

August 15, 2005

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, 2003, on which we have issued our report dated August 15, 2005, which was qualified due to our inability to obtain all the minutes of Board of Directors' meetings held from October 1, 2002 through August 15, 2005 and our inability to obtain adequate accounting records to support trade receivables, expendable parts, accounts payable 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 twenty-five cash receipts tested, we noted the following exceptions:

- Supporting documentation for four cash receipts (receipt #s 52001, 53014, 53113 and 54009) was not made available. Additionally, the supporting airway bill for receipt # 55584 indicated freight of 20 pounds totaling \$11; however, the receipt issued was for 18 pounds totaling \$10.
- Majuro station sales, which included receipt #s 52671, 53730, 53789, 54336, and 54651 for December 7, 2002, March 8 and 15, 2003, March 19, 2003, May 9 and 10, 2003, and May 13 and 17, 2003, respectively, were not deposited until December 17, 2002, March 20, 2003, March 26, 2003, May 19, 2003, and May 21, 2003, respectively; Ebeye station sales, which included receipt #s 53106 and 53113 for January 24, 2003 and January 29, 2003, respectively, were not deposited until February 26, 2003 and February 12, 2003, respectively.
- Deposits on December 9, 2002, March 20, 2003, April 28, 2003, May 21, 2003, and July 16, 2003, of cash sales by ticketing agents at the Majuro station were short by \$15, \$29, \$338, \$306, and \$120, respectively. Our discussions with accounting personnel indicated that these variances were not recorded in the general ledger, and no effort has been made to resolve them. Furthermore, the deposits on March 20, 2003 included repayment of an advance to employees, which was recorded as a sale overage. We were informed that the initial advance to employees was paid from the daily sales and recorded as a shortage.
- Deposits on June 2, 2003 of cash sales by a ticketing agent at the Majuro station included \$130 for which the supporting documentation was not made available. This was recorded as unearned revenue.

(1) Cash Receipts, Continued

- The daily cash receipts listings and deposit slips that included receipt #s 54238 and 55763 were not made available. Therefore, we were unable to verify their proper recording and timely deposit. Additionally, receipt #s 52294 and 52295 were both dated November 14, 2002; however, the related cash sales were deposited November 8, 2002.

We recommend that management ensure that source documentation supports all revenue items, all transactions are properly posted to the general ledger and collections are deposited in a timely manner. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002 and August 24, 2001.

(2) Payroll

Of twenty-five payroll disbursements tested, statutory deductions were incorrectly calculated for two employees (employee # MK00266 for pay periods ended December 17, 2002 and March 11, 2003 and employee # EA00625 for pay periods ended February 11, 2003 and August 12, 2003). We recommend that management ensure that payroll is accurately calculated. This matter was discussed in our previous letter dated August 8, 2003.

(3) Payroll

Of twenty-five payroll disbursements tested, we noted the following:

- The actual hours differed from the hours paid for the following employees:

<u>Employee #</u>	<u>PPE</u>	<u>Actual Hours</u>	<u>Paid Hours</u>
GJ00325	10/22/02	26.27 overtime	25.27 overtime
RL00496	11/19/02	71.13 regular	73.13 regular
KK00625	12/17/02	48.07 regular	45.09 regular
		31.93 overtime	34.91 overtime
MK00266	12/17/02	10.63 overtime	9.28 overtime
AM00272	12/31/02	74.75 regular	75.15 regular
		5.25 vacation	4.85 vacation
GL00260	12/31/02	4.00 sick	Paid as regular hours
EA00625	02/11/03	34.78 overtime	35.35 overtime
AL00212	03/25/03	29.71 regular	36.7 regular
		50.29 vacation	43.3 vacation
MK00266	03/11/03	16.07 overtime	39.55 overtime
EA00625	08/12/03	56.91 overtime	58.03 overtime

- Additionally, for employee # KK00625 for pay period ended 12/17/02, the annual leave form was not signed as approved and for employee # AL00212 for pay period ended 3/25/03, the annual leave was approved for 40 hours; however, the employee was paid 43.3 hours.
- For one employee (employee # AL00212) for pay period ended July 1, 2003, the actual hours were 24 regular and 56 annual leave; however, the employee was paid 24 regular, 47 annual leave, and 9 sick leave hours. We were informed by accounting personnel that sick leave hours are used to cover insufficient annual leave hours; however, there is no formal policy authorizing this action.

