AIR MARSHALL ISLANDS, INC.

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2004 AND 2003

Deloitte.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Air Marshall Islands, Inc.:

We have audited the accompanying statements of net assets of Air Marshall Islands, Inc. (AMI), a component unit of the Republic of the Marshall Islands, as of September 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of AMI's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraphs, we conducted our audits 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of 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 the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were unable to obtain all the minutes of AMI Board of Directors' meetings held from October 1, 2002 through August 15, 2005.

Because of inadequacies in the accounting records and internal control over financial reporting, we were unable to form an opinion regarding trade receivables, expendable parts, and air traffic liability as of September 30, 2004 and 2003 and accounts payable as of September 30, 2003. Trade receivables, expendable parts, accounts payable and air traffic liability enter materially into the determination of the results of operations for the years ended September 30, 2004 and 2003.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to obtain minutes of Board of Directors' meetings, as discussed in the third paragraph, and had the accounting records and internal control over financial reporting related to trade receivables, expendable parts, accounts payable and air traffic liability been adequate, as discussed in the fourth paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of AMI as of September 30, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 5 to the financial statements, AMI has recorded a receivable of $1.1 million from the Republic of the Marshall Islands. A substantial percentage of this balance is outstanding for in excess of 120 days. If AMI utilized its standard procedures for determining its allowance for doubtful accounts, bad debt expense and allowance for doubtful accounts would each increase by approximately $360,000 at September 30, 2004. Collection of these receivables is dependent on a successful reconciliation of these balances and their collection from RepMar. Management is currently unable to predict the ultimate outcome of this matter on the accompanying financial statements.

The Management's Discussion and Analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of AMI's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 15, 2005, on our consideration of AMI's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

August 15, 2005

AIR MARSHALL ISLANDS, INC.

Management's Discussion and Analysis
Year Ended September 30, 2004

Introduction

Our discussion and analysis of the Air Marshall Islands, Inc. (AMI) financial performance provides an overview of AMI's financial activities for the fiscal year ended September 30, 2004. This MD&A is to be used in conjunction with the financial statements that follow this section.

Deloitte & Touche, an independent registered public accounting firm, audited AMI's financial statements for FY2004 and issued a qualified opinion on certain accounts. However, except as discussed in the auditors' report, the Statement of Net Assets and the related Statements of Revenues, Expenses and Changes in Net Assets and Cash Flows present fairly, in all material respects, the financial position of AMI for the year ended in conformity with accounting principles generally accepted in the United States of America.

AMI is a component unit of the Republic of the Marshall Islands (RMI) and was established as the official air carrier of the Government of the Republic of the Marshall Islands by virtue of a Corporate Charter granted by the Cabinet of the Marshall Islands on October 12, 1989. AMI subsequently merged with Airline of the Marshall Islands, Inc., AMI being the surviving corporation, on January 26, 1990. AMI is governed by a five - member Board of Directors. The RMI Cabinet appoints members to the Board of Directors and presently, the Minister of Transportation and Communication is appointed as Chairperson of the Board.

Financial Highlights

Total assets amounted to $3,678,529 as at September 30, 2004. There is a slight increase of 5% or $158,727 from the prior year due to increase in trade receivables from affiliates.

Starting October 11, 2004, the Company has devoted significant effort to reconcile receivables from private and government entities, to determine the validity, extent, priority and correctness of recorded balances. To further this process, the Company made a series of representations with the Office of the Secretary of Finance for speedy action and collection of government debts.

In November 2004, the Company implemented a stringent policy in granting credits to private individuals or corporations including imposition of penalties on bouncing checks.

