

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, 2009

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, 2009, and have issued our report thereon dated January 21, 2011. 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

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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Responses (pages 3 through 8) as items 2009-1 through 2009-4 to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiencies described above to be material weaknesses.

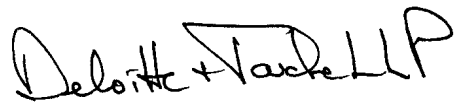
Compliance and Other Matters

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 grants, 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 21, 2011.

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, flowing style.

January 21, 2011

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses Year Ended September 30, 2009

Finding No. 2009-1

Bank Reconciliations

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

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 the following:

- The September 2009 payroll account reconciliation contains an unresolved \$4,235 reconciling item dated October 2008.
- Miscellaneous expense of \$19,177 was recorded as an adjustment to cash in bank (general account) without adequate supporting documentation. An audit adjustment was proposed to correct this error.
- Unreleased checks of \$33,492 had been reclassified to cash in bank and were also included as reconciling items on the September 2009 general account reconciliation. This resulted in an understatement of cash accounts. An audit adjustment was proposed to correct this error.

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 detected in a timely manner.

Recommendation: We recommend that management establish policies and procedures pertaining to reconciliation of bank accounts in a timely manner.

Auditee Response and Corrective Action Plan:

The \$4,235 reconciling item in the Bank Reconciliation for the payroll account are mostly voided checks and this will be adjusted accordingly in 2010. This happened when AMI transferred the payroll account from BOG to BOMI in March of 2008 and moved back to BOG in August of 2008.

The \$33,492 unreleased checks will be adjusted in the books upon receipt of the proposed adjustments.

The Chief Accountant resigned from employment due to medical illness and was replaced by Ms. Rosalina Lejja (incumbent AP Supervisor) as the General Accountant. Part of the responsibility is to ensure that all bank reconciling items are recorded in the books in a timely manner.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2009

Finding No. 2009-2

Expendable Parts

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

Condition: Of twenty-one inventory items tested, the following exceptions were noted:

<u>Item #</u>	<u>Part #</u>	<u>Description</u>	<u>Quantity at 9/30/2009</u>	<u>Aircraft</u>
1	0108900-49	Safety Belt, Co-Pilot	5	DO228
2	0108990-51	Safety Belt, Pilot	2	DO228
3	5013179	Disk Stationary	4	DO228
4	A-623040D00C	Upper Cowling Assy for Engine	1	DO228
5	A-623030B00C	Cowling Assy, Engine R/H	1	DO228
6	165949	Nicad Battery Cell	10	DHC-8
7	MS24665-136	Cotter Pin	200	DHC-8
8	VP400KH	Battery Cell	20	DHC-8
9	RB14-14	Terminal	81	Common Spare

For Item #s 1 and 2, the parts have been installed and only the release assembly, which is unusable by itself, remains. Further, for Item # 1, there were no purchases in fiscal year 2009; however, the quantity increased from 2 to 5 as of September 30, 2008 and 2009, respectively.

For Item # 3, the part # should be 5013170 and the quantity should be zero.

For Item #s 4, 5 and 8, the quantity should be zero.

Item # 6 related to parts for the Saab aircraft previously operated by AMI.

For Item #s 7 and 9, unit costs should be \$0.25 and \$0.63 rather than \$25 and \$63, respectively. This error is due to an incorrect unit of measurement. Further, for Item # 9, there were no issuances in fiscal year 2009; however, the quantity during the year decreased from 84 to 81.

Moreover, prices of several inventory items varied between the inventory and accounting departments or differed from vendor invoices.

Of twenty-six inventory items, exceptions were noted for the following items:

<u>Items</u>	<u>Part#</u>	<u>Description</u>	<u>Quantity at 9/30/2009</u>	<u>Aircraft</u>
1	A-621300C01B	Bracket Rear Engine	6	D0228
2	259K48G1	Main Tire	0	D0228

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2009

Finding No. 2009-2, Continued

Expendable Parts

For Item # 1, four more units were added to the count sheets after our count of two.

For Item # 2, we counted one unit; however, the count sheet and final valuation report had a quantity of zero.

We were informed that these discrepancies may be due to discovery of another storage location and issuances after the count.

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

Effect: The effect of the above condition is a possible misstatement of inventory.

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

Prior Year Status: Lack of reconciliation between inventory and accounting departments was reported as a finding in the audits of AMI for fiscal years 2006 through 2008.

Auditee Response and Corrective Action Plan: The reconciliation between inventory and listing (before finalization) is being done on a sampling basis. A 100% reconciliation require additional manning complement which may not be practical because of the financial status of the company. An alternate procedure is to increase the sample size of reconciliation and evaluate the quality of discrepancies. This compensating procedure will take place immediately.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued Year Ended September 30, 2009

Finding No. 2009-3

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 detail 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, including replacements and disposals.

Condition: Certain fixed assets, such as rotatable parts, are included in the annual physical count performed every year end; however, the FAR is not reconciled with results of this count. Further, a physical count has not been conducted for non-rotatable assets (e.g. vehicles, office equipment and furniture) for many years.

Moreover, based on observation, the FAR does not include serial or part numbers or other identification information to facilitate their location. Further, some assets are described based on vendor names, journal voucher number, or generic names with no other information. Additionally, AMI's capitalization threshold of \$2,500 is not consistently followed.

