

AIR MARSHALL ISLANDS, INC.
**(A COMPONENT UNIT OF THE REPUBLIC
OF THE MARSHALL ISLANDS)**

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2008 AND 2007

INDEPENDENT AUDITORS' REPORT

Board of Directors
Air Marshall Islands, Inc.:

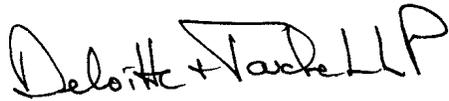
We have audited the accompanying statements of net assets of Air Marshall Islands, Inc. (AMI), a component unit of the Republic of the Marshall Islands, as of September 30, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. 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.

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 AMI'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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AMI as of September 30, 2008 and 2007, 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.

The Management's Discussion and Analysis on pages 3 through 6 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 May 1, 2009, 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 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.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

May 1, 2009

AIR MARSHALL ISLANDS, INC.

Management's Discussion and Analysis Years Ended September 30, 2008 and 2007

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, 2008. This MD&A is to be used in conjunction with the financial statements that precede this section.

AMI is a component unit of the Republic of the Marshall Islands (RMI) and was established as the official 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 seven - member Board of Directors. The RMI Cabinet appoints members to the Board of Directors and Mrs. Evelyn Lanki is appointed as Chairperson of the Board.

Adoption of GASB 34

Air Marshall Islands, Inc. has adopted GASB Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments, which was issued in June 1999. GASB 34 was developed to make financial reports of government entities easier to understand and more informative to oversight bodies. GASB 34 brought about significant changes in the format of the financial reports, one of which is the management's discussion and analysis.

Financial Highlights

Total assets amounted to \$5,032,199 as at September 30, 2008. There is a slight increase of 8% or \$359,911 from the prior year due to the following:

- (i) Dash 8 Engine PW120A was sent to Dallas Airmotive for overtemp and hot section inspection resulting in a major capital expenditure of \$257,500. While the AMI engine was undergoing major repair, AMI decided to lease an engine from International Turbine Service at an average monthly cost of \$18,500.
- (ii) Repair of Dornier engine gearbox amounting to \$39,033.

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets provide an indication of AMI's financial condition. AMI's net assets reflect the difference between assets and liabilities. A summary of AMI's Statement of Net Assets is presented below:

AIR MARSHALL ISLANDS, INC.

Management's Discussion and Analysis Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Assets:			
Current and Other Assets	\$ 1,067,062	\$ 1,094,476	\$ 1,288,343
Property and equipment, net	<u>3,965,137</u>	<u>3,577,812</u>	<u>1,861,389</u>
Total Assets	\$ <u>5,032,199</u>	\$ <u>4,672,288</u>	\$ <u>3,149,732</u>
Liabilities:			
Current liabilities	4,624,250	1,666,739	1,531,658
Non-current liabilities	<u>-</u>	<u>2,762,846</u>	<u>2,538,012</u>
Total Liabilities	<u>4,624,250</u>	<u>4,429,585</u>	<u>4,069,670</u>
Net Assets:			
Invested in capital assets	3,965,137	3,577,812	1,861,389
Unrestricted	<u>(3,557,188)</u>	<u>(3,335,109)</u>	<u>(2,781,327)</u>
Total Net Assets	<u>407,949</u>	<u>242,703</u>	<u>(919,938)</u>
	\$ <u>5,032,199</u>	\$ <u>4,672,288</u>	\$ <u>3,149,732</u>

