  
Year Ended September 30, 2003

## External Financial Reporting

### Finding No. 2003-11

Criteria: Board minutes are a primary means by which regulatory agencies and independent auditors can evaluate the administration of AMI's operations.

Condition: The Board of Directors' minutes of meetings held from October 1, 2002 through August 15, 2005 were not made available.

Cause: The cause of the above condition is the lack of adherence to established policies and procedures relating to documentation of Board of Directors' minutes of meetings.

Effect: The effect of the above condition is the possibility that directives of the Board are not properly disclosed or recorded in the financial statements of AMI.

Prior Year Status: Lack of formal documentation of minutes of meetings of the Board of Directors was reported as a finding in the audits of AMI for fiscal years 1999 through 2002.

Recommendation: We recommend that the Board of Directors ensure that all minutes of meetings are formally documented by the Secretary and approved by the Chairman.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The minutes of meetings during the period in question were documented (some were not yet signed by the Board) and received by the incumbent General Manager from the Board Secretary (resigned) in April 2005. We are making progress in documenting all board minutes of meetings and will secure approval from the Chairman of the Board.

**AIR MARSHALL ISLANDS, INC.**

Unresolved Prior Year Findings  
Year Ended September 30, 2003

The status of unresolved prior year findings is disclosed within the Schedule of Findings section of this report (pages 3 through 14).