

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, 2010

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, 2010, and have issued our report thereon dated November 4, 2011. Our report included an explanatory paragraph regarding a going concern uncertainty. 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 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 8), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in 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 2010-1 through 2010-4 to be material weaknesses.

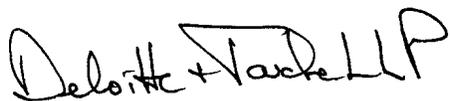
Compliance and Other Matters

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 November 4, 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, stylized font.

November 4, 2011

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses Year Ended September 30, 2010

Finding No. 2010-1

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 the following:

- The September 2010 general account reconciliation included an invalid \$7,464 reconciling item. An audit adjustment was proposed to correct this error.
- General account checks of \$9,742, which were voided in fiscal year 2011, were incorrectly reflected in fiscal year 2010 records. 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 timely detected.

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

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 audit of AMI for fiscal year 2009.

Auditee Response and Corrective Action Plan: This is an isolated case and corrective measures will be implemented to avoid similar incident in the future. Policies will be effected with regards to handling of reconciling items such that they will be adjusted promptly.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2010

Finding No. 2010-2

Expendable Parts

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

Condition: Of twenty-three items test counted at year end, 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.

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

<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.

For Item #s 2 and 3, 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.

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

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

Prior Year Status: Lack of reconciliation between accounting and spares departments was reported as a finding in the audits of AMI for fiscal years 2006 through 2009.

Auditee Response and Corrective Action Plan: The reconciliation of the valuation report against source documents submitted by spares department is an on-going process such that discrepancies between unit costs is reduced including that of the part number or description. Although manning complement is a problem in sustaining such efforts, both departments allocate man hours to fix the problem.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2010

Finding No. 2010-3

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, replacements or disposals, and should be reconciled with the general ledger control accounts in a timely manner.

The FAR should also reflect depreciation of assets over their estimated useful lives.

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 identifying information to facilitate location of assets. 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 nineteen items tested for existence, the following exceptions were noted:

<u>Item #</u>	<u>Type</u>	<u>Asset #</u>	<u>Description</u>	<u>Cost</u>
1	Dash 8 Rotable	SN DCL027/84/85	Nose Landing Gear	\$ 70,916
2	Dash 8 Rotable	SN#2008030793	Blade & Pin Assy, Propeller	\$ 54,535
3	Dash 8 Rotable	8900-121	Actuator	\$ 95,500
4	Dash 8 Rotable	14100-117	Main Landing Gear	\$ 44,000
5	Dash 8 Rotable	PW120A	Reduction Gear Box Overhaul - Vector	\$ 147,300
6	Dash 8 Rotable	sns2bhc/0041	Engine LWR Cowling	\$ 23,500
7	Dash 8 Rotable	SnDCL328-88	Main Landing Gear	\$ 36,000
8	Dash 8 Rotable	8864060385-W519 / 8861081361-W518	Finger Nails RH & LH	\$ 33,500
9	DO228 Rotable	SN#EAA1646	Propeller Overhaul	\$ 26,801
10	Motor Vehicle	Unknown	Suzuki APV 7 seater Van	\$ 15,999

For all the above items, accumulated depreciation and net book value in the FAR as of 9/30/2010 equal those as of 9/30/2009.

Item #s 1 and 5 are depreciated over 5 years; however, we were informed that a 10-year life is more appropriate for these assets. Further, for Item # 5, the correct part # is PN120A.

The following exceptions noted in a prior audit remain unresolved:

<u>Item #</u>	<u>Type</u>	<u>Asset #</u>	<u>Description</u>	<u>Cost</u>
1	Dash 8 Rotable	071-1192-26 KFS-576	ATC Control (S/N 3486)	\$ 2,800
2	Dash 8 Rotable	7003110-091	EFIS Display (S/N 93097868)	\$ 23,911

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued Year Ended September 30, 2010

