

August 15, 2005

CONFIDENTIAL

Board of Directors
Air Marshall Islands, Inc.

Dear Board Members:

In planning and performing our audit of the financial statements of Air Marshall Islands, Inc. (AMI) for the year ended September 30, 2004, on which we have issued our report 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, 2003 through August 15, 2005 and our inability to obtain adequate accounting records to support trade receivables, expendable parts and air traffic liability, we developed the following recommendations concerning certain matters related to AMI's internal control and certain observations and recommendations on other accounting, administrative, and operating matters. Our principal recommendations are summarized below.

(1) Cash Receipts

In a sample of twenty-five cash receipts tested, we noted the following exceptions:

- Cash receipts are not used in sequential order.
- Supporting documentation for six cash receipts (receipt #s 58746, 58933, 59047, 59630, 60370 and 61653) was not made available.
- Cash receipt # 59501 for \$16 did not agree to the associated daily sales report amount of \$22. Furthermore, this receipt is included in Lae station sales for November 26, 2003, which were not deposited to the bank until April 26, 2004.
- The cash receipts journals that included receipt #s 57328, 57410, 58240 and 58578 were not made available. Therefore, we were unable to trace these items to the general ledger. Furthermore, receipt # 57410 was for collections received from an agent at the Airport station for December 3rd to 6th and 8th, 2003 daily sales, which were deposited to the bank on December 9, 2003.
- The cash receipts that included receipt # 58578 were not attached to the associated daily cash receipts listing. Therefore, we were unable to verify their proper recording and timely deposit.
- Cash receipt # 58588 dated February 25, 2004 was payment for a freight charge included on the Ebon station daily sales report for February 12, 2004. The associated sales invoice was generated on May 27, 2004.

(1) Cash Receipts, Continued

- Cash receipt # 57321 was payment for freight; the associated airway bill was not made available. Furthermore, the total amount deposited, which included this receipt, was \$6 more than the receipts total and the associated cash receipts listing.
- The daily sales reports for two cash receipts (receipt #s 58337 and 58670) were not made available.

We recommend that management ensure that source documentation supports all revenue items, all transactions are properly posted to the general ledger and collections are deposited in a timely manner. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003, May 20, 2002 and August 24, 2001.

(2) Purchases/Disbursements

The supporting vendor invoices for two subsequent disbursements (Bank of Marshall Islands wire payment #s 52 and 92, amounting to \$25,000 and \$20,000, respectively) were not made available. We recommend that management ensure that all disbursements are supported by adequate documentation.

(3) Payroll

Of twenty-five payroll disbursements tested, statutory deductions were incorrectly calculated for three employees (employee #s EL00674, HR00479 and JM00681 and for pay periods ended December 16, 2003, January 13, 2004 and June 29, 2004, respectively). We recommend that management ensure that payroll is accurately calculated. This matter was discussed in our previous letters dated August 15, 2005 and August 8, 2003.

(4) Payroll

Of twenty-five payroll disbursements tested, we noted the following:

- The actual hours differed from the hours paid for the following employees:

<u>Employee #</u>	<u>PPE</u>	<u>Actual Hours</u>	<u>Paid Hours</u>
EL00674	12/16/03	26.00 overtime	26.20 overtime
AL00212	09/07/04	18.84 overtime	10.12 overtime

- For employee # LR00505 for pay period ended 05/04/04, the sick leave form was not signed as approved.
- For two employees (employee #s HR00479 and LT00209) for pay periods ended January 13, 2004 and July 13, 2004, respectively, the time cards were not signed as approved.

We recommend that management ensure that employees' hours are accurately calculated and approved and that established policies are adhered to relating to annual and sick leave. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003, May 20, 2002 and August 24, 2001.

(5) Payroll

Of twenty-five payroll disbursements tested, we noted that certain authorized allotment forms were not made available for the following employees:

<u>Employee #</u>	<u>PPE</u>
YA00360	12/02/03
HR00479	01/13/04
LR00505	05/04/04
LL00228	06/15/04
NJ00243	08/24/04

We recommend that management ensure that authorized allotment forms are retained. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003, May 20, 2002 and August 24, 2001.

