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May 30, 2019

Mr. Drauna Aisake Waqasokolala
General Manager
Air Marshall Islands, Inc.
P.O. Box 1319
Majuro MH 96960

Dear Mr. Waqasokolala:

In planning and performing our audit of the financial statements of Air Marshall Islands, Inc. (AMI) as of and for the year ended September 30, 2018 (on which we have issued our report dated May 30, 2019), 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, we considered AMI's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of AMI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of AMI's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to AMI's internal control over financial reporting and other matters as of September 30, 2018 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated May 30, 2019, on our consideration of AMI's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

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

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of AMI for their cooperation and assistance during the course of this engagement.

Very truly yours,

Deloitte + Touche LLP

SECTION I – CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving AMI's internal control over financial reporting as of September 30, 2018 that we wish to bring to your attention:

1) Collections

- Returned checks receivable decreased by $193 from $35,989 in FY2017 to $35,796 in FY2018, of which $27,466 pertains to balances dated FY2016 and earlier. We recommend management increase collection efforts. This matter was discussed in our previous letters to management for fiscal years 2009 to 2017.

- Employee receivables as of September 30, 2018 amounted to $63,203, of which $48,180 are aged over 90 days. We recommend management increase collection efforts. This matter was discussed in our previous letters to management for fiscal years 2006 to 2017.

- $56,703 of receivables are aged over six years, of which $27,103 pertain to returned checks. We recommend management enhance internal control policies over cash sales and collection efforts. Also, we recommend management establish internal control policies relative to timely reviewing and updating the aging report. This matter was discussed in our previous letter to management for fiscal year 2017.

2) Negative Balances in Accounts Receivables

As of September 30, 2018, 16 receivable balances reflected negative amounts aggregating $76,419. Negative balances pertain to customer overpayments or advances. Of this total, $53,062 pertains to prepayments or overpayments aged over a year. A proposed audit adjustment was recorded by AMI during the audit process to correct this matter. We recommend management revisit unusual balances and assess whether such constitutes a valid obligation or should be recognized as income.

3) Inventories

- Issuances of inventory during the year were recorded at year-end as part of the financial closing process. Inventories are logged upon issuance and an inventory requisition/issuance form is not consistently used. We recommend management implement internal control policies requiring adequate documentation and timely recording of inventory issuances.

- Adjustments to reduce inventory after conducting the physical count totaled $17,622 at September 30, 2018. Issuance slips should accompany items released from the warehouse and receiving reports should support additions to inventory. It appears that these adjustments represent undocumented issuances. We recommend management investigate discrepancies between cycle counts and inventory records and strengthen controls over inventory to provide more accurate financial information.

- One of nine inventory items tested indicated a variance in unit cost due to a costing error. We recommend management require that inventories be accurately valued based on average cost.

4) Revenues

- Of twenty-seven passenger revenue items tested, nine items were recorded as a student, senior citizen or as a child without a documented basis. In addition, three passenger revenue items tested did not document evidence of approval of special discounted fares. We recommend management establish policies and procedures relating to documenting discounted fares.

- Of ten cargo revenue items tested, one item was recorded at a freight rate instead of an excess baggage rate. We recommend management improve internal controls over the review of appropriate revenue rates assessed.

SECTION I – CONTROL DEFICIENCIES, CONTINUED

4) Revenues, Continued

- One of ten cargo revenue items tested were not made available for examination. We recommend management improve internal controls over filing of documentation supporting recorded revenues.

- Of nine charter revenue items tested, one item was charged at the Dash 8 rate ($90) instead of the Dornier rate ($50) resulting in the customer being overcharged. We recommend management improve internal controls over the review of charter revenue rates assessed.

5) Deposit of daily collections

One validated deposit slip indicated collections from an outer island agent was deposited 14 banking days after receipt or after 3 scheduled flights. We recommend management improve internal control policies over timely bank deposit of collections.

6) Advance payments to suppliers and capitalization of fixed assets

Two invoices were paid to suppliers with allegedly incorrect bank details and 1 invoice to an invalid unaccredited vendor aggregating $37,854, of which $25,185 was erroneously capitalized as fixed assets in FY2018. An audit adjustment was proposed to correct the improper capitalization and the advances made to suppliers continue to be in dispute or are being investigated. We recommend management improve internal control policies over procurement practices, payments of invoices, and capitalization of fixed assets.

7) Salaries and Wages

Nine of fifteen payroll items tested included lunch breaks in the calculation of working hours. AMI's informal policy of paying lunch hours if the employee worked 8 hours and below has no evidence of Board approval. We recommend management establish formal policies over lunch breaks and hours worked and require adequate review of employee timesheets prior to check preparation and payment.

8) Operating Expenses

One of twelve operating expense items tested was recorded in the wrong period due to typographical error resulting to projected overstatement of $23,223.

Insurance expense was overstated by $49,310 due to an error. Proposed audit adjustment was booked by AMI to correct insurance expense.

We recommend management improve internal control procedures over accuracy and timely recording of expenditures.

9) Accrued Expenses

Accrued expenses aggregating to $111,500 were recorded in FY2018 based on estimates and judgment with no supporting actual invoices. Audit adjustments were proposed to reverse unsupported accruals. We recommend management establish formal policy over accruals based on actual invoices.

SECTION I – CONTROL DEFICIENCIES, CONTINUED

10) <u>Timely Financial Reporting</u>

AMI did not close fiscal year September 30, 2018 financial information until February 27, 2019. During the year ended September 30, 2018, various accounting records do not appear to have been timely processed and updated including, but not limited to the following:

Variance noted per confirmation of accounts:

a. Accounts payable to RMIPA - understated by $19,966
b. Loans payable to MIDB – understated by $64,125
c. Advances from RepMar – understated by $14,043

We recommend management implement internal control procedures to facilitate timely and accurate reconciliation processes of general ledger accounts.

SECTION II – OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention at this time are as follows:

1) <u>Credit card transactions</u>

In FY2018, AMI's credit card of $5,679 was used for personal travel. This amount has not been repaid as of September 30, 2018. We recommend that management implement internal control and policies governing use of the Company credit card.

2) <u>Adequacy of Documents</u>

A lease for airport space could not be provided. Documentation should be on file to support financial statement transactions.

3) <u>Local noncompliance on RMI Procurement Code</u>

The following payments were not adequately documented to evidence compliance with the procurement process set forth in the criteria:

a. Purchase of other personnel expenses amounting to $783
b. Purchase of Stationeries/Office Supplies amounting to $1,630

We recommend that management establish adequate internal control policies and procedures requiring compliance with RepMar's Procurement Code.

SECTION III – DEFINITIONS

The definition of a deficiency is as follows:

A *deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

AMI's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.