

AIR MARSHALL ISLANDS, INC.

INDEPENDENT AUDITORS' REPORT ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2001



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, 2001, and have issued our report thereon dated May 20, 2002, which was qualified due to our inability to obtain minutes of Board of Directors' meetings held from October 1, 2000 through May 20, 2002 and our inability to obtain adequate accounting records to support expendable parts. 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 2001-1 through 2001-7.

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, we consider all of the reportable conditions described above 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 May 20, 2002.

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.

*Deloitte & Touche*

May 20, 2002

AIR MARSHALL ISLANDS, INC.

Schedule of Findings  
Year Ended September 30, 2001

Revenue/Receipts

Finding No. 2001-1

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

Condition: During the year ended September 30, 2001, we noted that ticket stock was not issued to ticketing agents/stations in sequential order and that certain auditor and flight coupons were not reported to revenue accounting in a timely manner. In addition, of twenty-five tickets tested, we noted the following exceptions:

- One flight coupon (Coupon # 5500-055113) and the associated daily sales report were not made available.
- Sales reports that included three flight coupons (Coupon #s 4400-047761, 5500-047996 and 5500-060335) indicated lack of review by the cashier.
- Two flight coupons (Coupon #s 4020-048039 and 5500-049096) 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.
- Cash sales made by ticketing agents at the Ebeye station for the periods November 13 and 14, 2000, December 15 and 16, 2000, and July 11 through 13, 2001 were not deposited to the bank until November 23, 2000, December 27, 2000 and July 17, 2001, respectively; cash sales made by a ticketing agent at the Likeip station on January 20, 2001 were not deposited to the bank until February 7, 2001; and cash sales made by ticketing agents at the Majuro station for the periods October 6, 2000, November 13 and 14, 2000, December 7, 2000, January 5, 2001, May 17, 2001, July 25 through 28, 2001 and September 6, 2001 were not deposited to the bank until October 10, 2000, November 23, 2000, December 11, 2000, January 10, 2001, May 21, 2001, August 2, 2001 and September 11, 2001, respectively.

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 adheres 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 audits of AMI for fiscal years 1999 and 2000.

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, 2001

Receivables

Finding No. 2001-2

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

Condition: As of September 30, 2001, AMI recorded receivables from the government of the Republic of the Marshall Islands (RepMar) amounting to \$727,681, the majority of which are more than six years old. A summary of these receivables is as follows:

Ministry of Finance	\$ 193,607
Cabinet	138,332
Ministry of Health and Environment	125,647
Ministry of Resources and Development	116,460
Office of the President	50,972
Nitijela	30,617
Ministry of Foreign Affairs and Trade	25,825
Ministry of Education	20,614
Other	<u>25,607</u>
	<u>\$ 727,681</u>

The corresponding payable recorded by RepMar amounted to \$30,080. The variance of \$697,601 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 \$640,146 as of September 30, 2001.

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 through 2000.

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, 2001

Receivables

Finding No. 2001-3

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

Condition: As of September 30, 2001, 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 \$693,280. 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 \$457,151 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.

Prior Year Status: Collectibility of receivables was reported as a finding in the audit of AMI for fiscal year 2000.

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, 2001

Receivables

Finding No. 2001-4

Criteria: Receivables should be supported by a reconciled subsidiary ledger.

Condition: As of September 30, 2001, AMI reconciled receivables to a preliminary subsidiary ledger resulting in identification of unrecorded receivable amounts totaling \$72,736. An audit adjustment was proposed to record this amount as of September 30, 2001.

Cause: The cause of the above condition is unknown.

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

Recommendation: We recommend that management ensure that receivables are properly reconciled to the supporting subsidiary ledger on a monthly basis and in a timely manner.