Total liabilities amounted to $2,617,201 as at September 30, 2004. The increase of 82% or $1,182,127 from prior year was attributed to a $2.0M loan granted by the government of RepMar in favor of AMI for the Dash 8 lease and start-up operation. Such loan shall be made reimbursable in full by AMI in quarterly installments within a period not to exceed five years. The C.M. 150 (2002) was signed by the President of RepMar on October 31, 2002. Details of loan proceeds as at September 30, 2004 are:

For the Period	Amount
July to September 2003	$ 150,000
October 2003 to September 30, 2004	900,000
Total	$1,050,000

Statement of Net Assets

	Year 2004	Year 2003	US Dollar Change	Percent Change
Assets				
Cash	$ 87,342	$ 96,495	$ (9,153)	-9%
Receivables (net of allowance)	1,012,562	799,647	212,915	27%
Expendable parts (net of allowance)	495,119	465,295	29,824	6%
Prepaid expenses and deposits	196,095	207,432	(11,337)	-5%
Total current assets	1,791,118	1,568,869	222,249	14%
Advance to RepMar	664,729	793,880	(129,151)	-16%
Advance to vendor (net of allowance of $2.1M)	-	-	-	
Plant and equipment (net of accumulated depreciation)	1,222,682	1,157,053	65,629	6%
Total assets	$3,678,529	$3,519,802	158,727	5%
Liabilities				
Accounts payable	$ 393,022	$ 326,612	66,410	20%
Air traffic liability	576,270	309,713	266,557	86%
Accrued expenses	359,979	437,804	(77,825)	-18%
Payable to affiliates	237,930	210,945	26,985	13%
Total current liabilities	1,567,201	1,285,074	282,127	22%
Loan payable (RepMar)	1,050,000	150,000	900,000	600%
Total liabilities	2,617,201	1,435,074	1,182,127	82%
Net assets				
Invested in capital assets	1,222,682	1,157,053	65,629	6%
Unrestricted	(161,354)	927,675	(1,089,020)	-117%
Total net assets	1,061,328	2,084,728	(1,023,400)	-49%
Total liabilities and net assets	$3,678,529	$3,519,802	$ 158,727	5%

Plant and Equipment

	2004	2003	US Dollar Change	Percent Change
Aircraft and improvements	$ 9,099,489	$ 8,955,595	$143,894	2%
Rotable spare parts	3,287,769	2,846,219	441,550	16%
Plant and equipment	404,009	350,476	53,533	15%
Office furniture and equipment	611,313	589,998	21,315	4%
Motor vehicles	140,675	118,396	22,279	19%
Buildings	1	1	-	-
Total	13,543,256	12,860,685	682,571	5%
Less: accumulated depreciation and amortization	12,320,574	11,703,632	616,942	
Net	$ 1,222,682	$ 1,157,053	$ 65,629	6%

AMI records its plant and equipment at acquisition cost including incidental expenses related to procurement. These assets are depreciated on a straight - line basis over their estimated useful lives to their residual values, over periods not to exceed ten years for flight equipment (from date of original manufacture) and five to ten years for rotable parts, from the date the asset is placed in service. Rotable spare parts are written off when beyond economic repair.

Expenditures for major additions, improvements and flight equipment modifications (if any) are generally capitalized and depreciated over the shorter of the estimated life of the improvement or the modified assets remaining lives or remaining lease term in the event that any modifications or improvements are made to operating lease equipment (none as of FY2004). Substantially, property and equipment of AMI as of FY2004, are free from liens and encumbrances nor pledged as collateral for indebtedness of the company.

Details of capital asset activity for the year 2004:

	2004	
	Additions	Retirements
Aircraft and improvements	$143,894	$ -
Rotable spare parts	441,550	-
Plant and equipment	53,533	-
Office furniture and equipment	21,315	-
Motor vehicles	22,279	-
Buildings	-	-
Total	$682,571	$ -

The 2% or 143,894 increase in aircraft and improvements in FY2004 resulted from DO 228 Engine overhaul done by Garret Aviation Services in December 2003.

The 16% or $441,550 of additions for rotable parts for the year is a combination of Euro and US dollar denominated purchases. Substantially, rotable parts for the Dornier are Euro denominated and the capital market (Euro) during the period is appreciating in value vs. the US dollar and this resulted in using more US Dollars to buy parts sourced from Euro denominated countries. Purchases for the year are:

	Amount
Dornier Rotable Parts	$216,504
Dash 8 Rotable Parts	225,046
Total	$441,550

Rotable parts are depreciated from 5 to 10 years; these are written off when determined to be beyond economic repair.

