

AIR MARSHALL ISLANDS, INC.
**(A COMPONENT UNIT OF THE REPUBLIC
OF THE MARSHALL ISLANDS)**

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

YEAR ENDED SEPTEMBER 30, 2012

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

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, 2012, and have issued our report thereon dated August 15, 2013. Our report was qualified for the inadequacy of accounting records over expendable parts and included an explanatory paragraph regarding a going concern uncertainty. 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

Management of AMI is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered AMI's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of AMI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of AMI's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Responses (pages 3 through 9), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2012-1 through 2012-5 to be material weaknesses.

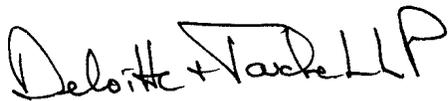
Compliance and Other Matters

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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of AMI in a separate letter dated August 15, 2013.

AMI's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit AMI's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Board of Directors, and others within the entity, 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, 2013

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses
Year Ended September 30, 2012

Finding No. 2012-1

Reconciliation of Balances

Criteria: Balances per the general ledger (GL) should be timely reconciled with balances per subsidiary ledgers (SL).

Condition: Certain GL accounts did not reconcile with SL balances:

<u>GL Account Name</u>	<u>GL Balance Over (Under) SL Balance</u>
AR System	\$ (63,855)
Due from Affiliates	37,619
AR - Employees	(4,483)
Inventory	12,497
AP System	85,027
Loan Payable	1,993
Unearned Revenue	6,231

In addition, a credit transaction of \$67,743 was posted without previously recording an original debt. As a result, the receivable balance was misstated.

Cause: The cause of this condition is the lack of established policies and procedures pertaining to timely reconciliation of GL and SL balances, resolution of reconciling items, and independent reviews.

Effect: The effect of the above condition is a misstatement of account balances and errors not being timely detected.

Recommendation: We recommend that management establish policies and procedures over timely reconciliation of account balances, resolution of reconciling items, and independent reviews to minimize opportunity for unreconciled differences.

Prior Year Status: Lack of established policies and procedures pertaining to timely reconciliation of GL balances against SL balances, resolution of reconciling items, and independent reviews was reported as a finding in the audit of AMI for fiscal year 2011.

Auditee Response and Corrective Action Plan: Management agrees with this finding and will make sure bank reconciliations are to be done regularly and directs the Accounting Department (Chief Accountant in particular) to make sure bank reconciliations are carried out in a timely manner, and appropriately.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No. 2012-2

Journal Entries

Criteria: Adequate accounting controls necessitate that journal entries and recorded adjustments be appropriately approved and documented. Furthermore, an independent review of journal vouchers should be performed.

Condition: Journal vouchers do not contain a signature of an independent reviewer.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures over processing journal entries.

Effect: The effect of the above condition is a potential for unauthorized journal entries.

Recommendation: We recommend that management adopt policies and procedures to evidence review and approval of journal entries.

Auditee Response and Corrective Action Plan: Management agrees with this finding and is designating the Chief Accountant as the airline official to be in charge of reviewing any and all journal vouchers (JVs) in close consultation with the General Manager and CEO. In other words, no JVs will be validated without the approval of the CEO through a short written explanation (memo) to the Accounting office, to instigate such JV.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No. 2012-3

Inventories

Criteria: Adequate accounting controls necessitate that inventories be appropriately recorded, monitored and valued based on the existing accounting policy. Information maintained by the accounting department and the inventory management system at the spares department should be reconciled. Furthermore, an independent review of inventory valuation report should be performed.

Condition:

1. Of sixteen (16) samples tested, the following exceptions were noted:

<u>Item #</u>	<u>Part #</u>	<u>Quantity at 9/30/12</u>	<u>Valuation Report Quantity at 9/30/11</u>	<u>Unit Cost</u>	<u>Difference</u>
1	5013179	4	2	\$ 1,286.56	\$ 2,573.12
2	A-112540A02W	2	1	1,838.28	1,838.28
3	A-112563B00C	4	2	1,327.67	2,655.34
4	A-262330A09B	6	4	3,092.00	6,184.00
5	MS20470AD-5-16	440	1	18.00	7,902.00

For item # 1, we noted that the item description is incorrectly presented on the valuation report as per confirmation with the Purchasing Manager. We noted no additional purchases during the fiscal year in contrast to the movement presented in the valuation report.

For items # 2 to 4, no additional purchase transactions occurred during FY12 in contrast to the movement noted in the valuation report.

For item # 5, there is inconsistency in accounting as last year's count was based per pack while this year's count was based on a per piece thus resulting in significant movement. In addition, we noted that the last purchase transaction for one (1) pack had a \$60 unit cost.

