

AIR MARSHALL ISLANDS, INC.

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2000



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED UPON THE AUDIT 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, 2000, and have issued our report thereon dated August 24, 2001, which was qualified due to our inability to obtain minutes of Board of Directors' meetings held from January 23, 1999 through August 24, 2001 and our inability to obtain adequate accounting records to support expendable parts and air traffic liability. Except as discussed in the preceding sentence, 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.

Compliance

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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered AMI's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect AMI's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings (pages 3 through 10) as items 2000-1 through 2000-6.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2000-1 through 2000-6 to be material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of AMI in a separate letter dated August 24, 2001.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

DeBitt & Jude

August 24, 2001

AIR MARSHALL ISLANDS, INC.

Schedule of Findings
Year Ended September 30, 2000

Revenue/Receipts

Finding No. 2000-1

Criteria: Ticket stock should be maintained in an orderly and systematic fashion.

Condition: During the year ended September 30, 2000, we noted that ticket stock was not issued to ticketing agents/stations in sequential order. In addition, of one hundred and fifteen tickets tested, we noted the following exceptions:

- Ten flight coupons (Coupon #s 4200-245113, 4200-248678, 4200-252487, 5500-028443, 5500-033101, 5500-033209, 5500-039978, 5500-040881, 5500-041679 and 5500-043907) and associated daily sales reports were not made available.
- Sales reports that included nine flight coupons (Coupon #s 4020-046189, 4020-046849, 4200-246820, 4200-251807, 4200-252379, 5500-032428, 5500-033807, 5500-033856 and 5500-041803) indicated lack of review by the cashier. Furthermore, sales reports that included five flight coupons (Coupon #s 4200-245776, 4200-252163, 5500-028953, 5500-030081 and 5500-646453) indicated lack of signature by the ticketing agents.
- Nine flight coupons (Coupon #s 4020-045549, 4020-047430, 4200-246820, 5500-031311, 5500-031327, 5500-035194, 5500-035503, 5500-035843, and 5500-045394) were based on student or child fares; however, no proof of eligibility for the fares indicated was made available.
- Twenty flight coupons (Coupon #s 4200-246820, 5500-028953, 5500-029368, 5500-029412, 5500-029684, 5500-030601, 5500-030768, 5500-030828, 5500-032824, 5500-032876, 5500-032981, 5500-033807, 5500-038035, 5500-041803, 5500-042356, 5500-044660, 5500-045001, 5500-045256, 5500-045394 and 5500-046453) could not be agreed to the respective flight manifest as the flight dates were not made available. Based on discussions with revenue accounting personnel, these tickets either were open-dated or were not used on the ticket dates. Furthermore, our discussions with revenue accounting personnel indicated that flown tickets were deleted from the DASH system and that no detailed reports of tickets flown by date were printed before deletion.
- Sales made by a ticketing agent at the Tawara station relating to two flight coupons (Coupon #s 4200-246820 and 4200-252379) were not recorded in the general ledger.
- One flight coupon (Coupon # 5500-043927) was not filed with the associated sales report. Furthermore, this ticket sale was incorrectly recorded as revenue for fiscal year 2001.
- Cash sales made by a ticketing agent at the Ebeye station for the period November 24, 1999 through November 26, 1999 and the period July 5, 2000 through July 20, 2000 were not deposited to the bank until December 10, 1999 and August 4, 2000, respectively. Furthermore, cash sales made by a ticketing agent at the Majuro station for the period January 17, 2000 through January 21, 2000 were not deposited to the bank until January 26, 2000.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Finding No. 2000-1, Continued

Cause: The cause of the above condition is the lack of adherence to established policies and procedures relating to control over and issuance of ticket stock.

Effect: The effect of the above condition is the possible misstatement of revenues and unearned revenues.

Recommendation: We recommend that management ensure the revenue accounting department adhere to established policies and procedures relating to control over and issuance of ticket stock.

Prior Year Status: Lack of adherence to established policies and procedures relating to control over and issuance of ticket stock was reported as a finding in the audit of AMI for fiscal year 1999.

Auditee Response and Corrective Action Plan: Management concurs with the finding and the relevant staff have been instructed to adhere to set policies and procedures for issuing tickets.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Receivables

Finding No. 2000-2

Criteria: Accounts receivable should be collected in a timely manner.

Condition: As of September 30, 2000, AMI recorded receivables from the government of the Republic of the Marshall Islands (RepMar) amounting to \$691,980, the majority of which are more than five years old. A summary of these receivables is as follows:

Ministry of Finance	\$ 182,661
Cabinet	144,601
Ministry of Resources and Development	116,460
Ministry of Health and Environment	112,725
Office of the President	48,091
Nitijela	30,343
Ministry of Foreign Affairs and Trade	25,800
Other	<u>31,299</u>
	<u>\$ 691,980</u>

The corresponding payable recorded by RepMar amounted to \$5,236. The variance of \$686,744 relates to services provided by AMI without authorized RepMar purchase orders.

Cause: The cause of the above condition is the lack of response by RepMar to management's efforts to collect the above balances and the lack of concurrence by RepMar with the amount.

Effect: The effect of the above condition is that receivables from related parties are potentially overstated, which resulted in an allowance for doubtful receivables of \$586,303 as of September 30, 2000.

Recommendation: We recommend that management continue its efforts to reach an agreement on the collection of the receivable balances.

Prior Year Status: Long outstanding receivables from related parties was reported as a finding in the audits of AMI for fiscal years 1998 and 1999.