Allowances for obsolescence for expendable parts are provided for excess, outmoded or obsolete parts. These allowances are based on management estimates, which are subject to change as conditions in AMI's business evolve. The allowance for 2004 and 2003 amounted to $100,000.

Subsequent events related to Property and Equipment:

In June 2004, the Dash 8 Aircraft experienced low power of the right hand engine and it was necessary to remove this engine for repair. Repair costs amounted to $390,437 and this was done by Atlantic Turbines International, an engine repair facility.

In October 2004, the Dash 8 experienced similar problems with the left hand engine and the repair cost estimate amounted to $774,613; however, an arrangement has been made through the aircraft leasing company, FINOVA to purchase a replacement exchange engine for $575,000.

On June 10, 2005, AMI was able to secure USD 800,000 loan facility from Bank of Marshall Islands through a Government Guarantee (C.P. 5389 (2005)) dated May 19, 2005. The guarantee is in the form of government funds held with the Marshall Islands Development Bank.

The first loan release of USD 400,000 was done on June 10, 2005. The balance of $400,000 shall be made available for drawdown when AMI is able to locate an exchange engine at a reasonable price. As of August 15, 2005, such activity is still in progress.

Operating Revenue

Total Operating Revenue increased by $674,876 or 20% from FY2003. Revenue Passenger Miles (RPM) is the basic measure of productivity for the airline industry. The load factor is the RPM achieved compared to the Available Seat Miles (ASM) flown.

	Year		Annual Change	
	2004	2003		Percent
Passengers Carried	27,963	25,673	2,290	9%
Flight Arrivals	3,139	3,344	(205)	-6%
Block Time	2,705	2,939	(234)	-8%
Available Seats	70,371	72,421	(2,050)	-3%
Available Seat Miles	9,593,385	10,174,634	(581,249)	-6%
Revenue Pax Miles	5,227,281	4,640,821	586,460	13%
Load Factor	54%	46%	8%	18%
Passenger Revenue	2,916,811	2,492,861	423,950	17%
Cargo Revenue	573,230	408,424	164,806	40%

Passengers Carried

For FY2004, AMI achieved 5,227,281 Revenue Passenger Miles (RPM) and produced 9,593,385 Available Seat Miles (ASM), which represents a load factor of 54%. This was a significant improvement (13%) over FY2003 when RPMs were just over 4.6 million and ASMs were just less than 10.2 million for a load factor of 46%. However, there was a 6% reduction in ASMs in 2004 - that is from 10.2 million to 9.6 million. This is attributed to one of the Do 228 being grounded for most of the year; the reason for this was lack of funds to purchase the parts required to return the aircraft to service.

Air Cargo

The amount of air cargo carried domestically has increased significantly since 1999. Cargo carried for FY2004 vs. 2000, increased by 140% or $334,604.

The higher productivity achieved in 2004 led to improved financial performance where the indicative Earnings before Interest and Tax (EBIT) is a loss of $1,023,793 compared to an average loss of $2.2 million over the past five years. The ability of AMI to achieve a better EBIT will rest on the airline improving its productivity and being allowed to increase air fares to break even its costs, and a predetermined subsidy where AMI is expected to service unprofitable routes.

Operating Expenses

Total Operating Expenses decreased by 4% or $226,184 from FY2003. The average operating cost per hour was $1,720 in 2004 and $1,681 in 2003. This would indicate that cost containment in most areas is working as planned, despite fuel cost increase of 64% or $.88 per gallon ($1.380 per gal in 2003 to $2.26 in 2004). The surge in fuel cost impacted our operating revenues by $231,568 for the year 2004.

AIR MARSHALL ISLANDS, INC.

