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June 2, 2020

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, 2019 (on which we have issued our report dated June 2, 2020), 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, 2019 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 2, 2020, 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, 2019 that we wish to bring to your attention:

1) Cash

The September 2019 bank reconciliation included the following exceptions:

- An unreleased check (check #61366 for $12,616) was recorded as an outstanding check.
- A $27,000 cash transfer to the payroll bank account was incorrectly recorded as deposit-in-transit.

Audit adjustments were proposed to correct these exceptions. We recommend management establish policies over the processing, reconciliation, monitoring and disposition of unreleased checks and deposits-in-transit.

2) Collection of Receivables

At September, 30, 2019, receivables included the following exceptions:

- Returned checks receivable decreased by $183 from $35,796 in FY2018 to $35,613 in FY2019, which checks originated in FY2017 and prior.
- Employee receivables amounted to $44,372, of which $35,971 is aged over 90 days.
- Trade receivables included $28,190 as aged over six years.

We recommend management increase collection efforts. Collection of receivables was discussed in our previous letters to management for fiscal years 2006 through 2018.

3) Allowance for doubtful accounts

At September 30, 2019, trade and other receivables aged above 90 days of $126,582 were not within the allowance for doubtful accounts. AMI has a policy of specifically identifying receivables that are doubtful as to collection. An audit adjustment was proposed to correct this matter. We recommend management revisit its current policy in determining the allowance for doubtful accounts.

4) Inventories

At September 30, 2019, inventories included the following exceptions:

- Inventory issuances during 2019 were only 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.
- Inventory adjustments of $14,665 to reduce inventory occurred after conducting the year end physical count. 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.
- Of 12 inventory items tested, 2 items were excluded from the prior year inventory valuation while no purchases were noted in FY2019. Small capital assets are usually uninstalled from aircraft and returned to the inventory storage room. Extrapolation of identified inventory misstatements resulted in a potential $119,662 overstatement. We recommend management establish internal control procedures for uninstalled aircraft parts.

## SECTION I – CONTROL DEFICIENCIES, CONTINUED

5) Long-Term Deposits

At September 30, 2019, long-term deposits included the following exceptions:

- A $120,000 capital asset deposit was erroneously recorded as prepaid expense.
- A $52,304 deposit representing a receivable was erroneously recorded as prepaid expense.
- An unknown $14,000 deposit has been outstanding since 2009.
- A $14,000 capital asset deposit were not reclassified to capital assets when received.

Audit adjustments were proposed to correct these exceptions. We recommend management perform regular analysis and monitoring of prepaid expense and long-term deposit accounts.

6) Property and Equipment

At September 30, 2019, we noted two replaced capital assets that were not removed from the capital asset register with a cost and accumulated depreciation of $28,360 and $25,761, respectively. We recommend management perform periodic inventories of AMI's capital assets to identify capital assets no longer in use and/or replaced.

7) Long-term Debt

At September 30, 2019, we noted a $273,614 variance between the confirmation received and the amortization of the Marshall Islands Development Bank note payable. No formal modifications to the original note payable were made available. We recommend management formalize amendments to the note payable to the Marshall Islands Development Bank.

8) Revenues

For the year ended September 30, 2019, we noted the following revenue exceptions:

- Of thirty passenger revenue items tested:
  - Eleven samples have a student, senior citizen or child rate without a documented basis. We recommend management establish policies and procedures relating to documenting discounted fares.
  - One sample was not invoiced due to pending travel authorization from the government employee. We recommend management implement internal control procedures over the reconciliation of the general ledger and the booking system.
- Of seven cargo revenue items tested, one item had the amount of quantity and weight mistakenly interchanged that resulted in a $31.90 understatement of revenues. In addition, one item was charged a discounted price available only to employees and immediate family members but with no attached evidence that the transaction was initiated by an employee. We recommend management improve internal controls over the review of airway bills and formalize policy and procedures over employee use of discounted prices.

9) Deposit of Daily Collections

For the year ended September 30, 2019, we noted two daily collections that were deposited three business days after receipt. We recommend management implement internal control policies over the timely deposit of daily collections.

## SECTION I – CONTROL DEFICIENCIES, CONTINUED

10) Salaries and Wages

For the year ended September 30, 2019, we noted for 13 of 23 payroll samples tested lunch breaks were included in the calculation of working hours. Starting the second quarter of FY2019, AMI has followed a policy of deducting 1 hour from timesheets extracted from the system for daily hours above 4. We recommend management continuously follow this established procedure.

11) Operating Expenses

For the year ended September 30, 2019, we noted the following operating expense exceptions:

- Rent expense of $33,594 was not recorded for months that AMI has not received billing statements from lessors. An audit adjustment was proposed to correct this matter.

- Training expense of $33,512 was not recorded that was initially recorded as prepaid expense. An audit adjustment was proposed to correct this matter.

We recommend management record rent expense based on contracts, even when no billing is received from vendors/lessors. Furthermore, we recommend management implement internal control procedures over the accuracy and timely recognition of operating expenses initially recorded as prepaid expense.

## 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) Credit Card Transactions

In the prior year, AMI's credit card was used by an unknown employee for a personal subscription without management authorization. AMI is being charged $12 per month as a result of this incident. We recommend that management implement internal control procedures governing use of the Company credit card.

2) Adequacy of Documents

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

3) Local Noncompliance - RMI Procurement Code

Travel expense and other supplies expense of $22,224 and $2,440, respectively, were not adequately documented to evidence compliance with the RMI Procurement Code. We recommend management require policies and procedures be established to demonstrate compliance with the RMI Procurement Code.

4) Local Noncompliance - Social Security Act

AMI's Social Security Tax Return for the quarter ended September 30, 2019 was not paid timely. We recommend management require policies and procedures be established to demonstrate compliance with the Social Security Act of 1990 and Social Security Health Fund Act of 1991.

## SECTION II – OTHER MATTERS, CONTINUED

5) Board Sitting Fees

During the year ended September 30, 2019, AMI paid sitting fees of $1,600 to Board members. These fees may constitute wages under the Income Tax Act 1989 and thus be subject to withholding taxes. No withholding taxes were withheld by AMI. We recommend management obtain an interpretation from the Ministry of Finance, Banking and Postal Services Chief of Revenue and Taxation concerning the applicability of withholding taxes on sitting fees paid to Board members.

## 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.