We recommend that management ensure that employees' hours are accurately calculated and paid and that established policies are adhered to relating to annual and sick leave. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002 and 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>
LK00238	10/08/02
RL00496	11/19/02
KK00625	12/17/02
EA00625	02/11/03
LL00628	05/20/03
PT00271	09/09/03

- A supporting allotment form for employee # AL00668 for the pay period ended September 9, 2003 was signed by the employee on August 7, 2004.

We recommend that management ensure that authorized allotment forms are retained. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002 and August 24, 2001.

(5) Payroll

The same individual performs all payroll functions. We recommend that management ensure that proper segregation of duties is in place over the payroll function to ensure accuracy and authorization.

(6) Cash

The Bank of Kiribati bank reconciliation at September 30, 2003 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 occurred. We recommend that management investigate the nature of this transaction and ensure that it is correctly recorded. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(7) Employee Advances

At September 30, 2003, AMI recorded employee advances (A/c # 12741, totaling \$31,000) that included two amounts of \$5,000 and \$1,000 to an individual and company, respectively, who were not employed by AMI. In addition, \$23,680 of total advances are over a year old. We recommend that management ensure that advances, including those to employees, are reimbursed in a timely manner. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(8) Accounts Receivable

At September 30, 2003, AMI recorded other receivables (A/c # 12711, totaling \$98,420) that included certain balances outstanding since September 1998, including a receivable from Pacific Air Express (PAE) of \$62,291, derived through three disbursements, totaling \$18,190, made on behalf of PAE for which no invoice was issued. PAE has indicated in the past that they have 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 8, 2003, May 20, 2002, 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. No payments have been received since January 2000. We recommend that management ensure the travel agency adheres to the established payment plan. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(10) Accounts Receivable - Returned Checks

At September 30, 2003, AMI recorded receivables relating to returned checks (A/c # 12714, totaling \$37,058) for which no reconciled supporting subsidiary ledger was made available. We recommend that management ensure that receivables relating to returned checks are reconciled to a supporting subsidiary ledger on a monthly basis. This matter was discussed in our previous letter dated August 8, 2003.

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

At September 30, 2003, AMI recorded VAT claims receivable (A/c # 12730, totaling \$6,419) that have been outstanding for a period in excess of three years. We recommend that management follow up on VAT claims receivable in a timely manner. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(12) Prepaid Expenses

At September 30, 2003, AMI recorded prepaid expenses (A/c # 14104, totaling \$31,952) that included certain balances totaling \$23,210 relating to fiscal year 2001. We recommend that management ensure that prepaid expenses are reviewed and reconciled to a supporting subsidiary ledger on a monthly basis.

(13) Advance to RepMar

At September 30, 2003, AMI recorded an advance to RepMar totaling \$793,880 that did not reconcile with the corresponding payable recorded by RepMar of \$744,763. Although the variance was not material to warrant an audit adjustment, we recommend that management ensure that the advance to RepMar is reconciled with RepMar on a monthly basis.

(14) Plant and Equipment

Additions to Dornier 228 rotables included one item for which acquisition information was not indicated in the subsidiary fixed asset register. Furthermore, one addition to Dash 8 rotables totaling \$13,950 did not include a related capitalizable \$40 freight cost. We recommend that management ensure that additions to fixed assets are properly recorded in the subsidiary register.

(15) Plant and Equipment

Several items listed in the subsidiary fixed asset register are either no longer in service or have been disposed of. We recommend that management ensure that the subsidiary fixed asset register properly reflect fixed assets in service and disposals. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002 and August 24, 2001.

(16) Accounts Payable - Others

At September 30, 2003, AMI recorded other payables (A/c # 20215, totaling \$22,715) that included certain amounts that have not been settled for over two years. We recommend that management ensure that these amounts are reviewed and settled in a timely manner. This matter was discussed in our previous letters dated August 8, 2003 and May 20, 2002.

(17) Cargo Revenue

Of twenty-five freight revenue items tested, we noted one item pertaining to excess baggage (baggage coupon # 4520032458) where the total amount charged of \$46 did not agree with the established rate of \$42, resulting in the overpayment by the customer of \$4. In addition, the total amount charged of \$23 for airway bill # 55402 did not agree with the established rate of \$25, resulting in the underpayment by the customer of \$2. We recommend that management ensure that rates charged for excess baggage are based on AMI's established rates. This matter was discussed in our previous letter dated August 8, 2003.