Management's Discussion and Analysis
Year Ended September 30, 2004

Statement of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2003 and 2002

	2004	2003	US Dollar Change	Percent Change
Operating revenues:				
Passenger	$ 2,916,811	$ 2,492,861	$ 423,950	17%
Cargo	573,230	408,424	164,806	40%
Charter	286,902	190,478	96,424	51%
Other	352,138	362,442	(10,304)	-3%
Total operating revenues	4,129,081	3,454,205	674,876	20%
Operating expenses:				
Flying operations	2,143,196	1,825,220	317,976	17%
Maintenance	1,060,356	1,309,755	(249,399)	-19%
Depreciation and amortization	616,942	1,018,591	(401,649)	-39%
General and administrative	593,798	472,490	121,308	26%
Promotion and sales	408,561	411,672	(3,111)	-1%
Aircraft and traffic servicing	330,021	341,330	(11,309)	-3%
Total operating expenses	5,152,874	5,379,058	(226,184)	-4%
Operating loss	(1,023,793)	(1,924,853)	901,060	-47%
Nonoperating income (expenses):				
Interest income	393	725	(332)	-46%
Loss on disposal of plant and equipment	-	(86,885)	86,885	-100%
Total nonoperating (expenses) income, net	393	(86,160)	86,553	-100%
Change in net assets	(1,023,400)	(2,011,013)	987,613	-49%
Net assets at beginning of year	2,084,728	4,095,741	(2,011,013)	-49%
Net assets at end of year	$1,061,328	$2,084,728	$(1,023,400)	-49%

AIR MARSHALL ISLANDS, INC.

Statements of Net Assets
September 30, 2004 and 2003

	2004	2003
ASSETS		
Current assets:		
Cash	$ 87,342	$ 96,495
Receivables:		
Trade	685,346	665,129
Employees	259,366	175,109
Affiliates (net of allowance for doubtful receivables of $640,146 at September 30, 2004 and 2003)	497,382	416,560
	1,442,094	1,256,798
Less allowance for doubtful receivables	(429,532)	(457,151)
Receivables, net	1,012,562	799,647
Expendable parts (net of allowance for obsolescence of $100,000 at September 30, 2004 and 2003)	495,119	465,295
Prepaid expenses and deposits	196,095	207,432
Total current assets	1,791,118	1,568,869
Advance to RepMar	664,729	793,880
Advance to vendor (net of allowance of $2,100,000 at September 30, 2004 and 2003)	-	-
Plant and equipment, net	1,222,682	1,157,053
	$ 3,678,529	$ 3,519,802
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	$ 393,022	$ 326,612
Air traffic liability	576,270	309,713
Accrued expenses	359,979	437,804
Payable to affiliates	237,930	210,945
Total current liabilities	1,567,201	1,285,074
Advances from RepMar	1,050,000	150,000
Total liabilities	2,617,201	1,435,074
Commitments and contingencies		
Net assets:		
Investment in capital assets	1,222,682	1,157,053
Unrestricted	(161,354)	927,675
Total net assets	1,061,328	2,084,728
	$ 3,678,529	$ 3,519,802

See accompanying notes to financial statements.

AIR MARSHALL ISLANDS, INC.

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2004 and 2003

	2004	2003
Operating revenues:		
Passenger	$ 2,916,811	$ 2,492,861
Cargo	573,230	408,424
Charter	286,902	190,478
Other	352,138	362,442
Total operating revenues	4,129,081	3,454,205
Operating expenses:		
Flying operations	2,143,196	1,825,220
Maintenance	1,060,356	1,309,755
Depreciation and amortization	616,942	1,018,591
General and administrative	593,798	472,490
Promotion and sales	408,561	411,672
Aircraft and traffic servicing	330,021	341,330
Total operating expenses	5,152,874	5,379,058
Operating loss	(1,023,793)	(1,924,853)
Nonoperating income (expenses):		
Interest income	393	725
Loss on disposal of plant and equipment	-	(86,885)
Total nonoperating (expenses) income, net	393	(86,160)
Change in net assets	(1,023,400)	(2,011,013)
Net assets at beginning of year	2,084,728	4,095,741
Net assets at end of year	$ 1,061,328	$ 2,084,728

See accompanying notes to financial statements.

AIR MARSHALL ISLANDS, INC.