(6) Payroll

The same individual performs all payroll functions. We recommend that management ensure that proper segregation of duties is in place over the payroll function to ensure accuracy and authorization. This matter was discussed in our previous letter dated August 15, 2005.

(7) Cash

The Bank of Kiribati bank reconciliation at September 30, 2004 included an unidentified bank debit, totaling AUD \$15,608, which appeared on the April 1999 bank statement. No explanation of this debit was made available and it did not appear that any follow-up with the bank occurred. We recommend that management investigate the nature of this transaction and ensure that it is correctly recorded. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(8) Accounts Receivable

At September 30, 2004, AMI recorded other receivables (A/c # 12711, totaling \$108,351) that included certain balances outstanding since September 1998, including a receivable from Pacific Air Express (PAE) of \$62,291, derived through three disbursements, totaling \$18,190, made on behalf of PAE for which no invoice was issued. PAE has indicated in the past that they have no outstanding balances with AMI. We recommend that management follow-up with PAE regarding amounts due to and from them. Furthermore, we recommend that management ensure that disbursements made on behalf of third parties are invoiced and collected in a timely manner. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(9) Accounts Receivable

Payment plans with debtors should be closely monitored to ensure that such are received in a timely manner. On June 16, 1999, a court judgement, totaling \$122,202, ordered a travel agency to make monthly payments of \$2,500, including interest, to AMI. No payments have been received since January 2000. We recommend that management ensure the travel agency adheres to the established payment plan. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(10) Accounts Receivable

At September 30, 2004, the accounts receivable subsidiary ledger included a receivable due from AMI of \$38,464, which represented various expenses incurred, including employee travel and training, which had not been expensed. We recommend that management ensure that employee travel and related training expenses are correctly recorded in the general ledger.

(11) Accounts Receivable

Total receivables of \$1,841,934 did not reconcile to the supporting subsidiary ledger balance of \$1,802,889. An audit adjustment was proposed to reconcile the variance. We recommend that management ensure that receivables are properly reconciled to the supporting subsidiary ledger on a monthly basis and in a timely manner. This matter was reported as a finding in the audit of AMI for fiscal year 2003.

(12) Accounts Receivable - Value Added Tax (VAT) Claim

At September 30, 2004, AMI recorded VAT claims receivable (A/c # 12730, totaling \$6,419) that have been outstanding for a period in excess of four years. We recommend that management follow up on VAT claims receivable in a timely manner. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(13) Advance to RepMar

At September 30, 2004, AMI recorded an advance to RepMar totaling \$664,729 that did not reconcile with the corresponding payable recorded by RepMar of \$614,459. Although the variance was not material to warrant an audit adjustment, we recommend that management ensure that the advance to RepMar is reconciled with RepMar on a monthly basis. This matter was discussed in our previous letter dated August 15, 2005.

(14) Plant and Equipment

Of nineteen plant and equipment acquisitions items tested, the descriptions of two additions to Dornier 228 rotables (signal conditioner serial # 031309700458 and ADF receiver) did not agree with the supporting purchase invoices. Furthermore, the ADF receiver replaced another rotatable part which was not removed from the subsidiary fixed asset register. In addition, two other additions to Dornier 228 rotables did not represent valid additions, and the supporting purchase invoices for one addition to Dash 8 rotables and one addition to plant and equipment were not made available. We recommend that management ensure that additions to fixed assets are properly recorded in the subsidiary register and that all additions to the subsidiary register are supported by adequate documentation.

(15) Plant and Equipment

Of thirty plant and equipment items tested for existence, the location of sixteen items could not be determined due to insufficient information contained in the subsidiary fixed asset register. We recommend that management ensure that all relevant information is included in the subsidiary fixed asset register, including asset location and identification number for tracking purposes.

(16) Accounts Payable

Of twelve trade accounts payable items confirmed, the vendor's response to one account amounting to \$82,484 was \$-0-. In addition, one vendor confirmed a prepaid balance from AMI amounting to \$41,286 which was not recorded in the general ledger. The prepaid balance was not material to warrant an audit adjustment. Furthermore, total accounts payable of \$440,472 did not reconcile to the supporting subsidiary ledger balance of \$480,437. An audit adjustment was proposed to reconcile the variance. We recommend that management ensure that payables are properly reconciled to the supporting subsidiary ledger on a monthly basis and in a timely manner. This matter was reported as a finding in the audit of AMI for fiscal year 2003.

