

June 30, 2008

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, 2007, on which we have issued our report dated June 30, 2008, 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:

**Cash**

1. Cash in a Closed Bank Account

As of September 30, 2007, AMI recorded cash in bank (A/c # 10103, totaling \$1,578), which pertained to a bank account that was closed in 2004. This matter was noted during the 2005 and 2006 audits.

Management should ensure that only valid cash accounts are recorded.

Auditee's Response:

This account will be adjusted accordingly in Fiscal year 2008.

**Accounts Receivables**

2. Long Outstanding Accounts Receivable

At September 30, 2007, AMI recorded other receivables (A/c # 12711, totaling \$92,117), which included certain balances outstanding since September 1998. These include a receivable from Pacific Air Express (PAE) amounting to \$62,291, which contains three disbursements, totaling \$18,190, made on behalf of PAE for which no invoice was issued. PAE has represented that they have no outstanding balances with AMI.

We recommend that management follow up with PAE regarding amounts due to and from them to resolve the outstanding balance. 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 noted during the 2000 through 2006 audits.

Auditee's Response:

This account will be written-off in 2008, since documents required to enforce collection are not available.

### 3. Repayment Agreements should be prepared for Sales to Employees

As of September 30, 2007, \$216,694 (or approximately 30%), of outstanding receivables are from employees. Of this amount, \$127,295 (or approximately 59%) relate to amounts due from employees who no longer work for AMI. Accordingly, an allowance of \$185,067 has been established, which includes a portion for employee receivables.

We recommend that repayment agreements be prepared for future transactions with employees and that management pursues legal collection of past amounts due.

#### Auditee's Response:

Management will pursue aggressive collection efforts including filing a case in the small claims court.

### 4. Ticket Issuance through Credit should be reviewed

Total trade receivables as of September 30, 2007 are \$515,868. Of the total, approximately 70% or \$360,000 is uncollectible and is fully provided by an allowance. It was noted that most of these uncollected accounts were due to unsupported transactions or transactions that were not properly authorized.

We recommend that formal policies and procedures be established in extending credit. This will guide employees on when and to whom credit should be extended.

#### Auditee's Response:

We stopped giving credits to customers effective 2004. Government accounts are paid on the next day that checks are scheduled for release; while private corporations and individuals are on a cash basis.

## **Inventory**

### 5. Incorrectly Posted Inventory Price

Inventory prices were incorrectly posted in the inventory system resulting in a variance of \$129,950 at fiscal year-end. Based on discussions with inventory personnel, this error was the result of incorrect input of inventory prices. Furthermore, there have been numerous changes in inventory personnel, which may also have resulted in incorrect inventory pricing. As a reconciliation of inventory counts to inventory records per the general ledger was not performed, the error was not timely corrected.

We recommend that management ensure that inventory records are reconciled to the general ledger. Adjustments processed to inventory should be reported to management and be compared with authorized source documents to ensure that changes were accurately input.

#### Auditee's Response:

After every wire transfer to suppliers, a copy of which shall be used to update the inventory listing. Price update shall be counter checked by the general accountant to ensure that prices are captured accurately.

#### 6. Preparation and Analyzes of Inventory Aging Reports and Policies and Procedures

Of \$100,722 in inventory items tested, \$68,359 appear to have been purchased in 1996 or earlier and have been slow moving since. These items may possibly be obsolete or damaged. However, there was no documented review of these items to determine the adequacy of the obsolescence provision nor is there an existing policy regarding identification of obsolete or defective items.

Preparation and review of inventory aging reports constitute an important detective control to monitor the aging and potential obsolescence of inventory items. This also provides management with information necessary to determine inventory movements.

In the prior year, management indicated that spares and accounting personnel will review aging reports to determine adequacy of allowance for obsolescence. However, it appears that this was not implemented.

#### Auditee's Response:

Spares Manager shall review the listing on a regular basis and submit a report to accounting department every six months as a basis for making appropriate adjustment in the books.

#### 7. Regular Assessment of Inventory Items

As part of performing physical inventory counts, management should assess whether the inventory is still usable. Factors that affect this assessment include both obsolescence and physical damage or defects. Typically, such goods are written down to their net realizable value and are sold at a reduced price or are otherwise disposed of.