Statements of Cash Flows
Years Ended September 30, 2004 and 2003

	2004	2003
Cash flows from operating activities:		
Cash received from customers	$ 4,182,723	$ 3,276,244
Cash payments to suppliers for goods and services	(3,112,009)	(3,050,923)
Cash payments to employees for services	(1,297,689)	(1,247,143)
Net cash used in operating activities	(226,975)	(1,021,822)
Cash flows from noncapital financing activities:		
Proceeds from RepMar advances	900,000	150,000
Net cash provided by noncapital financing activities	900,000	150,000
Cash flows from capital and related financing activities:		
Acquisition of plant and equipment	(682,571)	(552,935)
Proceeds from disposal of plant and equipment	-	95,000
Contribution from RepMar	-	1,018,500
Net cash provided by capital and related financing activities	(682,571)	560,565
Cash flows from investing activities:		
Interest received	393	725
Proceeds from sale of investments	-	51,095
Net cash provided by investing activities	393	51,820
Net decrease in cash	(9,153)	(259,437)
Cash at beginning of year	96,495	355,932
Cash at end of year	$ 87,342	$ 96,495
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (1,023,793)	$ (1,924,853)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation and amortization	616,942	1,018,591
(Increase) decrease in assets:		
Receivables:		
Affiliates	(80,822)	(218,740)
Trade	(20,217)	(11,001)
Employees	(111,876)	(97,546)
Expendable parts	(29,824)	37,955
Prepaid expenses and deposits	11,337	(80,851)
Liquidation of advance to RepMar	129,151	120,269
Increase (decrease) in liabilities:		
Accounts payable	66,410	(103,552)
Air traffic liability	266,557	149,326
Accrued expenses	(77,825)	78,763
Payable to affiliates	26,985	9,817
Net cash used for operating activities	$ (226,975)	$ (1,021,822)

See accompanying notes to financial statements.

(1) Organization

Air Marshall Islands, Inc. (AMI) was incorporated on October 12, 1989 to provide domestic and international carrier service within and from the Marshall Islands. AMI has issued 54,400, 460,528, 348,845 and 301,000 shares of $10 par value common stock to the Republic of the Marshall Islands (RepMar), the Marshall Islands Development Authority (MIDA), the Marshall Islands Development Bank (MIDB) and the Republic of the Marshall Islands Investment Development Fund (RMIIDF), respectively, as of September 30, 2004 and 2003. During AMI's initial operating year, RepMar contributed equity capital (including amounts resulting from the merger with Airline of the Marshall Islands, Inc.) amounting to $1,284,722.

AMI's financial statements are incorporated into the general purpose financial statements of RepMar as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of AMI conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. AMI has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

AMI considers passenger and related revenues and costs directly related to such revenues to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

GASB issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and modified by Statement No. 38, *Certain Financial Statement Disclosures*. These statements establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

To conform to the requirements of GASB 34, equity is presented in the following net assets categories:

- Investment in capital assets; capital assets, net of accumulated depreciation, plus construction or improvement of those assets.

- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

(2) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred.

Cash

For purposes of the statements of net assets and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2004 and 2003, cash was $87,342 and $96,495, respectively, and the corresponding bank balances were $114,341 and $134,938, respectively. Of the bank balance amounts as of September 30, 2004 and 2003, $67,645 and $65,531, respectively, were maintained in one financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. AMI does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized.

Receivables

Receivables are both interest free and uncollateralized and are primarily due from government agencies, businesses and individuals located within the Republic of the Marshall Islands.

Allowance for Doubtful Receivables

The allowance for doubtful receivables is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for losses on accounts receivable charged to expense.

Expendable Parts

Flight equipment expendable parts are carried at the lower of average cost or net realizable value.

Plant and Equipment

AMI does not have a capitalization policy for plant and equipment; however, items with a cost that equals or exceeds $5,000 are generally capitalized. Such assets are stated at cost. Maintenance and repairs are charged to operating expenses as they are incurred. Depreciation of plant and equipment and amortization of leasehold equipment are calculated on the straight-line method based on the estimated useful lives of the respective assets.

