COOPERS & LYBRAND

IN PRINCIPAL AREAS
OF THE WORLD

1251 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10020

June 16, 1975

Mr. Paul C. Velte, Jr.,
Chairman of the Board
Air America, Inc.
1725 K Street, N. W.
Washington, D. C.

Dear Mr. Velte:

In accordance with the Company's request, we offer the following comments on Mr. James W. Crowley's April 29, 1975 telex to Clyde S. Carter, Esq.

The following references are included in our comments:

AACL - Air Asia Company, Limited

AAM - Air America Inc.

Statement - Statement of Assets and Liabilities, January 31, 1975 of Air Asia Company, Limited accompanied by our report dated March 15, 1975.

1. AACL Inventory at Saigon

The AACL asset in question existed in the form of inventory at January 31, 1975. By their nature inventories are normally subsequently sold and thereby are converted into receivables. Subsequent to January 31, 1975, based on the October 4, 1974 memorandum in which AAM assumes responsibility for the safekeeping and return of this inventory, the Saigon inventory has been or will be converted into a receivable from AAM. The conversion of a Company's asset from inventory to a receivable should not be retroactively reflected in a statement as of a prior date. Accordingly, the AACL inventory in Saigon is properly included as an asset in the Statement.

It should be noted that even if the above conversion to a receivable was reflected in the Statement, total assets would be reduced, intercompany payables to Air America would also be reduced and there would be no change to the amount of the net asset value in excess of $3,218,000 as shown in the Statement.

2. Landing Costs Included in January 31, 1975 Inventory

Apparently near the end of each fiscal year, each landing cost account of AACL and AAM was adjusted so that the percentage of each landing cost account to the related inventory (or property) account equaled the percentage of total landing cost accounts to total related inventory. In effect, landing costs were transferred between companies to make each company's landing cost the same percentage of its inventory.

There apparently was no cost accounting principle behind this redistribution of landing costs between the companies, so that there can be no question that the cost accounting principles used in the Statement were inconsistent with those of the March 31, 1974 statement. We were informed the redistribution was done as a matter of clerical convenience to preclude several different landing cost percentages from having to be applied to subsequent inventory issuances. The appropriateness of having a single landing cost percentage was questioned in the past by AACL personnel and ourselves. It was decided at those times to continue redistributing such costs since it would be clerically easier and as a practical matter it would have little effect on the combined future revenues or costs of sales of the companies as each company was primarily a U.S. government contractor and the companies would bill such costs to the U.S. government either in their flying or maintenance contracts. From a consolidated statement standpoint the redistribution in itself does not change the inventory amount.

While each company's operations are at a normal level, any distortion due to this redistribution should not be unreasonable. However, during the ten month period ending January 31, 1975 ("1975") circumstances completely changed. AAM's operations declined considerably during 1975 (when two of its three main locations closed) and its operations have been subsequently completely phased out. As a result, AAM's average monthly material receipts declined 52% from fiscal 1974 to 1975 while AACL's declined only 10%. AACL's inventory turnover ratio was at least several times that of AAM during 1975.

The above, compounded by landing costs increasing as a percentage of total costs, makes the redistribution completely inappropriate as of January 31, 1975. This is demonstrated by the relatively small increase in

AACL's average landing cost percentage (if the redistribution were made) from March 31, 1974 to January 31, 1975, even though material receipts and landing cost percentages on receipts were quite high.

AACL

3/31/74 Inventory	$1,470,000
Materials received in 1975	1,529,000
1974 landing cost percentages:	
On stock materials received:	
Range - 17.5 to 28%	
Monthly average	19.9%
On 3/31/74 inventory	18.2%
1975 landing cost percentages:	
On stock materials received:	
Range - 28 to 34%	
Monthly average	31.8%
On 1/31/75 inventory: after redistribution	20.1%
prior to redistribution - 24.07%	

Note: Certain amounts included above are based on unaudited data provided by AACL.

3. Amortization of Building Costs on Leased Land at North Hollywood

The North Hollywood building is included in AACL account 1641.01 "Buildings and Other Improvements on Land Leased - Company Purchased Items." All buildings in this account are being amortized over 10 years. The buildings were included in AACL's statement of assets and liabilities at March 31, 1974 as ground property and such statement indicated that buildings are depreciated over 10 years. The buildings were not included in leasehold improvements which the statement indicated are amortized over the terms of the related leases.