Auditee Response and Corrective Action Plan: Management will continue to actively pursue the outstanding balances owed by RepMar.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Receivables

Finding No. 2000-3

Criteria: Accounts receivable should be recorded at net realizable value.

Condition: As of September 30, 2000, the aged accounts receivable subsidiary ledger, excluding affiliate accounts, indicated that customer accounts with balances greater than 120 days represented eighty-three (83) percent of the total balance of \$568,187. Although many of these balances have not had any recent activity, AMI has not evaluated the ultimate collectibility of these balances. A total allowance of \$383,846 has been recorded to offset this balance.

Cause: The cause of the above condition is the lack of procedures to evaluate the collectibility of recorded receivables.

Effect: The effect of the above condition is the possibility of misstatement of receivables.

Recommendation: We recommend that management review all outstanding receivables for collectibility.

Auditee Response and Corrective Action Plan: Management has instigated a detailed review of outstanding receivables as well as credit procedures in general. Outstanding accounts will be actively pursued.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Expendable Parts

Finding No. 2000-4

Criteria: Expendable parts cost should be supported by vendor invoices.

Condition: Of thirty-two expendable parts items tested, totaling \$188,631, the following variances between recorded cost and actual cost were noted:

<u>Part #</u>	<u>Description</u>	<u>Recorded Cost</u>	<u>Actual Cost</u>	<u>Overstatement/ (Understatement)</u>
270UZ01A4BA5B	Switch	\$ 3,296	\$ 3,189	\$ 107
25-455	Switch	2,924	2,829	95
590F110	Shutter	6,789	7,140	(351)
867923-1	Gearshaft and spur	4,063	1,177	2,886
A-112560D01B	Milled part without bearing	2,345	2,328	17
A-112563B00C	Road assembly	3,983	4,065	(82)
A-161210B00C	Bracket	3,365	2,897	468
A-221071A06B	Bushing	3,838	3,064	774
A-221130A03B	Bushing, MLG pivot bolt	3,728	2,592	1,136
A-222140A00C	Cabin window	2,691	5,586	(2,895)
A-251053A00C	Plastic bulkhead	5,469	4,230	1,239
A-521000F27B	Stub axle	12,167	12,094	73
A-331330B02B	Bush	3,229	4,404	(1,175)
A-413820B00F	Differential lever	6,975	6,646	329
A-511000B01B	Piston	26,288	13,876	12,412
A-511000F27B	Stub axle	12,167	12,094	73
A-613100B00C	Duct outlet	3,433	3,279	154
D3893-4-4	Bushing rubber	5,760	235	5,525
BX140110B00W	Cover wing	3,078	2,909	169
LN9264-4X100	Jumper bonding	7,372	6,118	1,254
SB228-074	Service bulletin	22,644	14,454	8,190
05K21104	Cylinder kit	1,115	1,104	11
9545K24	Rubber stopper	2,825	22	2,803
		<u>\$ 149,544</u>	<u>\$ 116,332</u>	<u>\$ 33,212</u>

Cause: The cause of the above condition is lack of adherence to established policies and procedures relating to the recording and valuation of expendable parts.

Effect: The effect of the above condition is the misstatement of expendable parts.

Recommendation: We recommend that management ensure that established policies and procedures are adhered to concerning the valuation of expendable parts.

Prior Year Status: Errors in expendable parts valuation were reported as a finding in the audits of AMI for fiscal years 1992 through 1999.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Finding No. 2000-4, Continued

Auditee Response and Corrective Action Plan: While a large number of the variances noted related to exchange rate fluctuations from the time the order was placed to the time the order was received, several items were misposted in previous periods. These errors will be corrected and appropriate adjustments posted in the current period. Management will instigate a goods received note system that will provide for posting of the balance as recorded by accounts payable to ensure no future variances due to exchange fluctuations.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Related Party Disclosure

Finding No. 2000-5

Criteria: In accordance with Statement of Financial Accounting Standards No. 57, *Related Party Disclosures*, material related party transactions are required to be disclosed.

Condition: A schedule of revenues earned from related parties during the fiscal year was not made available.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is noncompliance with Statement of Financial Accounting Standards No. 57, *Related Party Disclosures*.

Recommendation: We recommend that management establish policies and procedures for maintaining related party information during the year.

Prior Year Status: Noncompliance with Statement of Financial Accounting Standards No. 57, *Related Party Disclosures* was reported as a finding in the audit of AMI for fiscal year 1999.

Auditee Response and Corrective Action Plan: The airline ticketing system in place does not allow for identification of specific sales by customers as tickets are tracked by ticket number not by customer name. Nevertheless, management will endeavor to set up an appropriate system that will allow for identification of related party transactions.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

External Financial Reporting

Finding No. 2000-6

Criteria: Board minutes are a primary means by which regulatory agencies and independent auditors can evaluate the administration of AMI's operations.

Condition: The Board of Directors' minutes of meetings held from January 23, 1999 through August 24, 2001 were not made available.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is the possibility that directives of the Board are not properly disclosed or recorded in the financial statements of AMI.

Recommendation: We recommend that the Board of Directors ensure that all minutes of meetings are formally documented by the Secretary and approved by the Chairman.

Prior Year Status: Lack of formal documentation of minutes of meetings of the Board of Directors was reported as a finding in the audit of AMI for fiscal year 1999.

Auditee Response and Corrective Action Plan: Management will bring this audit finding to the attention of the Board of Directors.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Unresolved Prior Year Comments

The status of unresolved prior year findings is disclosed within the Schedule of Findings section of this report (pages 3 through 10).