

November 4, 2011

Mr. William Capelle
Acting General Manager
Air Marshall Islands, Inc.
P.O. Box 1319
Majuro MH 96960

Dear Mr. Capelle:

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, 2010 (on which we have issued our report dated November 4, 2011), 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, 2010 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated November 4, 2011, 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.

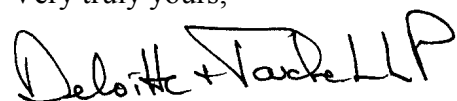
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

This report is intended solely for the information and use of the Board of Directors, management, others within the organization, and the Office of the Auditor-General 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, 2010 that we wish to bring to your attention:

(1) Revenue/Receipts

Of fifty-eight passenger revenue items tested, we noted the following exceptions:

- Nine receipts were not timely deposited:

<u>Ticket #</u>	<u>Fare (\$)</u>	<u>Receipt Date</u>	<u>Deposit Date</u>	<u>Days Delayed</u>
214051	152	1/27/2010	2/01/2010	5
217846	171	5/06/2010	5/12/2010	6
218754	61	7/15/2010	7/20/2010	5
219937	116	4/29/2010	5/04/2010	5
221762	342	9/17/2010	9/23/2010	6
222813	145	7/31/2010	9/07/2010	38
224605	125	12/23/2009	12/29/2009	6
224828	135	4/27/2010	5/03/2010	6
225410	344	4/29/2010	5/04/2010	5

Of six charter revenue items tested, we noted the following exceptions:

- Charges of \$1,580 were for flight request form # 1053; however, only \$1,574 was collected.
- Flight request form # 1011 was approved 5 days after the flight occurred; furthermore, this charter was not invoiced until 11 days later and was not collected until 6 months later.

We recommend that management timely verify the accuracy of invoicing of services and the timely deposit of collections. We further recommend that approval of chartered flights be timely documented. This matter was reported as a finding in the audits of fiscal years 1999 through 2008 and in our previous letter to management for the 2009 audit.

(2) Employee Receivables

At September 30, 2010, employee receivables represented 33% or \$256,000 of total outstanding receivables. Approximately 64% or \$163,000 of employee receivables is due from former employees. This balance amount is fully provided for by an allowance.

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 2009.

(3) Employee Advances

At September 30, 2010, AMI recorded employee advances (A/c # 12741, \$49,893) that include advances aggregating \$14,078 that are over a year old. Furthermore, the subsidiary ledger included a September 3, 2009 entry for \$150 with no employee name. 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 audit of fiscal year 2009.

(4) Returned Checks Receivable

At September 30, 2010, AMI recorded returned checks receivable (A/c # 12714, \$25,988), 98% of which are over a year old and are fully provided for by an allowance. 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 audit of fiscal year 2009.

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) Payroll Withholding Tax Returns

Tax returns were not consistently filed in a timely manner during fiscal year 2010, resulting in penalty and interest charges. We recommend that management file tax returns within deadlines.

(2) Lease Agreements

Lease agreements for Majuro and Ebeye offices expired on January 31 and March 1, 2006, respectively, and have not been renewed. Leases should be current to minimize disputes and to mitigate inherent legal risks. This matter was discussed in our previous letters to management for the audits of fiscal years 2005 through 2009.

(3) Segregation of Duties

Management believes that there is minimal risk regarding segregation of duties due to the size of the Company 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 2009.

(4) Information Technology Policies

AMI has not adopted and implemented policies and procedures concerning information technology, including those concerning systems backup. We recommend that management consider adopting information technology policies and procedures.

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.