In addition, the original appropriation request for construction of the North Hollywood building, approved by Messrs. Madison and Wueste, calls for a depreciation rate based on a 10 year life. The only relevant event which occurred since such approval is the exercise by AACL of its option to extend the lease from 1973 to 1983. Accordingly, we believe the accounting treatment of the North Hollywood building is not an "error" for purposes of the March 31, 1974 or January 31, 1975 statements.

Even if such treatment was an "error" at the time the March 31, 1974 and prior financial statements were prepared, it does not appear appropriate to make a retroactive adjustment at this time when a subsequent action (exercise of lease option) taken by AACL at its sole discretion has the effect of supporting the original accounting treatment. There is no doubt that at the conclusion of the audit AACL was receiving the economic benefit of the building in question.

4. Costs Related to IBM System 3 Disc Packs

The related appropriation request (No. 1072) indicates that certain costs associated with this project should be amortized over 24 months. The accumulation and deferral of the direct costs of establishing a computer installation (e.g., disc packs) is based on sound accounting principles. Naturally such deferral should be amortized over the period benefits are derived by the Company, which period would not normally start prior to the date such installation becomes operational.

5. Work-in-Process Inventory Adjustment Relating to Individual Accounts Receivable

Section 560, entitled "Subsequent Events," of the Statement on Auditing Standards published by the American Institute of Certified Public Accountants defines the type of subsequent events which should and which should not result in adjustment to financial statements.

It indicates, as an example, that a loss on trade accounts receivable "resulting from a customer's major casualty such as a fire or flood subsequent to the balance sheet date" should not result in adjustment to the financial statements. Based on Section 560, including the aforementioned example, the loss on work-in-process due to the Khmer Rouge take-over should not be reflected in the Statement.

6. Vocational Training Fund Liability
   If the transfer of the vocational training fund liability from AACL to AAM was reversed as of January 31, 1975, accrued liabilities shown in the Statement would be increased by $43,683, the AACL liability to AAM shown in the Statement (intercompany payables) would be decreased by $43,683 and the total liabilities and net asset value in excess of $3,218,000 shown in the Statement would not change.

7. Recording of Prepaid Insurance
   At January 31, 1975, the policies, a portion of whose premiums were included in prepaid insurance, were in effect. Such policies apparently were canceled in February 1975 and apparently would not have been canceled except for the fact that AACL was controlled by E-Systems during February 1975. Various AACL and E-Systems communications indicate that AACL personnel sought and received confirmation in February 1975 from the E-Systems Manager of Insurance as to the continuation, cancellation etc. of AACL's insurance coverage as it then existed. Accordingly, inclusion of the prepaid insurance as of January 31, 1975 in the Statement as an asset is appropriate.

8. Corporate Income Taxes
   AACL's tax consultant, Mr. Y. S. Liang, has previously informed us that although no tax loss carrybacks are available, tax losses may be carried forward for three years. Article 39 of the Income Tax Law as promulgated on December 30, 1968 states:

   > "Losses incurred in the operation of business of prior years shall not be included in the computation for the current year; provided that in the case of a profit-seeking enterprise organized as a company that keeps a complete set of account books, uses the blue returns as provided in Article 77 of this Law and files the same within the prescribed period, <u>taxation may be made on its net income after deduction of losses incurred in the preceding three years</u> as verified and determined by the local collection authority-in-charge."

9. Corporate Income Taxes

AACL's accounts as of March 31, 1974 and prior have included a provision for the possible disallowance of the difference between the provision for retirement obligations and actual payments. However, subsequent thereto, in August 1974 Air America agreed to indemnify AACL against income taxes.

Accordingly, if the Chinese tax authorities eventually do disallow the difference between the provision and the actual payments for the ten months ended January 31, 1975, AACL will be indemnified by AAM for the resulting taxes and the net assets of AACL will not decrease.

Our opinion was not qualified with respect to the deductibility of the tax loss carryforward (item 8). The tax loss carryforward is properly included in the computation of the liability for income taxes in accordance with generally accepted accounting principles.

The above comments are addressed to the items in Mr. Crowley's telex all of which would decrease the "Net assets of AACL in excess of $3,218,000" included in the Statement. The telex does not refer to nor have we included our observations on items which would increase such net assets.

If we can be of further assistance, please let us know.

Very truly yours,

Coopers & Lybrand

RKB