

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, 2011

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, 2011, and have issued our report thereon dated January 25, 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 10), 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 2011-1 through 2011-5 to be material weaknesses.

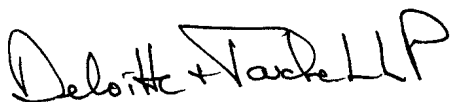
Compliance and Other Matters

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 January 25, 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 + Tatchell LLP". The signature is written in a cursive, stylized font.

January 25, 2013

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses Year Ended September 30, 2011

Finding No. 2011-1

Bank Reconciliations

Criteria: Monthly bank reconciliations should be performed and be independently reviewed in a timely manner. Further, reconciling items should be timely resolved.

Condition: Although monthly bank reconciliations are prepared and independently reviewed, such frequently occurs several months after each month end. Furthermore, it appears that the review process is not effective due to certain outstanding checks per the reconciliation (the latest of which was in year 2005), which aggregate \$13,670.

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

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

Recommendation: We recommend that management establish policies and procedures pertaining to timely reconciliation of bank accounts, resolution of reconciling items, and independent reviews.

Prior Year Status: Lack of policies and procedures pertaining to timely reconciliation of bank accounts, resolution of reconciling items, and independent reviews was reported as a finding in the audits of AMI for fiscal years 2009 and 2010.

Auditee Response and Corrective Action Plan: The management agrees with the finding and therefore will go ahead and establish policies (Standard Operating Procedures) in place to ensure bank reconciliation are done two weeks after each month and reconciling items are resolved at end of each month.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2011

Finding No. 2011-2

GL SL Reconciliation of Balances

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

Condition: Some GL balances do not reconcile with SL balances as follows:

GL Account Name	GL Balance under (over) SL balance
Inventory	\$ (2,416)
Receivables	3,793
Property and equipment	(25,729)
Accumulated depreciation	650,216
Accounts payable	(71,250)
RMI payroll withholding tax	(777)
Unearned passenger revenue	594

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

Auditee Response and Corrective Action Plan: We agree with the finding and will go ahead and establish policies to ensure that SL accounts are reconciled with GL accounts two weeks after each month end.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2011

Finding No. 2011-3

Inventory

Criteria: Information maintained by the accounting department and the inventory management system at the spares department should be reconciled.

Condition:

1. Of twenty-eight (28) items test counted at year end, two exceptions were noted:

<u>Item #</u>	<u>Part #</u>	<u>Quantity per Books as of 09/30/11</u>	<u>Quantity per Count as of 09/30/11</u>	<u>Difference (over) under</u>
1	13685XL	9	0	(9)
2	A-761100A08B	2	6	4

- For item #1, the items could not be located during the count. The unit cost for each item is \$26.18; hence, the overstatement amounted to (\$235.62).
- For item #2, the count per books was four less than our count. The total understatement amounted to \$1,001.

2. Of fourteen (14) items tested for valuation:

<u>Item #</u>	<u>Part #</u>	<u>Quantity per Books as of 09/30/11</u>	<u>Quantity per Count Sheet as of 09/30/11</u>	<u>Difference purchase (issuance)</u>
1	337-546-9001	16	26	10
2	A-262330A09B	4	6	2
3	1008965-100	4	4	0
4	896494-3	1	1	0
5	A-221130A02B	4	4	0
6	A-426749A06B	1	1	0
7	A-531050B00X	1	1	0
8	A-642300A201B	2	2	0
9	AN470M4-3	727	727	0
10	CR3523-4-2	1000	1000	0
11	MS21151-8	2	2	0
12	11-500-1	1	1	0
13	82410111-001	1	1	0
14	DSC-182-3	1	1	0

Additional discrepancies in quantities between books and count due to type of error were noted in items #1 and #2:

- For item #1, the total understatement amounted to \$1,283.
- For item #2, aside from the discrepancy in quantity, there was also an error in the unit cost encoded in the system. Based on the invoice, the unit cost was \$1,013 and not \$3,092. The total net overstatement amounted to (\$11,355).
- For items #3 to #14, the vendors' invoices were not provided as those can no longer be located.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2011

Finding No. 2011-3, Continued

Inventory, Continued

- For item #9, based on the inventory card, the unit cost should be \$0.1346 (\$98/728 pieces) and not \$1.50. The total overstatement amounted to (\$992.63).
- For item #10, the quantity of the other set of inventory item # CR3523-4-2 of 322 was incorrectly recorded in inventory item # CR3523-4-02, which should have a zero quantity, instead of adding to the first set of inventory item # CR3523-4-2 of 1,000.

