



August 24, 2001

CONFIDENTIAL

Board of Directors
Air Marshall Islands, Inc.

Dear Board Members:

In planning and performing our audit of the financial statements of Air Marshall Islands, Inc. (AMI) for the year ended September 30, 2000, on which we have issued our report 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, we developed the following recommendations concerning certain matters related to AMI's internal control and certain observations and recommendations on other accounting, administrative, and operating matters. Our principal recommendations are summarized below.

(1) Cash Receipts

Of forty-five cash receipts tested, supporting documentation for ten cash receipts (receipt #s 39616, 39940, 40226, 40913, 41236, 41558, 41940, 41992, 42525 and 42543) were not made available. In addition, we noted one cash receipt (receipt # 42464, totaling \$46) that was not posted to the general ledger. We recommend that management ensure that source documentation support all cash receipts and that all transactions are properly posted to the general ledger.

(2) Payroll

Of fifty-two payroll disbursements tested, we noted seven instances where employees on outer islands were paid based on a pay rate of 50 cents per hour. It was noted that these employees do not work a full 80 hours but are paid at this rate to compensate them at the agreed-upon bi-weekly amount. The rate being utilized to process paychecks for these employees is below the minimum wage rate for the Republic of the Marshall Islands. We recommend that all employees be paid at least the minimum wage rate and that hours be adjusted to compute the agreed-upon rate. This will ensure that AMI is complying with relevant local laws. This matter was brought to management's attention in our previous letters dated May 29, 2000 and January 22, 1999.

(3) Payroll

Of fifty-two payroll disbursements tested, we noted the following exceptions:

- For the pay period ended 11/09/99, withholding taxes for one employee (employee # LH00489) were under deducted by \$3.20;
- For the pay period ended 11/23/99, one employee (employee # SM00603) was not paid for 1.52 overtime hours worked on 11/21/99;
- For the pay period ended 01/04/00, one employee (employee # PB00263) was paid regular time for 4 hours worked on a holiday (12/25/99) instead of time-and-a-half;
- For the pay period ended 03/14/00, one employee (employee # LL00628) was paid regular time for 5.05 hours worked on a holiday (03/08/00) instead of time-and-a-half;
- For the pay period ended 08/29/00, one employee (employee # JP00499) was overpaid by 1.73 regular hours;
- For the pay period ended 08/29/00, one employee (employee # SE00246) was paid 32 regular hours instead of 32 annual leave hours. Furthermore, the employee was overpaid by 1.44 regular hours;
- For the pay period ended 9/26/00, one employee (employee # MM00619) was underpaid by 2 regular hours;
- Authorized personnel action forms were not made available to support the hourly pay rates to the following employees:

| <u>Employee #</u> | <u>PPE</u> | <u>Rate Paid</u> |
|-------------------|------------|------------------|
| BL00364 | 04/25/00 | \$ 0.50 |
| AI00252 | 05/10/00 | \$ 4.00 |
| JD00241 | 07/04/00 | \$ 0.50 |

- We were informed salaried employees do not utilize timecards; however, timesheet summaries for such employees are prepared and approved by the department supervisors. The timesheet summaries for the following salaried employees were not prepared:

| <u>Employee #</u> | <u>PPE</u> |
|-------------------|------------|
| DS00255 | 10/26/99 |
| LH00219 | 12/07/99 |
| PT00271 | 02/29/00 |
| MM00630 | 05/09/00 |
| HP00498 | 07/18/00 |

We recommend that management ensure that employees' hours are accurately calculated and paid, that authorized personnel action forms be retained to support established hourly rates, and that timesheet summaries be prepared for all salaried employees.