(2) Summary of Significant Accounting Policies, Continued

The estimated useful lives of these assets are as follows:

	Estimated Useful Lives
Aircraft	10 – 15 years
Rotable spare parts	5 – 10 years
Plant and equipment	5 years
Office furniture and equipment	5 – 7 years
Motor vehicles	3 years
Buildings	20 years

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits. As of September 30, 2004 and 2003, the accumulated vacation leave liability totals $82,992 and $86,784, respectively, and is included within the statements of net assets as accrued expenses.

Taxes

Corporate profits are not subject to income tax in the Republic of the Marshall Islands. The Government of the Republic of the Marshall Islands imposes a gross revenue tax of 3% on revenues. Pursuant to the Income Tax Act of 1989, as amended, revenue from domestic flights and operations of any government-owned corporation providing air transportation services are exempt from gross revenue tax. Accordingly, AMI is exempt from this tax relating to gross revenue.

Passenger Revenues

Passenger revenues are recognized as earned revenue when the transportation is provided.

New Accounting Standards

For fiscal year 2005, AMI will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3) and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. AMI has not evaluated the financial statement impact of the implementation of GASB Statement Nos. 40 and 42.

(3) Risk Management

AMI is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. AMI has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

(4) Plant and Equipment

Capital assets activity for the years ended September 30, 2004 and 2003, was as follows:

	2004			
	October 1, 2003	Additions	Retirements	September 30, 2004
Aircraft and improvements	$ 8,955,595	$ 143,894	$ -	$ 9,099,489
Rotable spare parts	2,846,219	441,550	-	3,287,769
Plant and equipment	350,476	53,533	-	404,009
Office furniture and equipment	589,998	21,315	-	611,313
Motor vehicles	118,396	22,279	-	140,675
Buildings	1	-	-	1
	12,860,685	682,571	-	13,543,256
Less accumulated depreciation and amortization	(11,703,632)	(616,942)	-	(12,320,574)
	$ 1,157,053	$ 65,629	$ -	$ 1,222,682

	2003			
	October 1, 2002	Additions	Retirements	September 30, 2003
Aircraft and improvements	$ 8,926,047	$ 269,548	$ (240,000)	$ 8,955,595
Rotable spare parts	2,585,410	260,809	-	2,846,219
Plant and equipment	1,039,546	4,100	(693,170)	350,476
Office furniture and equipment	571,520	18,478	-	589,998
Motor vehicles	118,396	-	-	118,396
Buildings	1	-	-	1
	13,240,920	552,935	(933,170)	12,860,685
Less accumulated depreciation and amortization	(11,436,326)	(1,018,591)	751,285	(11,703,632)
	$ 1,804,594	$ (465,656)	$ (181,885)	$ 1,157,053

(5) Related Party Transactions

AMI is owned by RepMar, MIDA, MIDB and RMIIDF, and is therefore affiliated with all RepMar-owned and affiliated entities. AMI's airline service is provided to RepMar and all RepMar-owned and affiliated entities. Services are extended to these entities at the same terms and conditions provided to third parties.

AMI utilizes services from certain affiliated entities at substantially the same terms and conditions as those incurred from third parties with the exception of services provided by the Marshall Islands Airports Authority (MIAA), a component unit of RepMar. Specifically, AMI utilizes MIAA's airport facilities at the Amata Kabua International Airport, including landing rights, for which no fees or charges are levied by MIAA.

(5) Related Party Transactions, Continued

During the years ended September 30, 2004 and 2003, AMI obtained advances totaling $900,000 and $150,000, respectively, from RepMar, in accordance with Cabinet Minute C.M. 150 (2002), which approved a loan to AMI in the amount of $2,000,000. The advances bear no interest and have a repayment term of no more than five years.

During the year ended September 30, 2002, AMI received an appropriation of $1,500,000 (derived from Compact Section 211 funding) from RepMar, of which $481,500 was received during 2002. The remaining balance of $1,018,500 was received in 2003. No appropriation was received during the years ended September 30, 2004 and 2003.