2. Of nineteen (19) items tested for valuation, we noted the following exceptions:

<u>Item #</u>	<u>Part #</u>	<u>Valuation Report</u>		<u>Unit Cost per Audit</u>	<u>Difference Over (Under) Extended</u>	
		<u>Quantity</u>	<u>Unit Cost</u>		<u>Unit Cost</u>	<u>Amount</u>
1	VS398	2	\$ 625.00	\$ 770.00	\$ (145.00)	\$ (290.00)
2	270UZ01A4BA5B	4	823.93	1,521.00	(697.07)	(2,788.28)
3	A-262110C00C	1	5,876.41	3,024.00	2,852.11	2,852.11
4	A-511030D00W	1	5,206.73	5,679.71	(472.98)	(472.98)
5	A-531050B00X	1	11,867.00	9,204.73	2,662.27	2,662.27
6	A-623030B03B	3	1,236.00	1,336.00	(100.00)	(300.00)
7	A-623070A01B	4	1,659.42	570.54	1,088.88	4,355.52
8	CS402-5	3	944.99	741.75	203.24	609.72
9	MS20470AD-5-16	440	18.00	60	(42.00)	7,860

For items # 1 to 8, the unit cost per item presented in the valuation report does not match with the lower of average cost or net realizable value.

For item # 9, there was an error in recording quantities. The listed quantity of 440 is considered one pack which is \$60 per pack, as evidenced by the last purchase transaction.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No. 2012-3, Continued

3. Of nineteen (19) inventory counts tested, we noted the following exceptions:

<u>Item #</u>	<u>Part #</u>	Quantity		<u>Unit Cost</u>	<u>Extended Cost</u>
		<u>Valuation Report</u>	<u>Per Audit</u>		
1	300-620-3	0	1	\$ 7,900.00	\$ 7,900.00
2	LM29700LA902A7	0	4	48.50	194.00
3	3000U	0	3	229.25	687.75
4	5009717	0	3	513.91	1,541.73
5	066-1072-04	0	2	1,250.00	2,500.00

Noted that for items # 1 to 5, actual count were not reflected in the valuation report.

4. An approved issuance slip was not available to support inventory issuances. As per discussion with the Spares and Purchasing Manager, a logsheet is available to log inventory issuances but this process is not always followed.

Cause: It appears that the condition is caused by lack of communication between the Spares and Maintenance Group and Accounting. It also appears that there is lack of a review process of the inventory valuation report that resulted in erroneous movements and incorrectly updated unit costs. In addition, it also appears that there are weak control policies with respect to actual inventory counts conducted at year-end. Furthermore, it appears that inventory management did not maintain adequate documents supporting inventory issuances.

Effect: The effect of the condition is a possible misstatement of inventory and consumable expenses and an audit qualification concerning expendable parts.

Recommendation: Management should adopt and implement appropriate internal control policies over recording, monitoring, and valuation of inventories.

Prior Year Status: Lack of reconciliation between accounting and inventory departments was reported as a finding in the audits of AMI for fiscal years 2006 through 2011.

Auditee Response and Corrective Action Plan: Management agrees with this finding and will designate two people: one from Accounting (preferably the Chief Accountant); and one from the Spare Parts at the Maintenance Department (preferably the Spare Parts Manager) to coordinate and reconcile—through regular communication—their respective records or logbooks (supported through their filing systems) to make sure inventories and aircraft parts are appropriately recorded, monitored and valued based on existing accounting policy, and by making sure all the supporting documents are in their proper place, and ready for examination from time to time. In addition, entry to the Spare Parts Room at the Hangar will soon be restricted and only the Spare Parts Manager and the Director of Maintenance will have access, and a parts clerk will be required to be at the parts room sign-out window from the time the Hangar opens early in the morning until it is closed in the evening including weekends and holidays whenever the aircraft is flying. Furthermore, the Accounting and the Spare Parts department staffs (led by their Chief Accountant and Spare Parts Manager, respectively) will be required to get together, along with their staffs, at the end of each fiscal year, and conduct an actual inventory count together.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued Year Ended September 30, 2012

Finding No. 2012-4

Property and Equipment

Criteria: Property and equipment should be periodically subjected to physical verification. Additionally, the subsidiary fixed asset register (FAR) should provide sufficient details to identify assets, including assignment of identification numbers to individual assets, and documentation of the location of such assets. Furthermore, the FAR should be updated for additions, replacements or disposals, and should be timely reconciled with general ledger control accounts.

Condition:

1. Capitalization of \$5,665 of inventories in 2010 were uninstalled as of September 30, 2012.
2. Overdepreciation of rotables installed resulting in \$59,231 of excess accumulated depreciation.
3. The capitalization threshold of \$2,500 is not consistently followed.
4. Differing views concerning fixed asset capitalization exist between Accounting and Spares and Maintenance personnel.
5. Several FY12 additions did not evidence sufficient details to allow for identification of the assets.

Cause: The cause of the above condition is a lack of physical inventory, property and equipment are not specifically tagged, and the lack of timely update and reconciliation of the FAR with the general ledger. It also appears that coordination between Accounting and Spares and Maintenance personnel could be improved.

Effect: The effect of the above condition is the possible misstatement of property and equipment and difficulty in locating assets due to insufficient FAR descriptions.

Recommendation: We recommend that management establish policies and procedures that allow periodic physical inventory, tagging fixed assets, compliance with internal accounting policies and timely FAR update and reconciliation.

