

May 20, 2002

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, 2001, on which we have issued our report 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, 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 twenty-five cash receipts tested, we noted the following exceptions:

- Supporting documentation for three cash receipts (receipt #s 45557, 45658 and 46518) were not made available.
- Three cash receipts (receipt #s 43270, 43797 and 44558) were not recorded in the general ledger.
- Majuro station sales which included receipt #s 44178 and 45487 for March 7, 2001 and August 3, 2001, respectively, were not deposited to the bank until March 12, 2001 and August 9, 2001, respectively.
- One cash receipt (receipt # 46181) was issued on September 18, 2001 for a cargo sale on August 10, 2001.
- Collections for three cash receipts (receipts #s 42770, 43461 and 44042) were undercollected.

We recommend that management ensure that source documentation support all revenue items, all transactions are properly posted to the general ledger, collections are deposited in a timely manner, and cash receipts are issued for collections. This matter was discussed in our previous letter dated August 24, 2001.

(2) Payroll

Of twenty-five payroll disbursements tested, we noted five 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 discussed in our previous letters dated August 24, 2001, May 29, 2000 and January 22, 1999.

(3) Payroll

Of twenty-five payroll disbursements tested, we noted that the number of hours paid varied from the number of hours worked for the following employees:

<u>Employee #</u>	<u>PPE</u>	<u>Hours Paid</u>	<u>Hours Worked</u>	<u>Over (Under) Payment of Hours</u>
GJ00325	11/07/00	91.30	93.44	(2.14)
TB00256	03/27/01	93.00	85.50	7.50
AJ00303	05/10/01	100.14	90.07	10.07
EM00204	09/25/01	71.29	72.83	(1.54)

We recommend that management ensure that employees' hours are accurately calculated and paid. This matter was discussed in our previous letter dated August 24, 2001.

(4) Payroll

Of twenty-five 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>
PT00271	10/10/00
KM00232	10/24/00
LK00238	11/22/00
YA00360	12/19/00
SR00264	01/02/01
LB00268	01/31/01
HT00020	04/10/01

- Certain voluntary deductions did not agree with authorized allotment forms for employee # YN00349, PPE 08/14/01.

- 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. This matter was discussed in our previous letter dated August 24, 2001.

(5) Cash

The Bank of Kiribati bank reconciliation at September 30, 2001 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. Additionally, we noted that an unidentified variance in the Bank of Hawaii general account reconciliation for the month of February 2001 was posted to returned checks. We recommend that management investigate the nature of these transactions and ensure that they are correctly recorded in AMI's general ledger. This matter was discussed in our previous letters dated August 24, 2001 and May 29, 2000.

(6) Cash

Outstanding checks should be included as bank reconciling items. The Bank of Kiribati bank reconciliation at September 30, 2001 did not include seven outstanding checks (#s 221028, 221054, 221058, 221059, 221060, 221061 and 221063) that had not cleared the bank. We recommend that management ensure that outstanding checks are included in bank reconciliations as reconciling items.

(7) Employee Advances

At September 30, 2001, AMI recorded employee advances (A/c # 12741, totaling \$19,080) 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 and an advance on May 18, 2001 for \$1,000 which had not been liquidated as of September 30, 2001. We recommend that management ensure that 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 discussed in our previous letters dated August 24, 2001 and May 29, 2000.

(8) Accounts Receivable

At September 30, 2001, AMI recorded other receivables (A/c # 12711, totaling \$92,117) 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. A confirmation was received from PAE that indicated that PAE had no outstanding balances with AMI. We recommend that management follow-up with PAE regarding amounts due to and from them. Furthermore, we recommend that management ensure that disbursements made on behalf of third parties are invoiced and collected in a timely manner. This matter was discussed in our previous letters dated August 24, 2001 and May 29, 2000.

(9) 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, 2001, no payment had been received. In addition, no payments were received subsequent to September 30, 2001 relating to this court judgment. We recommend that management ensure the travel agency adheres to the established payment plan. This matter was discussed in our previous letters dated August 24, 2001 and May 29, 2000.

(10) Accounts Receivable

At September 30, 2001, the accounts receivable subsidiary ledger included a receivable due from AMI of \$65,588, 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 employee travel and related training expenses be correctly recorded in the general ledger. This matter was discussed in our previous letter dated August 24, 2001.