3. Absence of monitoring of obsolete and/or slow moving inventory items and updating the list will result in an inadequate basis to determine the allowance for inventory obsolescence.

In addition, the following exceptions noted in prior audits remain unresolved:

Of twenty-three items test counted in the FY 2010 audit, one exception was noted wherein the final valuation report had a zero quantity for an item (part # 037-5060-01) that was counted as two. As of 09/30/2011, the quantity per actual count remained at two (2) but was recorded as zero.

<u>Item #</u>	<u>Part #</u>	<u>Description</u>	<u>Quantity at 9/30/2010</u>	<u>Aircraft</u>
1	5013179	Disk Stationary	4	DO228
2	MS24665-136	Cotter Pin	200	DHC-8
3	RB14-14	Terminal	81	Common Spare

For item # 1, the part # should be 5013170 and the quantity should be zero. As of 09/30/2011, the quantity per actual count remained at zero but was recorded in the books as two (2).

For items # 2 and #3, unit costs should be \$0.25 and \$0.63, respectively, rather than \$25 and \$63, respectively. This error was due to an incorrect unit of measurement.

Cause: The cause is the lack of reconciliation of records between the accounting and inventory departments.

Effect: The effect of the above condition is a possible misstatement in the amounts of inventory and consumable expense resulting in audit qualification over expendable parts.

Recommendation: We recommend that management establish policies and procedures pertaining to reconciliation of information between the accounting and inventory departments.

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 2010.

Auditee Response and Corrective Action Plan: The management recognizes this lack of communication between the Accounting Department and Spares/Inventory Department and will go ahead and work with both departments to have policies that will improve communication and reconciliation of parts as per books and logs.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued Year Ended September 30, 2011

Finding No. 2011-4

Property and Equipment

Criteria: Property and equipment should be physically verified on a regular basis. 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. Further, the FAR should be updated for additions, replacements or disposals, and should be reconciled with the general ledger control accounts in a timely manner.

Condition:

1. The FAR does not provide sufficient details to identify assets, including assignment of identification numbers to individual assets, and documentation of the location of such assets. Some assets are described based on vendor names, journal voucher number, or generic names with no other information.
2. Further, the FAR is not updated for additions, replacements or disposals. Per discussion with Rosalina Lejja, Chief Accountant, there were no disposals recorded during FY2011. However, based on the FAR, we noted various replacements and disposals (including those in PYs) that were never recorded. Hence, the amount of an adjustment, if any, cannot be quantified.
3. Capitalization threshold of \$2,500 is not consistently followed.
4. Assets whose estimated useful lives have already ended reflect net book value.
5. For the following assets: (a) reduction gear box overhaul – vector; (b) nose landing gear; and (c) other high valued rotatable parts, a 5-year life may be too short for this asset and 10-year life maybe more appropriate per discussion with the Quality Assurance Manager.
6. For items 3 and 4 above, the amount of potential adjustments cannot be quantified as the net book values were not yet updated and reconciled.

Cause: The cause of the above condition is the 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.

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

Recommendation: We recommend that management establish policies and procedures pertaining to physical inventory and tagging of fixed assets and timely update and reconciliation of the FAR.

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 and 2010.

Auditee Response and Corrective Action Plan: Management do acknowledge the recommendation and will establish policies to address the current deficiency to better manage and monitor assets of the airline. The policies will have to ensure that at month end, the Inventory Department will be mandated to do physical inventory of the all our assets. The management also recognizes that inventory software system will need to be reviewed and if necessary upgrade to better manage the assets of the airline.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2011

Finding No. 2011-5

Revenue

Criteria: Revenue should be correctly and timely recognized.

