AIR MARSHALL ISLANDS, INC.

(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2013 AND 2012
(AS RESTATED)

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

Years Ended September 30, 2013 and 2012
Table of Contents

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Air Marshall Islands, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of Air Marshall Islands, Inc. (AMI), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for Qualified Opinion

Because of inadequacy of accounting records, we are unable to form an opinion regarding the amounts at which expendable parts is recorded in the accompanying statements of net position at September 30, 2013 and 2012 (stated at $485,702 and $498,662, respectively). Expendable parts enter materially into the determination of the results of operations for the years ended September 30, 2013 and 2012.

Opinion

In our opinion, except for the matter described in the "Basis for Qualified Opinion" paragraph the financial statements referred to above present fairly, in all material respects, the financial position of AMI as of September 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

Restatement

As discussed in Note 8 to the financial statements, the 2012 financial statements have been restated to correct an error.

Going Concern

The accompanying financial statements have been prepared assuming that AMI will continue as a going concern. As discussed in Note 7 to the financial statements, AMI's recurring losses from operations and deficient net position raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 7 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated July 17, 2014, 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 internal control over financing reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering AMI's internal control over financial reporting and compliance.

Deloitte + Touche LLP

July 17, 2014

OVERVIEW

Air Marshall Islands, Inc. (AMI) is pleased to present herewith a Management's Discussion and Analysis of AMI's financial performance for the financial year ended 30th September 2013, which shall be read in conjunction with our financial statements and the accompanying notes to our financial statements in this report.

FINANCIAL HIGHLIGHTS

AMI's total net position continued to improve as the deficient net position decreased by $141,648 in 2013 and $792,771 in 2012 due mainly to increases in non-operating revenues.

AMI continued to face great operational difficulties and huge financial losses as it operated with one 19-seater Dornier 228 and one 34-seater Dash 8, operating to extremely poor airports in the outer islands that are considered some of the worst in the world thus, contributing to unscheduled and costly breakdown of our aircraft.

On September 13, 2011, the Dash 8 was pulled from service for a major D-check that initially required over $1 million to commence the repair work, but due to no immediate funding available, the Dash 8 sat at the hangar for about nine months or until June 2012 when it finally was sent over to Cairns Australia, financed by funding from the Marshall Islands Marine Resources Authority (MIMRA).

During the D-check, the Dash 8's left engine was also discovered to be badly corroded and required overhaul at the engine manufacturer in Canada. More downtime time resulted and the cost increased beyond the funding provided by MIMRA of $1.6 million. From the initial 60 days turn-around period expected, repair work took more than a year. The aircraft finally returned to the Marshall Islands in July 2013, with a total repair cost of $4.1 million.

During the time the Dash 8 was out of service, the numbers of flights decreased and operating revenue fell by 30%-40% with passenger revenue decreasing from $1,874,290 in 2011 to $1,054,260 in 2012 as the Dornier 228 was left as the sole aircraft doing all the flying. Passenger revenue rebounded slightly increasing from $1,054,260 in 2012 to $1,132,050 in 2013.

Net operating revenues increased by $482,696 from $1,878,419 in 2012 to $2,361,115 in 2013. This increase was due to additional increases in passenger revenue ($77,790) and charter revenue ($360,241) in 2013 as compared to 2012, and was due mainly to increased charters to the drought affected atolls and islands in the northern region of the country.

Total operating expenses increased slightly from $3,262,228 in 2012 to $3,394,236 in 2013, representing an increase of $132,008. This increase was due mainly to higher depreciation expense, aircraft fuel costs, spare part purchases, and general administrative expenses, which included personnel, centralized electricity billing, etc.

Operating loss continued to be on a declining trend as it decreased from $1,708,159 in 2011 to $1,383,809 in 2012 and further decreased to $1,033,121 in 2013. This continuing trend is the result of improvement in net operating revenues over net operating expenses. In 2013, several factors helped boost revenues such as board approved ticket rate of 15% increase; Cabinet approved travel policy requiring all government agencies and affiliates to first utilize AMI air service, especially between Kwajalein and Majuro except when the airline cannot provide the service; and the drought emergency relief effort for the northern islands that required charter service; and finally re-entry of the Dash 8 in August 2013.

FINANCIAL ANALYSIS OF AMI

In accounting and finance, total net position refers to the value of a company's total assets minus its total liabilities so the higher the company's total net position value, the higher the value of the whole company, or vice versa (net deficiency).