Statement of Revenues, Expenses, and Changes in Net Assets

A summary of AMI's statement of revenue, expenses and changes in net assets is presented below:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating Revenues:			
Passenger	\$ 621,507	\$ 2,145,824	\$ 2,620,672
Cargo	127,288	427,805	455,438
Charter	190,275	496,536	338,393
Other	<u>171,352</u>	<u>370,587</u>	<u>223,430</u>
Operating revenues	1,110,422	3,440,752	3,637,933
Less: provision for doubtful accounts	<u>(51,938)</u>	<u>(30,000)</u>	<u>(15,829)</u>
Net operating revenues	<u>1,058,484</u>	<u>3,410,752</u>	<u>3,622,104</u>
Operating Expenses:			
Flying operations	1,010,725	1,685,620	2,014,958
Maintenance	998,960	794,210	907,274
Depreciation and amortization	634,151	491,564	625,866
General and administrative	507,835	459,440	536,639
Promotion and sales	153,376	231,247	370,355
Aircraft and traffic servicing	<u>333,191</u>	<u>306,771</u>	<u>250,268</u>
Total operating expenses	<u>3,638,238</u>	<u>3,968,852</u>	<u>4,705,360</u>
Operating loss	<u>(2,579,754)</u>	<u>(558,100)</u>	<u>(1,083,256)</u>
Nonoperating revenues (expenses), net	<u>2,745,000</u>	<u>(279,259)</u>	<u>(70,315)</u>
Loss before capital contributions	<u>165,246</u>	<u>(837,359)</u>	<u>(1,153,571)</u>
Capital contributions	<u>-</u>	<u>2,000,000</u>	<u>-</u>
Change in net assets	\$ <u>165,246</u>	\$ <u>1,162,641</u>	\$ <u>(1,153,571)</u>

AIR MARSHALL ISLANDS, INC.

Management's Discussion and Analysis Years Ended September 30, 2008 and 2007

The Statement of Revenues, Expenses and Changes in Net Assets identifies various revenue and expense items that affect the change in net assets. Operating revenues for FY08 showed a 68% decrease (\$2,330,330) from \$3,440,752 in 2007 to \$1,110,422 in 2008.

In 2008, the number of passengers carried is 4,313 vs. 17,967 in 2007. This is equivalent to 414 block time hours in 2008 vs. 2,071 in 2007.

The aircraft on the ground or "AOG" situation for the year 2008 is equivalent to 46% or 166 days mainly due to major repairs and funding requirements by the Dash 8. The Dornier for most part of the year is on the ground and is expected to be operational by the second quarter of 2009 after undergoing major repair.

Operating expenses for FY08 showed a decrease of 8% or \$330,614 from \$3,968,852 in 2007 to \$3,638,238 in 2008. Depreciation for the year increased by 29% or \$142,587 and this is attributed to the acquisition of the Dash 8 starting February of 2007.

Capital Assets and Debt Administration

For additional information concerning AMI capital assets, please refer to Note 4 to the financial statements.

During the year ended September 30, 2008, AMI eliminated its long-term liabilities. For additional information about this matter, please refer to Note 5 to the financial statements

Subsequent Events and Economic Decisions that May Effect Next Year's Performance.

Repair of Dornier 228

- (i) AIR Marshall Islands, Inc. entered into an Aircraft Maintenance Service Agreement with Air Asia Company Limited on September 15, 2008 for the repair of Dornier 228. The ferry flight shall take place on the last week of March 2009. The turn around time for the repair is 41 days and require capital expenditure of \$172,960 for the basic work plus overhead and materials.

Loan

- (ii) On December 15, 2008 AMI obtained a loan from a bank in the amount of \$180,000. RMI executed a deed of guarantee for the same amount and such shall be paid when the anticipated income or subsidy from ROC (Taiwan) is received. On December 23, 2008 AMI obtained another loan from a bank in the amount of \$200,000 duly guaranteed by RMI.

As of March 20, 2009 both loans were fully paid by RMI.

The purpose of these loans is to pay a two-month deposit to General Aviation Maintenance (Australia) for the lease of a Dornier aircraft and one-month advance rental including required parts for the Dash 8.

Commercial flights for the leased Dornier Aircraft started on February 09, 2009 and it is anticipated that the lease will be for six months giving enough time for the repair of the Dornier in Taiwan.