Condition: Of seventy-five passenger revenue items tested, we noted the following exceptions:

1. Passengers Manifest Sheets were not on file and could not be located for the following samples:

<u>Item #</u>	<u>Ticket #</u>	<u>Date of Flight</u>	<u>Segment</u> <u>From</u>	<u>To</u>
1	7785500226656	11/10/2010	WJA	MAJ
2	7785500229259	1/24/2011	MAJ	KIO

2. The amount of cash per Cash Receipt Listing did not agree with the deposit slips for the following samples examined:

<u>Item #</u>	<u>Ticket #</u>	<u>Date Deposited</u>	<u>Over (under)</u> <u>by</u>	<u>Cash Receipt</u> <u>#</u>
1	7785500228053	12/10/2010	\$ 306.92	CR4168
2	7785500227623	11/30/2010	(464.00)	CR4108
3	7785500230268	4/12/2011	(170.00)	CR4547
4	7785500237312	7/20/2011	(2,607.64)	CR4789

For item # 4 above, we further noted that a \$2,608 deposit slip had no evidence that this was actually deposited. The deposit slip was not signed or stamped as received by the bank, and there was no receipt of deposit. Furthermore, such amount cannot be traced to bank statements.

3. We noted that for international sales, only after fiscal year-end, the Revenue Accountant posts the transactions due to the untimely receipt of cash reconciliations, expense reports. Reports and reconciliations for the periods from April 2011 to September 2011 were received in October 2011 only and the related sales and expense transactions were recorded on May 23, 2012. Details of these transactions are as follows:

<u>GL Account</u>	<u>Amount</u>
Aircraft fuel - DO228	\$ 4,336.12
Ground handling -DO228	2,523.70
Ground handling -D8	323.09
Training	7,728.49
Commission - passenger	2,313.18
Entertainment/representation	1,158.35
FOP over/short	322.42
Excess baggage - DO228	(470.78)
Fuel surcharge	(699.65)
Passengers revenue	(17,534.92)

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2011

Finding No. 2011-5, Continued

Revenue, Continued

4. Cash receipts were not timely deposited for the following samples examined:

<u>Item #</u>	<u>Ticket #</u>	<u>Date of Payment</u>	<u>Date Deposited</u>	<u>No. of Days Delayed</u>
1	7785500233217	4/21/2011	4/25/2011	4
2	7785500234889	6/15/2011	6/21/2011	6
3	7785500232781	4/21/2011	4/25/2011	4
4	7785500230951	3/7/2011	3/14/2011	7
5	7785500237146	8/18/2011	8/31/2011	13
6	7785500238909	8/12/2011	8/15/2011	3
7	7785500230777	4/29/2011	5/3/2011	4
8	7785500229158	1/5/2011	1/19/2011	14
9	7785500225951	10/1/2010	10/8/2010	7
10	7785500237962	9/7/2011	9/14/2011	7
11	7785500240109	9/15/2011	9/19/2011	4
12	7785500233633	5/30/2011	6/3/2011	4
13	7785500226137	10/11/2010	10/13/2010	2
14	7785500234177	6/8/2011	6/14/2011	6
15	7785500229691	1/14/2011	1/17/2011	3
16	7785500235540	6/24/2011	6/28/2011	4
17	7785500226498	11/8/2010	12/2/2010	24
18	7785500232675	5/27/2011	5/30/2011	3
19	7785500234812	6/10/2011	6/14/2011	4
20	7785500227376	12/24/2010	1/6/2011	13
21	7785500238285	8/12/2011	8/15/2011	3
22	7785500229174	1/10/2011	1/19/2011	9
23	7785500230268	4/8/2011	4/12/2011	4
24	7785500231273	5/12/2011	5/19/2011	7

Effect: The effect of the above conditions is misstatements of revenue, cash and other related accounts.

Recommendation:

We recommend that:

- The Revenue Accountant validates the completeness and existence of Passengers Manifest Sheet to monitor actual tickets sold/reserved.
- The Revenue Accountant should perform a detailed daily cash and sales reconciliation. The CFO counterchecks the amount of cash actually deposited to the bank by reconciling the amount per deposit slips (stamped received by the bank) with the Cash Receipt Listing.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued Year Ended September 30, 2011

Finding No. 2011-5, Continued

Revenue, Continued

- For international sales, the sales report, cash reconciliations, expense reports and other related documents be timely submitted to the Revenue Accountant to facilitate reconciliation and transaction posting.
- The CFO verifies that cash received from sales is timely deposited.

Auditee Response and Corrective Action Plan: The management acknowledges the recommendation by the auditor and will go ahead and establish policies as a way forward effort in resolving this finding. The policies will cover the daily deposits and reconciliation for sales domestically and international as well. The CFO will be working closely with the Revenue Accountant to ensure daily sales are received on time and are accounted for.

AIR MARSHALL ISLANDS, INC.

Unresolved Prior Years' Findings
Year Ended September 30, 2011

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses section (pages 3 through 10) of this report.