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Mr. Jefferson Barton
General Manager
Air Marshall Islands, Inc.
P.O. Box 1319
Majuro MH 96960

Dear Mr. Barton:

In planning and performing our audit of the financial statements of the Air Marshall Islands, Inc. (AMI), as of and for the year ended September 30, 2011 (on which we have issued our report dated January 25, 2013), 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, we considered AMI's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, 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. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to AMI's internal control over financial reporting and other matters as of September 30, 2011 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated January 25, 2013, on our consideration of AMI's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

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

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of AMI for their cooperation and assistance during the course of this engagement.

Very truly yours,

SECTION I – CONTROL DEFICIENCIES

We identified, and have included below, deficiencies involving AMI’s internal control over financial reporting as of September 30, 2011 that we wish to bring to your attention:

(1) Revenue/Receipts

Comment:

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

- Five tickets paid through check do not indicate the check number.

<u>Ticket #</u>	<u>Date of Flight</u>	<u>Segment</u>	
		<u>From</u>	<u>To</u>
7785500233217	4/18/2011	MAJ	ENT
7785500238346	8/8/2011	MAJ	UIT
7785500226137	10/14/2010	MAJ	ENT/MAJ
7785500234177	6/8/2011	KWA	MAJ/KWA
7785500234812	6/10/2011	MAJ	KWA/MAJ

- The fare type (i.e. adult, student, infant) in one ticket examined was not indicated.

<u>Ticket #</u>	<u>Date of Flight</u>	<u>Segment</u>	
		<u>From</u>	<u>To</u>
7785500228053	12/10/2010	MAJ	WTE

Of eighteen cargo revenue items tested, we noted the following exception:

- Charges of \$404.50 for airway bill #995291 dated July 28, 2011 were charged in the amount of \$404.95.

Of thirteen charter revenue items tested, we noted the following exception:

- For flight request form # 1069 (flight type: ground time), the date of the flight was not indicated.

Recommendation:

We recommend the following:

- The issuer of the ticket should indicate the check number on the ticket to monitor sales paid through cash or check and to identify the customer in case the check bounces.
- An officer or supervisor, independent of issuing tickets, should countercheck the completeness and verify the correctness of the data indicated therein.

(2) Operating Expenses

Comment:

Of thirty-six operating expense items tested, one item pertained to lease rental expense for which there is no lease agreement executed between AMI and the lessor.

Recommendation:

We recommend that copies of executed leases be obtained to support related transactions.

SECTION I – CONTROL DEFICIENCIES, CONTINUED

(3) Employee Receivables

Comment:

At September 30, 2011, employee receivables represent 33% or \$220,641 of total outstanding receivables. Approximately 74% or \$163,000 of employee receivables is due from former employees. This amount is fully provided for by an allowance.

Recommendation:

We recommend that employee repayment agreements be prepared for future transactions and that management pursue legal collection of amounts past due. This matter was discussed in our previous letters to management for the audits of fiscal years 2006 through 2010.

(4) Employee Advances

Comment:

At September 30, 2011, AMI recorded employee advances (GL A/c # 12741, \$4,480) of \$14,078 that are over a year old. Furthermore, the subsidiary ledger included a September 3, 2009 entry for \$150 with no employee name.

Recommendation:

We recommend that management establish policies and procedures pertaining to employee advances and liquidation thereof. This matter was discussed in our previous letter to management for the audits of fiscal years 2009 and 2010.

(5) Returned Checks Receivable

Comment:

At September 30, 2011, AMI recorded returned checks receivable (GL A/c # 12714, \$24,800), 98% of which are over a year old and are fully provided for by an allowance.

Recommendation:

We recommend that management pursue legal collection and consider writing off those deemed uncollectible. This matter was discussed in our previous letter to management for the audits of fiscal years 2009 and 2010.

SECTION II – OTHER MATTERS

Our observations concerning other matters related to operations and best practices involving internal control over financial reporting that we wish to bring to your attention are as follows:

(1) Segregation of Duties

Comment:

Management believes that there is minimal risk regarding segregation of duties due to the size of AMI as well as the simplicity of transactions; however, most systems of internal control rely on assigning responsibilities to different individuals or segregating incompatible functions. The following existing duties were noted to be incompatible:

- The person responsible for inventory custody also has access to inventory records and master files. This matter may be mitigated by records maintained at accounting and the performance of periodic cut-off procedures.
- The person responsible for payroll processing also has access to employee data. Management believes that this incompatible function is mitigated by the General Manager and the Chief Financial Officer's review and approval of all personnel-related matters.

This matter was discussed in our previous letters to management for the audits of fiscal years 2006 through 2010.

(2) Payroll Withholding Tax Returns

Comment:

Tax returns were not timely filed during fiscal year 2011, resulting in penalties and interest. This matter was discussed in our previous letter to management in the audit of fiscal year 2010.

Recommendation:

We recommend that management file tax returns within required deadlines

(3) Information Technology Policies

Comment:

AMI has not adopted and implemented policies and procedures concerning information technology, including those concerning system backups.

Recommendation:

We recommend that management consider adopting information technology policies and procedures.

(4) Absence of Employee Code of Conduct

Comment:

AMI has not consistently provided an Employee Code of Conduct to its employees, which may result in employee actions not within AMI's vision, mission, policies and procedures, and government laws and regulations.

Recommendation:

We recommend that management provide copies of the Employee Code of Conduct to its employees upon hiring. Employees should sign for the receipt of the document.

5) Lease Agreements

Comment:

The lease agreements for the Majuro airport and downtown offices expired on February 28, 2010 and January 31, 2006, respectively. The lease agreement for Ebeye office also expired on March 1, 2006. These lease agreements have not been renewed. This matter was discussed in our previous letters to management for the audits of fiscal years 2005 through 2010.

Recommendation:

We recommend that management obtain new lease agreements with counterparties to minimize disputes and to mitigate inherent legal risks.

SECTION III – DEFINITIONS

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* 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 deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

AMI's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.