(17) Accrued Expenses

At September 30, 2004, the unearned transportation liability account (A/c # 21600) had a debit balance totaling \$32,562, which we were informed represented receivables from non-IATA airlines. We recommend that receivables are properly recorded in the general ledger.

(18) Cargo Revenue

The associated daily cash receipts listings for thirty freight revenue items tested were not made available. Consequently, we were unable to verify that the items were deposited in a timely manner and properly recorded in the general ledger. Furthermore, the daily sales report for two airway bills (AWB #s 68645 and 73422), the airway bills for eighteen items, and the excess baggage coupon for three items were not made available. We recommend that management ensure that source documentation is retained. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003 and May 20, 2002.

(19) Cargo Revenue

We were informed that the minimum charge for freight and excess baggage are \$5 for cash sales and \$10 for charge sales, however, this policy is not in writing. We recommend that all policies are approved by the Board in writing.

(20) Charter Revenue

The associated daily cash receipts listings for thirteen charter revenue items (flight request #s 336, 338, 342, 345, 349, 351, 371, 379, 390, 392, 400, 417 and 441) tested were not made available. Consequently, we were unable to verify that the items were deposited in a timely manner and properly recorded in the general ledger. Furthermore, for one item (flight request #s 349), the customer was overcharged by \$581; for six items (flight request #s 336, 338, 371, 379, 390 and 441), the customers were invoiced between ten days to two months after the flights were chartered; and for one item (flight request # 400), the customer has not been invoiced for the chartered flight on April 18, 2004. We also noted that the prenumbered flight request forms are not being tracked to ensure the completeness of recording revenue. We recommend that management ensure that source documentation supports all transactions and that all services are properly invoiced and collected in a timely manner. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003 and May 20, 2002.

(21) Other Revenue

Of nineteen other revenue items tested, we noted one item pertaining to flight ground time (invoice # 0000360-IN) that was recorded as DHL services revenue. We recommend that management ensure that other revenues are properly recorded in the general ledger.

(22) Expenses

Of thirty-three non-payroll expenses tested, we noted two items (JV #s J0097 and J0133, totaling \$22,323 and \$13,319, respectively) pertaining to fiscal year 2003 that were recorded as fiscal year 2004 expenses. We recommend that management ensure that expenses are recorded in the proper period. This matter was discussed in our previous letter dated August 15, 2005.

(23) Cash Shortage/Overage

Advances to pilots paid from daily sales are recorded as cash shortages and repayments of such are recorded as sales overages. Advances to employees should be recorded as receivables from employees. We recommend that management ensure that advances to employees are properly recorded. This matter was discussed in our previous letter dated August 15, 2005.

(24) Sales Invoices

Prenumbered sales invoices facilitate the completeness of recording revenue. Prenumbered sales invoices are not utilized. We recommend that management ensure that prenumbered sales invoices are utilized to facilitate the completeness of recording revenue. This matter was discussed in our previous letters dated August 15, 2005, August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(25) RMI Withholding Taxes

During the year ended September 30, 2004, AMI incurred penalties and interest totaling \$1,680 related to AMI's late filing of withholding tax returns. Such penalties and interest were deducted from the balance of AMI's advance to RepMar. We recommend that management ensure that withholding tax returns are filed in a timely manner to avoid future penalties and interest.

(26) Capitalization Policy

AMI currently does not have a formal capitalization policy for plant and equipment. We recommend that management establish a formal capitalization policy for the recording of capital assets.

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We have communicated certain matters noted during our audit of the financial statements of AMI for the year ended September 30, 2004, which we considered to be reportable conditions, in our report dated August 15, 2005.

This report is intended solely for the information and use of the Board of Directors, management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We would like to express our appreciation to management and staff for their assistance and cooperation provided during the course of this engagement. Should you have any questions regarding matters discussed herein, please feel free to contact our office at your convenience.

Very truly yours,