Prior Year Status: Lack of policies and procedures requiring physical inventory and tagging of property and equipment, and timely update and reconciliation of the FAR with general ledger control accounts was reported as a finding in the audits of AMI for fiscal years 2009 through 2011.

Auditee Response and Corrective Action Plan: Management agrees with this finding and will firstly attempt the fixing of our airline's fixed asset registry (FAR) by assigning both the Accounting Department and Spare Parts and Maintenance to work together and update every single line item in that FAR, and to make sure this is updated from time to time (Accounting Department), and will complement that effort through establishing internal control procedures necessary to make sure this finding is gradually reduced and eventually eliminated altogether from future audits, including making sure all items purchased by the airline are tagged with assigned numbers and location of such items (including names of airline staffs which such items are assigned to) are recorded in the computer system, and/or by the FAR.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No. 2012-5

Revenue

Criteria: Adequate accounting controls necessitate that revenues be appropriately reviewed, documented, and recorded.

Conditions:

1. Of forty-nine (49) passenger ticket samples tested, we noted the following:
 - a. One ticket sold in January 2013 was erroneously included in the January 2012 Summary Report.
 - b. Daily Sales Reports indicated that three tickets tested were missing. Thus, completeness and existence of ticket sales was not validated.
 - c. Ten tickets were not timely deposited, as follows:

<u>Ticket Number</u>	<u>Fare Sales Report</u>	<u>Payment Date/ Invoice Date</u>	<u>Deposit Date</u>	<u>No. of Working Days Delayed</u>
5500241853	\$ 15	12/17/2011	12/22/2011	3
5500233114	41	12/28/2011	1/3/2012	4
5500240597	122	3/19/2012	3/21/2012	2
5500245250	85	6/22/2012	6/27/2012	3
5500245675	132	6/19/2012	6/21/2012	2
5500246449	145	6/17/2012	6/28/2012	8
5500247657	58	7/30/2012	8/2/2012	3
5500242000	122	1/2/2012	1/4/2012	2
4200272924	319	10/17/2011	10/19/2011	2
4200272785	638	10/24/2011	10/26/2011	2

In addition, twenty-two tickets per the daily sales collection report did not match with the deposited amount. The variances relate to the use of cash receipts to pay for disbursements before the amount was deposited. Instances of unsupported variances between collection and deposits were also noted.

2. Of three excess baggage revenues tested, we noted the following:
 - a. Of three (3) samples for excess baggage revenues, we noted the following exceptions:

<u>Ticket Number</u>	<u>Ticket Amount</u>	<u>Date Collected</u>	<u>Date Deposited</u>	<u>No. of Working Days Delayed</u>
29900	\$ 730.98	6/22/2012	6/26/2012	2
30382	763.75	8/13/2012	8/20/2012	5
30342	665.00	7/25/2012	7/27/2012	2

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No. 2012-5, Continued

Revenue, Continued

3. Of eight freight revenues tested, we noted the following:
- a. Air Waybill # 997639 resulted in an overcharged fee of \$4.50.
 - b. Air Waybill # 100223 resulted in an overcharged fee of \$166.80.
 - c. Air Waybill # 996358, undercharged by \$5.
 - d. Three cash sale tickets were not timely deposited.

<u>Ticket Number</u>	<u>Amount</u>	<u>Date Collected</u>	<u>Date Deposited</u>	<u>No. of Working Days Delayed</u>
997752	\$ 443.00	1/7/2012	1/16/2012	6
997904	98.10	12/19/2011	12/22/2011	3
997442	717.60	11/15/2011	11/18/2011	3

Cause: The above condition appears to be due to control policies that do not allow for monitoring and filing of documents, independent review of reports, and inadequate coordination and communication between personnel.

Effect: The above condition may result in misstatements and may adversely impact financial information.

Recommendation: Management should adopt and strengthen control policies over management coordination, independent review of reports, timely deposits of collections, and proper filing, reconciliation, and maintenance of documents.

Prior Year Status: Recommendation concerning control policies and procedures over monitoring and filing of documents, independent review of reports to provide accurate financial information, and coordination and communication among departments was reported as a finding in the 2011 audit.

Auditee Response and Corrective Action Plan: Management agrees with this finding and will strengthen its cash sales handling procedures. This is will be part and parcel of the attempt by management to strengthen internal control system and putting in place more but necessary stringent rules and procedures to safeguard against loss of documents, potential irregularities, and misstatement of cash revenues. This will be an important role of the Accounting Department staffs to make sure rules and procedures of handling cash revenues are properly followed and adhered to at all times; and it will be the sole responsibility of the Chief Accountant/Chief Financial Officer, with random involvement of the GM from time to time, to make sure all cash sales received as income to the AMI are all accounted for according to accounting standards and existing, and/or to be established, working procedures.

AIR MARSHALL ISLANDS, INC.

Unresolved Prior Years' Findings
Year Ended September 30, 2012

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses section (pages 3 through 9) of this report.