

June 13, 2008

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, 2006, on which we have issued our report dated June 13, 2008, 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:

Cash

1. Cash in a Closed Bank Account

As of September 30, 2006, AMI recorded cash in bank (A/c # 10103, totaling \$1,578) that pertained to a bank account that was closed in 2004.

Management should ensure that only valid cash accounts are recorded.

Auditee's Response: Bank is not providing us a Bank Statement so we decided to write off this account in FY2007.

Accounts Receivables

2. Long Outstanding Accounts Receivable

At September 30, 2006, AMI recorded other receivables (A/c # 12711, totaling \$92,117) that included certain balances outstanding since September 1998. The balance includes a receivable from Pacific Air Express (PAE) of \$62,291, which contains three disbursements, totaling \$18,190, made on behalf of PAE for which no invoice was issued. PAE has previously indicated that they have no outstanding balances with AMI.

We recommend that management resolve the outstanding balance. 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 15, 2005, August 8, 2003, May 20, 2002, August 24, 2001 and May 29, 2000.

Auditee's Response: These accounts were fully provided in fiscal year 2007.

3. Recording of Sales in Prior Years

The following sales that occurred in past years were recorded in the current fiscal year.

| <u>Customer</u> | <u>Amount</u> |
|-----------------|-------------------|
| Air Nauru | \$ 67,624 |
| OIDS | 33,183 |
| Majuro Hospital | <u>7,061</u> |
| | \$ <u>107,868</u> |

Sales should be recorded on a timely basis.

Auditee's Response: This was part of the clean-up process before write-off will be done.

4. Repayment Agreements should be prepared for Sales to Employees

As of September 30, 2006, \$239,766 of outstanding receivables are from employees. An allowance of approximately \$226,278 or 94% has been provided. Currently, credit has been extended to only a few employees.

We recommend that repayment agreements be prepared for transactions with employees and that management pursue legal collection of past amounts due.

Auditee's Response: A memo was issued by the office of the GM to stop extending new credits to employees with long outstanding accounts. This applies also to allotments outside of AMI.

Inventories

5. Preparation and Analyzes of Inventory Aging Reports and Policies and Procedures

Approximately 27% of inventories were purchased in 1996 or earlier. These items may possibly be obsolete or damaged. However, a documented review of these items did not occur to determine the adequacy of the obsolescence provision nor is there an existing policy regarding identification of obsolete or defective items.

Preparation and review of inventory aging reports is an important detective control to monitor the age and potential obsolescence of inventory items. This control also provides management with information necessary to determine inventory movements.

Auditee's Response: Spares and Accounting will review Aging Reports to determine adequacy of allowance for obsolescence.

6. Regular Assessment of Inventory Items

Approximately 27% of inventories are slow-moving. However, there is no formal assessment to determine whether these slow-moving items are also obsolete or defective items.

6. Regular Assessment of Inventory Items, Continued

As part of performing physical inventory counts, management should assess whether inventory is still usable. Factors that affect this assessment includes both obsolescence and physical damage or defects. Typically, such goods are written down to their net realizable value and are sold at a reduced price or are otherwise disposed of.

Auditee's Response: Physical inventory is done every year, a joint effort by accounting and spares department. During this exercise, spares and maintenance department shall determine the usability of the inventory item starting FY07.

The following standards to determine obsolete or defective items will be implemented effective next year:

- a. Any item that can no longer be utilized or unapproved for fitment to the current fleet of aircraft in accordance with the aircraft IPC manual.
- b. Parts deemed obsolete by airworthiness, directive and/or service bulletins.
- c. Parts which are time expired (o-rings, seals, etc.).
- d. Aircraft parts or materials that do not have the documentation of origin, or any document to support, the release approval, or compliance with manufacturing standards.

Plant and Equipment

7. Recording of Fixed Assets

One item, amounting to \$14,725, was received by the inventory department, but was not recorded by the accounting department.

Item number 789842-6-009L6, with a net book value off \$8,750, was recorded twice.

Coordination between the two departments should exist to ensure that items received are correctly recorded.

Auditee's Response: The supplier's invoice stamped as "received" serves as a basis for recording in the books. Accounting will closely coordinate with spares section regarding items received but not yet forwarded (invoice) to accounting.

8. Fixed Asset Register Updates

The description and value of five of thirty three items tested were not updated in the fixed asset register. The tested items have been replaced or were deemed obsolete.

Over time, fixed asset records may become inaccurate. Management should review the asset register on a periodic basis to identify significant changes and to verify the propriety of listed information.

The valuation and realizability of fixed assets should also be periodically reviewed and appropriate adjustments recorded. Such procedures may include the identification of obsolete equipment.

Auditee's Response: The asset register will be improved as we move on to FY07.

9. Recording of Depreciation

An asset (Mitsubishi Delica Van) was disposed of in September 2006; however, related depreciation for the months of October to August 2006 was not recorded.

Expenses should be recorded and classified to appropriate accounts.

Auditee's Response: We will depreciate the items on timely basis to compute for the correct gain/loss accounts.

10 Description of Asset in the Fixed Asset Register

While most fixed assets subjected to existence testing were located, identification was difficult due to insufficient information. Some items were described based on vendor names while some had generic descriptions. This may not represent a problem if part numbers or serial numbers were included in the register. However, serial numbers or asset numbers were not consistently used. Items were located based on historical costs and dates.

Auditee's Response: Asset descriptions and part numbers will aid asset identification.

Expenses

11. Expenses

Fiscal year 2005 expenses of \$26,098 were recorded in fiscal year 2006.

Auditee's Response: We will ensure that invoices received are timely and correctly recorded in the books.

General

12. Segregation of Duties

Management believes that there is a very minimal risk regarding segregation of duties due to the size of the Company as well as the lack of complexity of transactions; however, most systems of internal control rely on assigning certain responsibilities to different individuals, or segregating incompatible functions. The following existing duties were noted to be incompatible:

- The person responsible for the custody of inventory also has access to inventory records and master files. This matter may be mitigated by records maintained at accounting and through performance of periodic cut-off procedures.
- The person responsible for payroll computations also has access to employee data. Management believes that this incompatible function is mitigated since the hiring, firing, promotion and demotion are reviewed and approved by the General Manager and the Chief Financial Officer.

Auditee's Response: We are aware of these incompatible duties, but because of the simplicity of transactions, and the manning complement limitations, we were not able to effectively manage this supervisory review. Control will be enhanced next fiscal year.

13. Lease Contract Agreements

Lease agreements for the Majuro and Ebeye offices expired on January 31 and March 1, 2006, respectively. Lease agreements for both offices were not renewed.

Lease agreements should be prepared to prevent disputes or to mitigate inherent legal risks.

Auditee's Response: We submitted a contract to the lessee for their conformance but did not receive any response. With regards to Ebeye Office, we have plans to move to another place and that is the reason why we opted to have an open date verbal agreement.

14. Sequential Ticket Numbering

The airway bill series 951000 to 960000 was skipped. AMI ordered the correct numbers; however, the wrong series was provided.

Review of documents is important to ensure that correct documents are used and accounted for.

Auditee's Response: This was noted (by Moana of Revenue Accounting) and that such numbers were tracked accordingly.

15. Formal Document for Freight and Excess Baggage Charges

Minimum charges for freight and excess baggage are \$5 for cash sales and \$10 for charge sales; however, this policy is not in writing.

A written policy should be prepared to serve as a formal document for passenger and employee guidance.

Auditee's Response: We are going to prepare a written policy to support this minimum charges for freight and excess baggage.

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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, 2006, which we considered to be reportable conditions, in our report dated June 13, 2008.

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,