AIR MARSHALL ISLANDS, INC.

Management's Discussion and Analysis
Years Ended September 30, 2008 and 2007

Liquidated Damages

- (iii) A promissory note was entered into between AMI and Dallas Airmotive, Inc. to pay liquidated damages in the amount of USD100,000 payable in twelve (12) equal instalment payments of USD8,333.33 commencing October 15, 2008.

The amount is the result of a compromise agreement between AMI and DAI.

Management's Discussion and Analysis for the year ended September 30, 2007, is set forth in AMI's report on the audit of financial statements, which is dated June 30, 2008. That Discussion and Analysis explains the major factors impacting the 2007 financial statements and can be obtained from AMI's General Manager via the contact information below.

Additional Financial Information

The discussion and analysis is designed to provide AMI's customers and other parties with an overview of AMI's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information please contact the Air Marshall Island, Inc. General Manager at P.O. Box 1319, Majuro, MH 96960.

AIR MARSHALL ISLANDS, INC.

Statements of Net Assets September 30, 2008 and 2007

<u>ASSETS</u>	<u>2008</u>	<u>2007</u>
Current assets:		
Cash	\$ 77,594	\$ 6,526
Receivables:		
Trade	469,664	515,868
Employees	207,018	224,889
Affiliates (net of allowance for doubtful accounts of \$222,471 and \$130,889 at September 30, 2008 and 2007, respectively)	<u>17,096</u>	<u>120,599</u>
	693,778	861,356
Less allowance for doubtful receivables	<u>(585,804)</u>	<u>(682,048)</u>
Receivables, net	<u>107,974</u>	<u>179,308</u>
Expendable parts (net of allowance for obsolescence of \$174,130 and \$138,000 at September 30, 2008 and 2007, respectively)	<u>572,723</u>	<u>533,834</u>
Prepaid expenses and deposits	<u>176,693</u>	<u>141,284</u>
Total current assets	934,984	860,952
Advance to RepMar	132,078	233,524
Property and equipment, net	<u>3,965,137</u>	<u>3,577,812</u>
	<u>\$ 5,032,199</u>	<u>\$ 4,672,288</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Current portion of long-term debt	\$ -	\$ 237,154
Accounts payable	399,920	384,510
Air traffic liability	179,402	197,994
Accrued expenses	47,080	89,056
Payable to affiliates	880,958	758,025
Advances from RepMar	<u>3,116,890</u>	<u>-</u>
Total current liabilities	4,624,250	1,666,739
Advances from RepMar	-	2,000,000
Long-term debt, net of current portion	<u>-</u>	<u>762,846</u>
Total liabilities	<u>4,624,250</u>	<u>4,429,585</u>
Commitment and contingencies		
Net assets:		
Invested in capital assets	3,965,137	3,577,812
Unrestricted	<u>(3,557,188)</u>	<u>(3,335,109)</u>
Total net assets	<u>407,949</u>	<u>242,703</u>
	<u>\$ 5,032,199</u>	<u>\$ 4,672,288</u>

See accompanying notes to financial statements.

AIR MARSHALL ISLANDS, INC.

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Passenger	\$ 621,507	\$ 2,145,824
Cargo	127,288	427,805
Charter	190,275	496,536
Other	<u>171,352</u>	<u>370,587</u>
Total operating revenues	1,110,422	3,440,752
Less provision for doubtful accounts	<u>(51,938)</u>	<u>(30,000)</u>
Total net operating revenues	<u>1,058,484</u>	<u>3,410,752</u>
Operating expenses:		
Flying operations	1,010,725	1,685,620
Maintenance	998,960	794,210
Depreciation and amortization	634,151	491,564
General and administrative	507,835	459,440
Promotion and sales	153,376	231,247
Aircraft and traffic servicing	<u>333,191</u>	<u>306,771</u>
Total operating expenses	<u>3,638,238</u>	<u>3,968,852</u>
Operating loss	<u>(2,579,754)</u>	<u>(558,100)</u>
Nonoperating revenues (expenses):		
RepMar subsidy	2,740,000	100,000
Interest expense	-	(74,368)
Gain on disposal of property and equipment	5,000	-
Other expense	<u>-</u>	<u>(304,891)</u>
Total nonoperating revenues (expenses) , net	<u>2,745,000</u>	<u>(279,259)</u>
Loss before capital contributions	165,246	(837,359)
Capital contributions:		
Contributions from RepMar	<u>-</u>	<u>2,000,000</u>
Change in net assets	165,246	1,162,641
Net assets at beginning of year	<u>242,703</u>	<u>(919,938)</u>
Net assets at end of year	<u>\$ 407,949</u>	<u>\$ 242,703</u>