(18) Cargo Revenue

Of twenty-five freight revenue items tested, supporting documentation for seven airway bills (AWB #s 51144, 511604, 53437, 54661, 54931, 55823 and 58511) 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 is issued in sequential order. This matter was discussed in our previous letters dated August 8, 2003 and May 20, 2002.

(19) Cargo Revenue

Of twenty-five freight revenue items tested, sales for January 14 to 16, 2003 (Majuro station), February 17, 2003 (Majuro station), and August 19, 2003 (Jaluit station) were not deposited until February 5, 2003, February 25, 2003, and September 9, 2003, respectively. In addition, airway bill # 56930 dated April 8, 2003 was not invoiced until September 30, 2003 and airway bill # 55402 indicated an employee charge; however, the charge was not included in the employee's receivable account. Also, the cash receipt journals were not made available for airway bill #s 52392 and 55740. Consequently, we were unable to trace these items to the general ledger. We recommend that management ensure that sales are deposited and services are invoiced and collected in a timely manner, and source documentation is retained.

(20) Charter Revenue

Of twelve charter revenue items tested, supporting documentation for three items (flight request #s 225, 231 and 259) were not made available. In addition, we noted six items (flight request #s 233, 305, 307, 312, 313 and 317) for which no invoices were issued during 2003. The invoices were issued and recorded as revenue for fiscal year 2004 upon our request for the invoices for the chartered flights. We recommend that management ensure that source documentation support all transactions and that all services are recorded in the proper period and invoiced and collected in a timely manner. This matter was discussed in our previous letters dated August 8, 2003 and May 20, 2002.

(21) Other Revenue

Of twenty-two other revenue items tested, we noted one item pertaining to a flight diversion (flight request # 269) on February 9, 2003 was not invoiced until April 7, 2003. Furthermore, the amount invoiced of \$702 should have been \$629. 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 properly invoiced and collected in a timely manner and that prenumbered service forms are tracked to ensure completeness of recorded revenue. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002 and August 24, 2001.

(22) Expenses

Of forty non-payroll expenses tested, we noted four items (check #s 32763, 33289, 33965 and wire payment # 15, totaling \$25,163, \$12,040, \$6,285 and \$22,108, respectively) pertaining to fiscal year 2002 that were recorded as fiscal year 2003 expenses. Additionally, the supporting documentation for one journal voucher (JV # J0251) was not made available. We recommend that management ensure that expenses are recorded in the proper period and that transactions posted to the general ledger are supported by adequate documentation. This matter was discussed in our previous letter dated August 8, 2003.

(23) Expenses

Of forty non-payroll expenses tested, we noted three items (check # 33216, wire payment # 61 and journal voucher # J0177) totaling \$1,301, \$20,000 and \$13,285, that were recorded in the wrong general ledger account. Additionally, one item (wire payment # 7) included rotatable parts totaling \$70,725 that were not recorded as additions to fixed assets and depreciated accordingly. An audit adjustment was proposed to properly record the rotatable parts. We recommend that management ensure that expenses are recorded in appropriate general ledger accounts.

(24) Cash Shortage/Overage

Advances to pilots paid from daily sales are recorded as cash shortages and repayments of such are recorded as sales overages. Advances to employees should be recorded as receivables from employees. We recommend that management ensure that advances to employees are properly recorded.

(25) Sales Invoices

Prenumbered sales invoices facilitate the completeness of recording revenue. Prenumbered sales invoices are not utilized. We recommend that management ensure that prenumbered sales invoices are utilized to facilitate the completeness of recording revenue. This matter was discussed in our previous letters dated August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

(26) General Accounting

Journal entries should be prepared and reviewed by separate individuals to ensure accuracy and approval. We noted no evidence that journal entries are independently reviewed and approved. We recommend that management ensure that journal entries are independently reviewed and approved.

(27) Capitalization Policy

AMI currently does not have a formal capitalization policy for plant and equipment. We recommend that management establish a formal capitalization policy for the recording of capital assets.

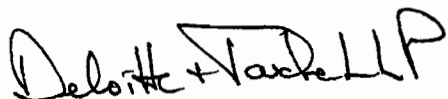
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We have communicated certain matters noted during our audit of the financial statements of AMI for the year ended September 30, 2003, which we considered to be reportable conditions, in our report dated August 15, 2005.

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,

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, slightly stylized font.