(11) Accounts Receivable - Returned Checks

At September 30, 2001, AMI recorded receivables relating to returned checks (A/c # 12714, totaling \$25,597), which included certain checks, totaling \$18,760, 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 discussed in our previous letters dated August 24, 2001, May 29, 2000 and January 22, 1999.

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

At September 30, 2001, AMI recorded VAT claims receivable (A/c # 12730, totaling \$6,419) 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 discussed in our previous letters dated August 24, 2001 and May 29, 2000.

(13) Plant and Equipment

At September 30, 2001, additions to Dornier 228 rotables included one item, totaling \$30,073, for which the detail of the supporting receiving report was not made available. We recommend that management ensure that additions to fixed assets represent items actually received. This matter was discussed in our previous letter dated August 24, 2001

(14) Plant and Equipment

During our testing of plant and equipment, we noted several items listed in the supporting subsidiary fixed assets register that are no longer in service. In addition, we noted a used pickup truck that was not listed in the supporting subsidiary fixed assets register and a disposed pickup truck that was not reflected as a disposal in the supporting subsidiary fixed assets register. We recommend that management ensure that the supporting subsidiary fixed assets register properly reflects fixed assets in service and disposals. This matter was discussed in our previous letter dated August 24, 2001.

(15) Accounts Payable - Others

At September 30, 2001, AMI recorded other payables (A/c # 20215, totaling \$22,823) that included balances, totaling \$21,559, which have not been settled for over one year. We recommend that management ensure that these amounts are reviewed and settled in a timely manner.

(16) Accrued Expenses

AMI's annual leave policy states that employees may carry over no more than 160 unused annual leave hours per calendar year. We noted two employees (#s MT00213 and JA00205) whose annual leave hours at September 30, 2001 had exceeded the expected maximum allowable hours of 280. We were informed by payroll personnel that exceptions were made by department supervisors for these two employees; however, documentation of such was not made available for our review. We recommend that management ensure that established policies are adhered to concerning the accumulation of annual leave hours.

(17) Cargo Revenue

Of fifteen freight revenue items tested, collection of two airway bills (AWB #s 31226 and 37256) and one item pertaining to excess baggage (baggage coupon # 26801) were deposited to the bank twelve days after receipt. Furthermore, the sale for AWB # 37256 was incorrectly recorded as revenue for fiscal year 2002. We recommend that management ensure that collection of sales be deposited to the bank in a timely manner and that all transactions are posted to the general ledger in a timely manner.

(18) Cargo Revenue

Of fifteen freight revenue items tested, supporting documentation for nine airway bills (AWB #s 28649, 28741, 31137, 31656, 33410, 34366, 34615, 36642 and 37256) were not made available. We also noted that airway bill stock was not issued to agents/stations in sequential order. We recommend that management ensure that source documentation is retained and that airway bill stock be issued in sequential order.

(19) Charter Revenue

Of eight charter revenue items tested, supporting documentation for six items (flight request #s 64, 71, 84, 96, 109 and 114) were not made available. In addition, we noted one item (flight request # 144) for which no invoice appeared to have been issued and did not appear to have been posted to the general ledger. We recommend that management ensure that source documentation support all transactions and that all services are invoiced and collected in a timely manner.

(20) Other Revenue

Of twelve other revenue items tested, we noted two items pertaining to ground handling (service form #s 262 and 546, totaling \$200 each) that did not appear to have been posted to the general ledger until collected several months later. 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. This matter was discussed in our previous letter dated August 24, 2001.

(21) Expenses

Of fifty-seven non-payroll expenses tested, we noted three disbursements (check #s 34305, 35197 and 35988, totaling \$450, \$4,853 and \$10,850, respectively) for rental space and consulting fees for which the supporting contracts were not made available. We recommend that management ensure that source documentation support all disbursements. This matter was discussed in our previous letters dated August 24, 2001 and May 29, 2000.

(22) 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 discussed in our previous letters dated August 24, 2001 and May 29, 2000.

(23) RMI Withholding Taxes

During the year ended September 30, 2001, AMI incurred penalties and interest, totaling \$2,046 and \$1,149, respectively, related to AMI's late filing of withholding tax returns, which were not recorded in the general ledger. Such penalties and interest were deducted by RepMar from the balance of AMI's advance to RepMar. We recommend that management ensure that withholding tax returns are filed by the due dates to avoid unnecessary penalties and interest.

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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, 2001, which we considered to be reportable conditions, in our report dated May 20, 2002.

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,