(4) Payroll

Of fifty-two payroll disbursements tested, we noted the following:

- Certain authorized allotment forms were not made available for the following employees:

| <u>Employee #</u> | <u>PPE</u> |
|-------------------|------------|
| DS00255 | 10/26/99 |
| AJ00303 | 10/26/99 |
| BL00364 | 04/25/00 |
| SR00264 | 05/23/00 |
| HJ00604 | 08/15/00 |
| HJ00285 | 09/12/00 |

- Certain voluntary deductions did not agree with authorized allotment forms for the following employees:

| <u>Employee #</u> | <u>PPE</u> |
|-------------------|------------|
| PB00263 | 01/04/00 |
| AB00259 | 08/01/00 |
| AI00248 | 08/15/00 |
| SE00246 | 08/29/00 |

We were informed that two employees (employee #s SE00246 and AI00248) had increased their allotments; however, the authorized allotment forms evidencing the increase were not made available. In addition, we were informed that AMI's established policy allowed for a maximum of four allotments at any one time. Six employees maintained allotments in excess of the number permitted.

We recommend that management ensure that authorized allotment forms are retained and that established policies are adhered to relating to employee allotments.

(5) Cash

The Bank of Kiribati bank reconciliation at September 30, 2000 included an unidentified bank debit, totaling AUD \$15,608, which appeared on the April 1999 bank statement. No explanation of this debit was made available and it did not appear that any follow-up with the bank had occurred. We recommend that management investigate the nature of this transaction and ensure that it is correctly recorded in AMI's general ledger. This matter was brought to management's attention in our previous letter dated May 29, 2000.

(6) Employee Advances

At September 30, 2000, AMI recorded employee advances (A/c # 12741, totaling \$16,922) that included an amount of \$5,000 to an individual who did not appear to be an employee of AMI. In addition, there were certain advances to employees that have been outstanding since November 1998. We recommend that management ensure advances, including those to employees, are reimbursed in a timely manner, including establishment of bi-weekly payroll allotments with the respective employees. This matter was brought to management's attention in our previous letter dated May 29, 2000.

(7) Accounts Receivable

At September 30, 2000, AMI recorded other receivables (A/c # 12711, totaling \$103,347) that included balances, totaling \$91,453, which have been outstanding since September 1998. This amount included a receivable from Pacific Air Express (PAE) of \$62,291, which included three disbursements, totaling \$18,190, made on behalf of PAE for which no invoice appeared to have been issued. We noted correspondence with PAE that indicated that PAE might have offset its payables to AMI with its receivables due from AMI. We recommend that management forward delinquent receivable accounts to the Office of the Attorney General for collection. Furthermore, we recommend that management ensure disbursements made on behalf of third parties are invoiced and collected in a timely manner. This matter was brought to management's attention in our previous letter dated May 29, 2000.

(8) Accounts Receivable

Payment plans with debtors should be closely monitored to ensure that such are received in a timely manner. On June 16, 1999, a court judgement, totaling \$122,202, ordered a travel agency to make monthly payments of \$2,500, including interest, to AMI. As of September 30, 2000, only five payments had been received. We recommend that management ensure the travel agency adheres to the established payment plan. This matter was brought to management's attention in our previous letter dated May 29, 2000.

(9) Accounts Receivable

At September 30, 2000, AMI recorded trade receivables (A/c # 12701, totaling \$1,145,871) that did not agree to the supporting subsidiary ledger balance of \$1,162,083. No explanation was made available relating to the unreconciled variance of \$16,212. As this amount was not considered material to the financial statements, an audit adjustment was not proposed. The subsidiary ledger included a receivable due from AMI of \$109,311, which represented various expenses incurred, including employee travel and training, which had not been expensed. An audit adjustment was proposed to record the appropriate expenses in the general ledger. We recommend that management ensure that trade receivables reconcile to the supporting subsidiary ledger. Furthermore, we recommend that employee travel and related training expenses be correctly recorded in the general ledger.

(10) Accounts Receivable - Returned Checks

At September 30, 2000, AMI recorded receivables relating to returned checks (A/c # 12714, totaling \$23,338), which included certain checks, totaling \$14,703, that have been outstanding for a period in excess of one year. We recommend that management forward receivables relating to returned checks to the Office of the Attorney General for collection, or consider writing off amounts deemed uncollectible. This matter was brought to management's attention in our previous letters dated May 29, 2000 and January 22, 1999.

(11) Accounts Receivable - Value Added Tax (VAT) Claim

At September 30, 2000, AMI recorded VAT claims receivable (A/c # 12730, totaling \$6,419) which included certain VAT claims, totaling \$3,924, that have been outstanding for a period in excess of one year. We recommend that management follow up VAT claims receivable in a timely manner. This matter was brought to management's attention in our previous letter dated May 29, 2000.