Auditee Response and Corrective Action Plan: Management concurs with the finding and will ensure accounting staff establish a subsidiary ledger to support receivables.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2001

Expendable Parts

Finding No. 2001-5

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

Condition: Of forty-seven expendable parts items tested, totaling \$223,153, we noted the following exceptions:

- . The recorded cost varies from the actual cost for the following items:

<u>Part #</u>	<u>Description</u>	<u>Recorded Cost</u>	<u>Actual Cost</u>	<u>Overstatement/ (Understatement)</u>
270UZ01A4BA5B	Switch	\$ 3,296	\$ 3,139	\$ 157
337-546-9001	Filter for manifold	3,850	3,638	212
590F110	Shutter	4,587	4,824	(237)
A-112550C21B	Strut	2,250	3,371	(1,121)
A-112560B05B	Bolt	2,990	2,833	157
A-112560D01W	Milled part with bearing	9,379	8,808	571
A-112560D02W	Flap arm assy with bearing	7,015	6,731	284
A-112563B00C	Rod assy	7,966	7,518	448
A-161210B00C	Bracket	3,365	2,724	641
A-221071A06B	Bushing	3,838	3,064	774
A-221130A03B	Bushing, MLG pivot bolt	3,728	2,592	1,136
A-251053A00C	Plastic bulkhead, ctr	2,735	2,115	620
A-261101B00C	Bearing bracket	2,098	1,964	134
A-262100D00C	Window assy	5,876	5,567	309
A-262110C00C	Window assy R/H	5,876	5,567	309
A-262330B50B	Scoop emergency exit	3,759	1,184	2,575
A-312124B00C	Bracket assy	3,972	3,787	185
A-332300B00W	Bracket assy	3,557	3,329	228
A-413472A00D	Rod end	2,545	2,399	146
A-511000F27B	Stub axle	12,167	12,094	73
A-521000F27B	Stub axle	12,167	12,094	73
A-531000B14W	Steering ring crank assy	4,048	3,826	222
A-531070A00D	Bell crank assy	2,374	2,265	109
A-541000C01B	Bolt - bearing	8,000	7,871	129
A-543000B00W	Bolt assy, NLG	4,838	5,022	(184)
A-613100B00C	Duct outlet	3,433	3,279	154
A-681000B03B	Bolt	2,322	2,195	127
A-949301C00A	Cable assy w. switch	3,790	3,571	219
AA535600B00C	Mud guard assy	2,984	2,820	164
AA733045A01B	Curtain	2,786	10,057	(7,271)
BX140110B00W	Cover wing, inb.	3,078	2,909	169
D3894-120	Firewire	2,471	1,950	521
SB228-209	Service bulletin	22,644	20,797	1,847
05K21104	Cylinder kit, R/H Eng only	1,115	1,104	11
RD8-10	Terminal	4,791	192	4,599
		<u>\$ 175,690</u>	<u>\$ 167,200</u>	<u>\$ 8,490</u>

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2001

Finding No. 2001-5, Continued

- Vendor invoices for the following four items were not made available:

<u>Part #</u>	<u>Description</u>
A-511000D03W	Nut assembly
BX211111A00C	Bracket for nose WH pivot bolt
W101MB6R	Push button
9545K25	Rubber stopper

- Count sheets for the year end physical inventory count were not made available.

Additionally, of thirty items selected for test counts during the year end physical inventory count, two items (part #s KDS35 and 925X5) had zero quantity in the final inventory listing.

Cause: The cause of the above condition is lack of retention of appropriate documentation and 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 supporting invoices or other appropriate documentation to substantiate expendable parts cost be retained and 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 2000.

Auditee Response and Corrective Action Plan: Management has implemented procedures to ensure that all supporting documents for expendable parts cost are maintained in a central file. In addition, a receiving report has been designed and procedures for its use will be written.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2001

Related Party Disclosure

Finding No. 2001-6

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 audits of AMI for fiscal years 1999 and 2000.

Auditee Response and Corrective Action Plan: Management has instructed the accounting staff to develop policies and procedures for maintaining related party information to be submitted for approval as soon as possible.

AIR MARSHALL ISLANDS, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2001

External Financial Reporting

Finding No. 2001-7

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 October 1, 2000 through May 20, 2002 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 audits of AMI for fiscal years 1999 and 2000.

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

AIR MARSHALL ISLANDS, INC.

Unresolved Prior Year Comments  
Year Ended September 30, 2001

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