Based on prior year's response, management stated that the spares and accounting department shall determine the usability of inventory items starting in fiscal year 2007. However, it appears that this was not implemented.

#### Auditee's Response:

The hangar was moved to the new location making it difficult to conduct regular assessment of the inventory items. However, the assessment process is in progress and in 2008, obsolete items shall be determined accordingly.

#### 8. Inventory Room is Open to All Employees, resulting in Possible Pilferages

During the year-end inventory count, we noted differences between actual counts and amounts reported per the inventory system. Per discussion with inventory personnel, numerous AMI personnel have key access to the warehouse. Oftentimes, these personnel will obtain inventory parts without updating the system, resulting in potential differences.

We recommend that only authorized personnel be allowed access to the inventory area, and any movement in inventory be immediately posted. Strict security over inventory is important for safeguarding inventory from theft and unintentional errors.

Auditee's Response:

This was attributed to the resignation of one staff. We planned to provide additional manning or overtime to ensure that the parts room is adequately safeguarded.

9. Inventory Count Reconciliation

Inventory items were incorrectly adjusted during the inventory count, resulting in a variance of \$13,089 at year-end. Based on discussion with inventory personnel, this error was the result of incorrect input of inventory items. Since there was no reconciliation of inventory counts to the inventory records; and inventory record to the general ledger, the error was not timely corrected

We recommend that inventory counts be reconciled to inventory records and inventory records be reconciled to the general ledger.

Auditee's Response:

Inventory reconciliation is a tedious process and this is being done after the count. The posting of changes in the final listing, if not properly reviewed, may cause the error. We will ensure that all changes shall be reviewed accordingly.

**Fixed Assets**

10. Fixed Asset Register Updates

Based on our observations, it appears that the fixed asset register does not consistently use serial numbers or any identification information. While most of the fixed assets subjected to existence testing were located, identification was difficult due to insufficient information. Some items were described based on vendor names while some had generic descriptions. This may not represent a problem if part numbers or serial numbers were included in the register. However, serial numbers or asset numbers were not consistently used. Items were located based on historical costs and dates.

This was noted in the prior year, and based on prior year's management response; management will improve the fixed asset register the next fiscal year. However, it appears that this was not implemented.

We will reiterate our recommendation for management to review the asset register on a periodic basis to identify significant changes.

Auditee's Response:

Serial Numbers (if available) is the point of reference in the register and will be used consistently.

## **Retained Earnings**

### 11. Retained Earnings not tie up with Audited Balance

During the year, the beginning retained earnings account did not agree with the audited closing balance from prior year. We noted that audit adjustments for the prior year were either not posted or were posted twice.

We recommend that management ensure audit adjustments are posted timely and accurately.

#### Auditee's Response:

Audit adjustments will be posted on a timely manner.

## **General**

### 12. Lease Contract Agreements

Lease agreements for Majuro and Ebeye offices expired on January 31 and March 1, 2006, respectively. Lease contract agreements for both offices were not renewed.

Lease agreements should be prepared to prevent disputes or to mitigate legal risks inherent in every operation. Lease agreements should be current.

#### Auditee's Response:

There is a plan to move out and locate to another suitable office. Written contracts shall be provided accordingly.

### 13. Segregation of Duties

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

- The person responsible for the custody of inventory also has access to inventory records and master files. This matter maybe mitigated by records maintained at accounting and the performance of periodic cut-off procedures.
- The person responsible for payroll computations also has access to employee data. Management believes that this incompatible function is mitigated since hiring, firing, promotion and demotion are reviewed and approved by the General Manager and the Chief Financial Officer.

#### Auditee's Response:

Employee data and payroll computation shall be segregated accordingly.

Board of Directors  
Air Marshall Islands, Inc.  
June 30, 2008

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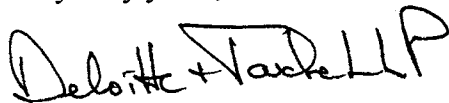
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We have communicated certain matters noted during our audit of the financial statements of AMI for the year ended September 30, 2007, which we considered to be significant deficiencies, in our report dated June 30, 2008.

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,

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