Finding No. 2010-3, Continued

Property and Equipment

<u>Item #</u>	<u>Type</u>	<u>Asset #</u>	<u>Description</u>	<u>Cost</u>
3	Dash 8 Rotable	99122087	Display Electronic	\$ 8,517
4	Dash 8 Rotable	2-1466-4	Brake Assembly (S/N 0881)	\$ 5,544
5	Dash 8 Rotable	14100-117	Main Landing Gear	\$ 44,000
6	Office Equipment	Unknown	Computers	\$ 6,300
7	Dash 8 Rotable	Unknown	Actuator	\$ 3,601
8	Office Equipment	Unknown	Logicare	\$ 2,100
9	Dash 8 Rotable	Unknown	Hawker Pacific Pty	\$ 9,589
10	Plant & Equipment	Incomplete	Air Condition	\$ 3,065
11	Sign	Unknown	Sign	\$ 2,650
12	Dash 8 Rotable	MI585353	Antenna Pedestal Assembly	\$ 7,488
13	Dash 8 Rotable	LM-431-52	Engine Mount Assembly	\$ 4,329
14	Tools & Small Equipment	Unknown	Torque Wrench	\$ 2,262
15	Dash 8 Rotable	90111666	Advisory Display	\$ 18,950
16	Office Equipment	Unknown	VHF Base/Mobile Radio	\$ 2,870

Item # 1 is 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 is incorrectly recorded at a cost of \$12,750 instead of \$2,250.

Item #s 2 through 4 are 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 are separately recorded in the FAR and the new serial # is not recorded. Item #s 3 and 4 represent repair costs of assets purchased in prior years. The original costs were not written off.

Item # 5 is described in the FAR as 'Audit Adjustment No. 19' with no part number at a cost of \$43,000, which excludes \$1,000 in modification costs.

Item #s 6 through 9 cannot be located due to insufficient information in the FAR. For Item #s 8 and 9, asset description is a vendor's name. Further, Item #9 represents inspection charges that should have been added to the asset cost.

Item # 10 represents more than one unit, which cannot all be located due to insufficient information in the FAR.

Item # 11 cannot be located due to insufficient information in the FAR.

Item #s 12 through 14 represent repair and calibration costs and, thus, do not represent capital assets.

Item # 15 is described in the FAR as 'Rotables Per JV 118' without a part number.

Item # 16 represents several units, which cannot all be located due to insufficient information in the FAR. Furthermore, not all the units located are tagged.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued Year Ended September 30, 2010

Finding No. 2010-3, Continued

Property and Equipment

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 audit of AMI for fiscal year 2009.

Auditee Response and Corrective Action Plan: Inventory control or physical count over rotables considered as high valued items are given priorities over non-rotatable items the likes of vehicles, office equipments and furnitures. Although compensating controls exist (complete source documents) we need to continue random physical count and the results thereof be reconciled with the FAR.

The previous employee handling the FAR including the lapsing schedule of fixed assets had no time turning over such function to the employee assuming such function due to terminal illness. Manning complement is a source of the problem due to costs constraint and we have no recourse but to pool all our resources and come up with such schedule. An employee was appointed to assume such responsibility effective immediately.

Change in the life of certain assets from 5 to 10 years was the result of the periodic assessment of the useful life of rotables by the quality department. These high valued items (nose landing gears, reduction gear box) are low maintenance and they are overhauled/replaced once over the life of the aircraft. Quality inspection coupled with daily update or posting of cycles or hours provide an accurate information as to the accuracy of the estimated life of high valued rotables.

Although some expenditures fall below the USD2,500 capitalization policy, incidental expenses related to the on-going repairs of rotables are capitalized when completed (electronic display units). For purpose of consistency in enforcing the capitalization threshold, a memo will be issued as a reminder.

In order to provide sufficient information in the FAR, the journal voucher must have a complete supporting documents including that of the asset description and part number. This will be reflected in the FAR for easy reference. Units that cannot be easily located during random inspection or verification can will be addressed by the said control feature. Tagging of the fixed asset will be consistently done including timely update and reconciliation of the FAR.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2010

Finding No. 2010-4

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.

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 possible misstatement of account balances.

Recommendation: We recommend that management thoroughly review all journal entries prior to posting. Furthermore, management should determine 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 through 2009.

Auditee Response and Corrective Action Plan: Review of all proposed audit adjustments shall be critically reviewed before, during and after posting to ensure accuracy.

Unresolved prior year findings indicated under pages 3 to 8 shall be resolved in FY11 by providing corrective actions immediately.

AIR MARSHALL ISLANDS, INC.

Unresolved Prior Year Findings
Year Ended September 30, 2010

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