A company with negative net position is normally in big trouble. Through AMI's Statements of Net Position, as indicated below, it is shown that AMI has been consistently experiencing deficient net position. Such portrays a very poor financial situation that needed continued government operating subsidies and capital contributions to keep the service afloat.

Presented herewith are AMI's Summary Statements of Net Position:

	2013	2012	2011
Assets:			
Current and other assets	$ 739,861	$ 646,946	$ 790,221
Capital assets	6,936,827	5,195,590	3,966,951
Total Assets	$ 7,676,688	$ 5,842,536	$ 4,757,172
Liabilities:			
Current and other liabilities	$ 5,780,147	$ 6,357,356	$ 5,357,922
Long-term liabilities	2,737,341	467,628	1,174,469
Total Liabilities	8,517,488	6,824,984	6,532,391
Net Position:			
Net investment in capital assets	6,936,827	5,195,590	3,966,951
Unrestricted	(7,777,627)	(6,178,038)	(5,742,170)
Total Net Position	(840,800)	(982,448)	(1,775,219)
	$ 7,676,688	$ 5,842,536	$ 4,757,172

As indicated above, AMI's total assets have been consistently increasing from $4,757,172 in 2011 to $5,842,536 in 2012, and increased further to $7,676,688 in 2013. This increase was primarily the result of increases in long-term debt and capital contributions from the RMI government to fund aircraft overhaul costs.

Current and other liabilities also increased consistently from $5,357,922 in 2011 to $6,357,356 in 2012 due to increases in amounts owed to RMI government and affiliated entities for employee and employer payroll related costs as well as overhaul related costs incurred pertaining to the Dash 8. Such liabilities decreased from $6,357,356 in 2012 to $5,780,147 in 2013 due to certain decreases in these liabilities funded by increases in operating subsidies received from the RMI government.

Net capital assets also increased consistently from $3,966,951 in 2011 to $5,195,590 in 2012 and increased further to $6,936,827 in 2013. This increase was due mainly to the reasons stated earlier. So, all in all, AMI's deficient net position has gradually improved over the years; however, AMI continued to require government subsidy that represented 33% (or $1,177,040) in 2013 of total revenue, which was used to finance the following:

1. Operating subsidies	$ 473,569
2. Direct Payment for social security arrears	306,183
3. Direct Payment to Secretary of Finance for w/holding taxes arrears	31,183
4. Direct Payment to Air Asia Ltd in Taiwan for DO228 overhaul overdue debt	129,285
5. Auto payment for AMI's BOMI default loan	236,820
	$ 1,177,040

Presented herewith are AMI's Summary Statements of Revenues, Expenses and Changes in Net Position:

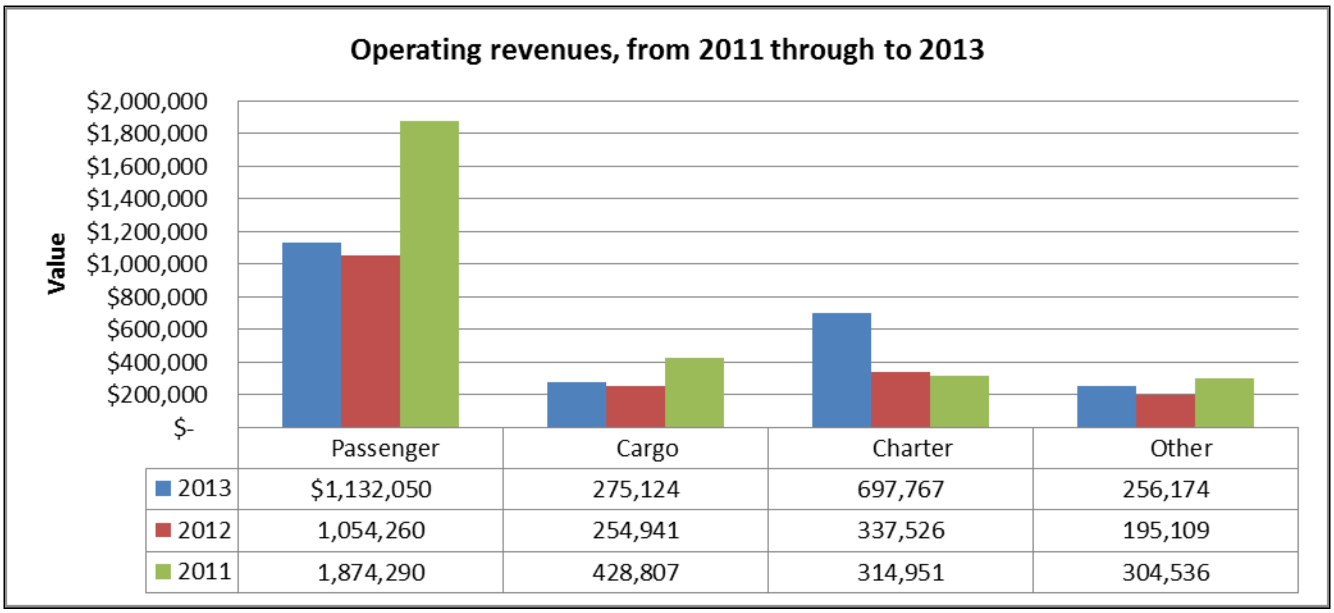
	2013	2012	2011
Revenues:			
Net operating revenues	$ 2,361,115	$ 1,878,419	$ 2,922,584
Non-operating revenues	1,177,040	772,872	719,267
Capital contributions	76,767	1,495,598	-
Total Revenues	3,614,922	4,146,889	3,641,851
Expenses:			
Operating expenses	3,394,236	3,262,228	3,686,323
Non-operating expenses	79,038	91,890	159,613
Total Expenses	3,473,274	3,354,118	3,845,936
Change in net position	$ 141,648	$ 792,771	$ (204,085)