See accompanying notes to financial statements.

AIR MARSHALL ISLANDS, INC.
 Statements of Cash Flows
 Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Cash received from customers	\$ 1,122,209	\$ 3,316,082
Cash payments to suppliers for goods and services	(2,024,737)	(2,215,292)
Cash payments to employees for services	(853,982)	(1,263,977)
Net cash used for operating activities:	<u>(1,756,510)</u>	<u>(163,187)</u>
Cash flows from noncapital financing activities:		
Operating subsidy received from RepMar	2,740,000	100,000
Advance from RepMar	128,316	-
Net cash provided by noncapital financing activities	<u>2,868,316</u>	<u>100,000</u>
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(1,021,476)	(2,141,987)
Proceeds from sale of property and equipment	5,000	-
Capital contributions from RepMar	-	2,000,000
Proceeds from issuance of long term debt	-	289,229
Principal repayments of long-term debt	(11,426)	(38,055)
Interest paid on long-term debt	(12,836)	(65,632)
Net cash (used in) provided by capital and related financing activities	<u>(1,040,738)</u>	<u>43,555</u>
Net change in cash	71,068	(19,632)
Cash at beginning of year	6,526	26,158
Cash at end of year	\$ <u>77,594</u>	\$ <u>6,526</u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (2,579,754)	\$ (558,100)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation and amortization	634,151	491,564
Bad debts expense	51,938	30,000
Inventory obsolescence	33,000	-
(Increase) decrease in assets:		
Receivables:		
Affiliates	11,921	(150,675)
Trade	(10,396)	24,917
Employees	17,871	22,115
Expendable parts	(71,889)	14,880
Prepaid expenses and deposits	(35,409)	48,283
Advance to RepMar	101,446	118,715
Increase (decrease) in liabilities:		
Accounts payable	15,410	(95,727)
Air traffic liability	(7,609)	(21,027)
Accrued expenses	(40,123)	(8,459)
Payable to affiliates	122,933	(79,673)
Net cash used for operating activities	\$ <u>(1,756,510)</u>	\$ <u>(163,187)</u>
Non-cash investing, capital, and financing activities:		
Refinancing of long-term debt:		
Proceeds from issuance of long-term debt	\$ -	\$ 1,560,771
Principal repayment of long-term debt	-	(1,560,771)
	<u>\$ -</u>	<u>\$ -</u>
Note payable to bank	\$ 988,574	\$ -
Advance from RepMar	(988,574)	-
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(1) Organization

Air Marshall Islands, Inc. (AMI) was incorporated on October 12, 1989 to provide regular scheduled domestic and international passenger, charter and cargo service within and from the Marshall Islands. As of September 30, 2008, AMI operated a fleet of two Dornier Do228 aircraft and a single de Havilland Canada Dash 8 (DHC-8) Series 100 aircraft. 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 is governed by a six-member Board of Directors appointed by the Cabinet of RepMar.

AMI's financial statements are incorporated into the 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 charter and cargo 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: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements established 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 asset categories:

- Invested 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.

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(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

Custodial credit risk is the risk that in the event of a bank failure, AMI's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. AMI does not have a deposit policy for custodial credit risk.