During the year ended September 30, 2000, AMI advanced $1,750,000 to RepMar. AMI's liability for payroll taxes totaling $129,151 and $120,269 during the years ended September 30, 2004 and 2003, respectively, and delinquent payroll taxes and related penalties and interest totaling $835,851 for prior years has been applied against this advance. AMI management expects that the remaining advance balance of $664,729 and $793,880 as of September 30, 2004 and 2003, respectively, will be applied against future payroll taxes withheld by AMI.

A summary of related party transactions for the years ended September 30, 2004 and 2003 and related receivable (less allowance for doubtful receivables) and payable balances as of September 30, 2004 and 2003, is as follows:

	2004		
	Receivables	Expenses	Payables
RepMar	$ 1,105,222	$ -	$ 82,484
Marshall Islands Social Security Administration	224	115,359	56,292
Marshall Islands National Telecommunications Authority	249	162,950	10,716
Marshalls Energy Company, Inc.	-	42,343	6,536
Other	31,833	-	81,902
	1,137,528	$ 320,652	$ 237,930
Less allowance for doubtful receivables	(640,146)		
	$ 497,382		

	2003		
	Receivables	Expenses	Payables
RepMar	$ 984,343	$ -	$ 84,174
Marshall Islands Social Security Administration	224	114,318	63,508
Marshall Islands National Telecommunications Authority	898	174,390	7,441
Marshalls Energy Company, Inc.	5,847	46,486	3,322
Other	65,394	-	52,500
	1,056,706	$ 335,194	$ 210,945
Less allowance for doubtful receivables	(640,146)		
	$ 416,560		

(5) Related Party Transactions, Continued

As of September 30, 2004 and 2003, AMI maintained a demand deposit account with an affiliated financial institution, amounting to $18,149 and $15,224, respectively.

(6) Commitments and Contingencies

Commitments

AMI entered into an aircraft lease agreement on December 11, 2002 for three years, with a base rent of $33,000 monthly. Future minimum lease payments under this lease for subsequent years ending September 30 are as follows:

Year Ending September 30,	
2005	$ 396,000
2006	79,200
	$ 475,200

AMI entered into two lease agreements for its offices in Majuro and Ebeye expiring on January 31, 2006 and March 1, 2006, respectively. Total future minimum lease payments under these leases for subsequent years ending September 30 are as follows:

Year Ending September 30,	
2005	$ 55,049
2006	18,862
	$ 73,911

Contingencies

Management acknowledges that it is currently dependent on RepMar for cash funding in order to maintain AMI as a going concern. Although RepMar has provided funding in the past, AMI does not have a formal agreement with RepMar to provide funds in the future. Management believes that the continuation of AMI's operations is dependent upon the future financial support of RepMar, the offering of additional common stock and/or significant improvements in operations, achieved through significant reductions in operating expenses.

On May 15, 2000, AMI cancelled a purchase agreement to acquire two Dornier 328 aircraft at a total cost of $28,045,780. AMI made predelivery payments totaling $2,100,000. In October 2000, AMI sued the aircraft manufacturer for repayment of the predelivery payments and for other claims. On August 17, 2001, a court awarded damages in favor of AMI in the amount of $4,065,000, plus pre-judgment interest in the amount of $115,411. On April 2, 2002, the aircraft manufacturer filed for bankruptcy protection. The ultimate outcome of collection of this judgment is uncertain. As of September 30, 2004, AMI has not been repaid the predelivery payments and has recorded a provision for uncollectible advances of $2,100,000.

(6) Commitments and Contingencies, Continued

Management does not believe that AMI is liable for certain billings, totaling approximately $160,000, that pertain to attorney fees for services which were not authorized by AMI's Board of Directors. The billings are not recorded by AMI and the ultimate resolution of this matter is uncertain.

(7) Subsequent Events

During the period from October 1, 2004 through August 15, 2005, AMI received advances from RepMar amounting to $950,000.

On June 10, 2005, AMI entered into an $800,000 loan agreement with a bank.