Of eleven additions tested, the following exceptions were noted:

<u>Item #</u>	<u>Asset #</u>	<u>Description</u>	<u>Cost</u>
1	071-1192-26 KFS-576	ATC Control (S/N 3486)	\$ 2,800
2	7003110-091	EFIS Display (S/N 93097868)	\$ 23,911
3	99122087	Display Electronic	\$ 8,517
4	2-1466-4	Brake Assembly (S/N 0881)	\$ 5,544

Item # 1 was described in the FAR as 'Rotables Per JV No. 031' with no part number at a cost of \$5,475, which includes other amounts below the \$2,500 capitalization threshold. We further noted inspection charges of \$170 that should have been expensed. Item #1 replaced another part (S/N 3671) that was not removed from the FAR and which had been incorrectly recorded at a cost of \$12,750 instead of the actual cost of \$2,250.

Item #s 2 through 4 were described in the FAR as 'Rotables Per JV No. 032' at a cost of \$39,635, which includes another amount below the \$2,500 capitalization threshold. Further, Item # 2 represents additional charges for a part that replaced another (S/N 85110880) that was not removed from the FAR. Initial charges of \$2,150 were separately recorded in the FAR and the new serial # was not recorded. Item #s 3 and 4 represent repair costs that approximate original costs when purchased in prior years. The original costs were not written off.

Of thirty-six items tested for existence, exceptions were noted for the following:

<u>Item #</u>	<u>Asset #</u>	<u>Description</u>	<u>Cost</u>
1	14100-117	Main Landing Gear	\$44,000
2	Unknown	Computers	\$6,300
3	Unknown	Actuator	\$3,601
4	Unknown	Logicare	\$2,100
5	Unknown	Hawker Pacific Pty	\$9,589
6	Incomplete	Air Condition	\$3,065
7	Unknown	Daewoo Mini-Van	\$10,950
8	Unknown	Sign	\$2,650

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued Year Ended September 30, 2009

Finding No. 2009-3, Continued

Property and Equipment

<u>Item #</u>	<u>Asset #</u>	<u>Description</u>	<u>Cost</u>
9	MI585353	Antenna Pedestal Assembly	\$7,488
10	LM-431-52	Engine Mount Assembly	\$4,329
11	Unknown	Torque Wrench	\$2,262
12	90111666	Advisory Display	\$18,950
13	Unknown	VHF Base/Mobile Radio	\$2,870

Item # 1 was described in the FAR as 'Audit Adjustment No. 19' with no part number at a cost of \$43,000, which excludes \$1,000 of modification costs.

Item #s 2 through 5 lack sufficient information which prohibited their sighting. For Item #s 4 and 5, asset description is a vendor's name. Further Item #5 represents inspection charges that should have been added to the asset cost.

For Item # 6, one unit was sighted; however, we were informed that the line item represents more than one unit. This could not be verified due to insufficient information.

For Item # 7, we were informed that this vehicle was disposed of approximately five years ago. An audit adjustment was proposed to correct this matter.

For Item # 8, due to insufficient information, we were unable to sight the asset.

For Item #s 9 through 11, we were informed that these are repair and calibration costs and, thus, do not represent capital assets.

For Item # 12, it was described in the FAR as 'Rotables Per JV 118', respectively, with no part number.

For Item # 13, we were informed that it represented several units; however, due to insufficient information, we were unable to verify that all units had been sighted. We further noted that the units sighted lacked identification tags and asset numbers.

Cause: The cause of the above condition is the lack of policies and procedures requiring that property and equipment be physically inventoried, tagged, and referenced in the FAR.

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 counts of fixed assets, reconciliation of count results with the FAR, and adequate reference in the FAR.

Auditee Response and Corrective Action Plan: Physical inventory, tagging (or retagging) and referencing them to the FAR require substantial workforce and time, however, a cyclic count and reconciliation such that all items are accounted for in a given time is attainable. The referencing and/or tagging can be done immediately after purchase of the item and before issuance to the end user. This control procedure will be done immediately.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2009

Finding No. 2009-4

External Financial Reporting

Criteria: General journal entries should be reviewed and adequately supported.

Condition: Discussions with management indicated that adjustments are prepared by the accountants and are reviewed by management prior to posting. However, the number of proposed audit adjustments indicates that the review process may not be effective. Furthermore, we noted a \$27,573 (JV-J0123) transaction recorded as other income that was not adequately supported. An audit adjustment was proposed to correct this matter.

Cause: The cause of the above condition is that journal entries are not thoroughly reviewed for accuracy and support.

Effect: The effect of the above condition is the possible misstatement of account balances.

Recommendation: We recommend that management thoroughly review all journal entries prior to posting. Furthermore, management should ensure that all transactions are adequately supported.

Prior Year Status: Ineffective review and inadequate support of journal entries was reported as a finding in the audits for fiscal years 2007 and 2008.

Auditee Response and Corrective Action Plan: Will ensure that adequate supporting documents are attached to the vouchers before final approval or posting is done on the books.

AIR MARSHALL ISLANDS, INC.

Unresolved Prior Year Findings
Year Ended September 30, 2009

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses section (pages 3 through 8) of this report.