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, 2008 and 2007, cash was \$77,594 and \$6,526, respectively, and the corresponding bank balances were \$74,350 and \$11,034, respectively. Of the bank balances, \$24,656 and \$5,759, 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 insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Receivables

Receivables from providing passenger, charter and cargo services are based on contracted prices, which are both interest free and uncollateralized and are primarily due from government agencies, businesses and individuals located within the Republic of the Marshall Islands. 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 collectability 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. An allowance for obsolescence is provided for flight equipment expendable parts to allocate the costs of these assets, less estimated residual value, over the useful lives of the related aircraft and engines.

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(2) Summary of Significant Accounting Policies, Continued

Property and Equipment

Flight equipment and other property with a cost that equals or exceeds \$2,500 are capitalized, as well as major additions, betterments and renewals. Such assets are stated at cost. Aircraft maintenance and repairs are charged to operations as they are incurred. Depreciation of property and equipment and amortization of leasehold equipment are calculated on the straight-line method based on the estimated useful lives of the respective assets.

The estimated useful lives of these assets are as follows:

	<u>Estimated Useful Lives</u>
Building and improvements	20 years
Aircraft and improvements	10 – 15 years
Rotable spare parts	5 – 10 years
Office furniture and equipment	5 – 7 years
Plant and equipment	5 years
Motor vehicles	3 years

Modifications that significantly enhance the operating performance and/or extend the useful lives of property and equipment are capitalized and amortized over the remaining life of the asset. Costs associated with aircraft modifications that enhance the usefulness of the aircraft are capitalized and depreciated over the estimated remaining useful life of the aircraft or modification, whichever is less.

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, 2008 and 2007, the accumulated vacation leave liability totals \$47,080 and \$43,498, respectively, and is included within the statements of net assets as accrued expenses.

Revenue Recognition

Passenger revenue is recognized either when the transportation is provided or when tickets expire unused. The value of passenger tickets for future travel is included as air traffic liability. Charter and cargo revenue is recognized when the transportation is provided. Other components of other operating revenue are recognized as revenue when the related goods and services are provided.

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.

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During fiscal year 2008, AMI implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*, and GASB Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing, and includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components and GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements September 30, 2008 and 2007

(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) Property and Equipment

Capital asset activity for the years ended September 30, 2008 and 2007 was as follow:

	2008			September 30, 2008
	October 1, 2007	Additions	Retirements/ Tranfers	
Aircraft and improvements	\$ 12,318,562	\$ 315,945	\$ -	\$ 12,634,507
Rotable spare parts	3,968,831	706,320	(3,455)	4,671,696
Plant and equipment	433,373	2,599	-	435,972
Office furniture and equipment	652,946	18,132	-	671,078
Motor vehicles	187,188	29,640	(77,277)	139,551
Building improvements	<u>12,538</u>	<u>-</u>	<u>-</u>	<u>12,538</u>
	17,573,438	1,072,636	(80,732)	18,565,342
Less accumulated depreciation and amortization	<u>(14,046,786)</u>	<u>(634,151)</u>	<u>80,732</u>	<u>(14,600,205)</u>
	3,526,652	438,485	-	3,965,137
Construction in progress	<u>51,160</u>	<u>-</u>	<u>(51,160)</u>	<u>-</u>
	<u>\$ 3,577,812</u>	<u>\$ 438,485</u>	<u>\$ (51,160)</u>	<u>\$ 3,965,137</u>
	2007			
	October 1, 2006	Additions	Retirements/ Tranfers	September 30, 2007
Aircraft and improvements	\$ 10,436,492	\$ 1,882,070	\$ -	\$ 12,318,562
Rotable spare parts	3,714,976	253,855	-	3,968,831
Plant and equipment	428,226	5,147	-	433,373
Office furniture and equipment	639,842	13,104	-	652,946
Motor vehicles	187,188	-	-	187,188
Building improvements	<u>9,887</u>	<u>2,651</u>	<u>-</u>	<u>12,538</u>
	15,416,611	2,156,827	-	17,573,438
Less accumulated depreciation and amortization	<u>(13,555,222)</u>	<u>(491,564)</u>	<u>-</u>	<u>(14,046,786)</u>
	1,861,389	1,665,263	-	3,526,652
Construction in progress	<u>-</u>	<u>51,160</u>	<u>-</u>	<u>51,160</u>
	<u>\$ 1,861,389</u>	<u>\$ 1,716,423</u>	<u>\$ -</u>	<u>\$ 3,577,812</u>