(12) Plant and Equipment

At September 30, 2000, AMI reclassified prepayments, totaling \$152,722, as Dornier 228 rotables for which the detail of supporting receiving reports was not made available. We recommend that management ensure that reclassified prepayments represent rotatable parts actually received.

(13) Plant and Equipment

During the year ended September 30, 2000, AMI recorded automobile fixed asset additions, totaling \$58,058, which included one item, totaling \$13,010, relating to the purchase of a used truck. Of this amount, \$6,850 related to the actual acquisition cost of the used truck with the remaining amount of \$6,160 relating to the acquisition of rotatable parts. In addition, AMI recorded the disposal of office furniture and equipment, totaling \$10,444, located at AMI's Suva office. These fixed assets were not reflected as disposals in the supporting subsidiary fixed assets register. We recommend that management ensure that fixed asset additions and disposals be properly recorded within the supporting subsidiary fixed assets register.

(14) Cargo Revenue

Of thirteen freight revenue items tested, we noted one item pertaining to excess baggage (baggage coupon # 778 4520024244, totaling \$23) where the rate charged of \$0.50 per pound did not agree with the established rate of \$0.60 per pound, resulting in the underpayment by the consignee of \$5. In addition, we noted two airway bills (AWB #s 778 4520018454 and 778 4520025623, totaling \$240 and \$142, respectively), for which AMI had provided the services, that were recorded as unearned revenue, and one item pertaining to excess baggage (baggage coupon # 778 4520026264, totaling \$36) that was not recorded in the general ledger. We recommend that management ensure that rates charged for excess baggage are based on AMI's established rates. Furthermore, we recommend that management ensure that all transactions are properly posted to the general ledger. This matter was brought to management's attention in our previous letter dated May 29, 2000.

(15) Commission Revenue

Of one hundred and fifteen tickets tested, we noted seven flight coupons (Coupon #s 4200-245227, 4200-245776, 4200-245804, 4200-246148, 4200-246528, 4200-246549 and 4200-247072) relating to sales for other airline segments for which no commission income was recorded. Instead, an adjustment was recorded at year-end to reduce unearned revenue and record commission revenue. We recommend that commission income be recorded on a monthly basis based on ICH billings.

(16) Other Revenue

Of seven other revenue items tested, we noted one item pertaining to ground handling (service form # 0165, totaling \$575) for which no invoice appeared to have been issued and did not appear to have been posted to the general ledger. We also noted that the prenumbered service forms are not being tracked to ensure the completeness of recording revenue. We recommend that management ensure that services are invoiced and collected in a timely manner and that prenumbered service forms are tracked to ensure the completeness of recorded revenue.

(17) Expenses

Of thirty-three non-payroll expenses tested, we noted three disbursements (check #s 28903, 29081 and 30403, totaling \$4,474, \$2,358 and \$4,853, respectively) for which supporting invoices were not made available. In addition, we noted one disbursement (check # 28833, totaling \$6,269), which related to a travel advance (TA # 110199), where the per diem rate of \$48 per day exceeded the established rate of \$30 per day. We recommend that management ensure that invoices or other source documentation support all disbursements. Furthermore, we recommend that management ensure that per diem rates are based on AMI's established rates. This matter was brought to management's attention in our previous letter dated May 29, 2000.

(18) Sales Invoices

Prenumbered sales invoices facilitate the completeness of recording revenue. During our testing of charter revenue, we noted that prenumbered sales invoices were not being utilized. We recommend that management ensure prenumbered sales invoices are utilized to facilitate the completeness of recording revenue. This matter was brought to management's attention in our previous letter dated May 29, 2000.

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We have communicated certain matters noted during our audit of the financial statements of AMI for the year ended September 30, 2000, which we considered to be reportable conditions, in our report dated August 24, 2001.

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

We would like to express our appreciation to management and staff for their assistance and cooperation provided during the course of this engagement. Should you have any questions regarding matters discussed herein, please feel free to contact our office at your convenience.

Very truly yours,

Deloitte & Touche