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements September 30, 2008 and 2007

(5) Long-Term Debt

At September 30, 2007, AMI had a note payable to a bank amounting to \$1,000,000, interest at 8.5% per annum, payable in monthly installments of \$24,700, including interest and collateralized by a time certificate of deposit (TCD) owned by the Marshall Islands Development Bank (MIDB) and by a guarantee of RepMar. In December 2007, the note foreclosed, resulting in the bank seizing the TCD collateral belonging to MIDB. The foreclosure transferred the liability from a note payable to payable to RepMar (see note 6).

Changes in long-term liabilities for the year ended September 30, 2008 were as follows:

	Balance October 1, <u>2007</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2008	Due Within <u>One Year</u>
Loans payable	\$ 1,000,000	\$ -	\$ (1,000,000)	\$ -	\$ -
Advances from RepMar	<u>2,000,000</u>	<u>1,116,890</u>	-	<u>3,116,890</u>	<u>3,116,890</u>
	<u>\$ 3,000,000</u>	<u>\$ 1,116,890</u>	<u>\$ (1,000,000)</u>	<u>\$ 3,116,890</u>	<u>\$ 3,116,890</u>

Changes in long-term liabilities for the year ended September 30, 2007 were as follows:

	Balance October 1, <u>2006</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2007	Due Within <u>One Year</u>
Loans payable	\$ 748,826	\$ 1,850,000	\$ (1,598,826)	\$ 1,000,000	\$ 237,154
Advances from RepMar	<u>2,000,000</u>	-	-	<u>2,000,000</u>	-
	<u>\$ 2,748,826</u>	<u>\$ 1,850,000</u>	<u>\$ (1,598,826)</u>	<u>\$ 3,000,000</u>	<u>\$ 237,154</u>

(6) Related Party Transactions

AMI is a component unit of RepMar 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, including the Marshall Islands Development Bank (MIDB) and the RMI Ports Authority (RMIPA). 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 RMIPA, a component unit of RepMar. Specifically, AMI utilizes RMIPA's airport facilities at the Amata Kabua International Airport, including landing rights, for which no fees or charges are levied by RMIPA.

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements September 30, 2008 and 2007

(6) Related Party Transactions, Continued

A summary of related party transactions for the years ended September 30, 2008 and 2007 is as follows:

	2008			
	Receivables	Revenues	Payables	Expenses
RepMar	\$ 93,293	\$ 159,552	\$ 59,928	\$ -
Marshall Islands Social Security Administration	224	-	607,153	88,636
Marshall Islands National Telecommunications Authority	2,284	381	12,871	54,846
Marshalls Energy Company, Inc.	2,028	208	3,710	27,363
Other	<u>141,738</u>	<u>10,275</u>	<u>197,296</u>	<u>-</u>
	239,567	\$ <u>170,416</u>	\$ <u>880,958</u>	\$ <u>170,845</u>
Less allowance for doubtful receivables	<u>(222,471)</u>			
	\$ <u>17,096</u>			

	2007			
	Receivables	Revenues	Payables	Expenses
RepMar	\$ 87,132	\$ 394,190	\$ 103,993	\$ -
Marshall Islands Social Security Administration	224	-	461,523	95,789
Marshall Islands National Telecommunications Authority	2,083	2,813	11,827	68,711
Marshalls Energy Company, Inc.	1,870	1,151	12,255	57,079
Other	<u>160,179</u>	<u>792</u>	<u>168,427</u>	<u>-</u>
	251,488	\$ <u>398,946</u>	\$ <u>758,025</u>	\$ <u>221,579</u>
Less allowance for doubtful receivables	<u>(130,889)</u>			
	\$ <u>120,599</u>			

A summary of advances from RepMar as of September 30, 2008 and 2007 follows:

	2008	2007
Advances in accordance with Cabinet Minute C.M. 150 (2002), no interest and due in May 2008.	\$ 2,000,000	\$ 2,000,000
Transfer of note payable to bank to payable to affiliate as a result of bank seizing the TCD collateral belonging to MIDB, terms and interest rate is currently under negotiation.	988,574	-
Funding assistance in accordance with Cabinet Minute C.M. 118 (2007), no interest and on reimbursable basis.	<u>128,316</u>	<u>-</u>
	\$ <u>3,116,890</u>	\$ <u>2,000,000</u>

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(6) Related Party Transactions, Continued

AMI previously advanced \$1,750,000 to RepMar from which AMI's liability for payroll taxes, totaling \$101,446 and \$118,715, during the years ended September 30, 2008 and 2007, respectively, and certain delinquent payroll taxes and related penalties and interest from prior years has been applied against such advance. AMI management expects that the remaining advance of \$132,078 and \$233,524 as of September 30, 2008 and 2007, respectively, will be applied against future payroll taxes withheld by AMI.

During the year ended September 30, 2008, in accordance with Cabinet Minute C.M. 009(2008), C.M. 060 (2008) and C.M. 060 (2007), AMI received operating subsidies from RepMar totaling \$1,840,000. AMI also received \$900,000 from the Government of Republic of China during the fiscal year. These were used to assist in the subsidization of certain flight schedules.

During the year ended September 30, 2007, AMI received an operating subsidy from RepMar of \$100,000 to assist in the subsidization of certain flight schedules in accordance with Cabinet Minute C.M. 148 (2006). In addition, AMI received a capital contribution from RepMar of \$2,000,000 to assist in the purchase of the DHC-8 aircraft, which was previously being leased by AMI.

As of September 30, 2008 and 2007, AMI maintained a demand deposit account with an affiliate financial institution amounting to \$46,322 and \$1,794, respectively.

(7) Commitment and Contingencies

Commitment

AMI leases office space at the Amata Kabua International Airport. Total future minimum lease payments under this lease for subsequent years ending September 30 are as follows:

<u>Year Ending</u> <u>September 30</u>	
2009	\$ 2,059
2010	2,059
2011	<u>858</u>
	\$ <u>4,976</u>

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, to be achieved through significant reductions in operating expenses.

AIR MARSHALL ISLANDS, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(7) Commitment and Contingencies, Continued

Contingencies, Continued

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 pre-delivery payments totaling \$2,100,000. In October 2000, AMI sued the aircraft manufacturer for repayment of the pre-delivery 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, 2008, AMI has not been repaid the pre-delivery payments and has recorded a provision for uncollectible advances of \$2,100,000.

Management does not believe that AMI is liable for certain billings approximating \$160,000 for 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.

(8) Other Expense

In November 2006, a court ordered AMI to pay delinquent social security contributions, totaling \$304,891, by May 15, 2007. Compliance with this order allows AMI to petition the court to extinguish the balance of a \$611,627 judgment. AMI has paid the \$304,891 as ordered, which has been recorded as other nonoperating expense in the accompanying financial statements. Management has yet to petition the court for the aforementioned purpose.

(9) Subsequent Events

In accordance with Cabinet Minute C.M. 202 (2008), AMI received a subsidy from RepMar in the amount of \$187,600 in order to resume flights and restore services to outer islands.