The above identifies the various revenue and expense items that contributed to AMI's change in net position during the three financial years. The above table shows that AMI's total operating revenue decreased by $1,044,165 to $1,878,419 in 2012 from $2,922,584 in 2011, and increased by $482,696 to $2,361,115 in 2013 from $1,878,419 in 2012. The decrease in 2012 was due to the absence of the Dash 8 from service, while the increase in 2013 was due to increased charter flights during the drought that affected the atolls and islands in the northern region of the Marshall Islands. The capital contributions from the RMI government of $1,495,598 in 2012 and $76,767 in 2013 for the Dash 8 overhaul as well as the significant operating subsidies of $772,872 in 2012 and $1,177,040 in 2013 largely helped AMI achieve a positive change in net position in those two years, while the absence of capital contributions in 2011 led AMI to have a negative change in net position.

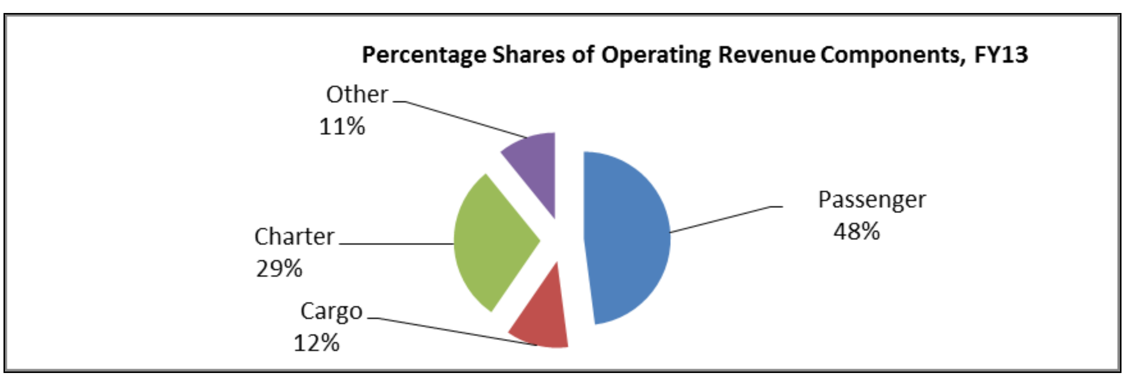
AMI's ability to maintain a reliable flight schedule continued to be hampered by lack of spare parts on shelves, which is called MEL or minimum equipment list, continued to be caused by lack of adequate and timely payment. In addition, shortages of essential manpower such as pilots, mechanics, avionic technicians, etc., continued to also prevent AMI from maintaining a reliable schedule.

Selling of passenger tickets to our customers has been AMI's main source for our operating revenue. So, as AMI continued to operate below expected capacity due to an unreliable flight schedule, this major component to our operating revenue continued to be greatly affected and prevented the airline from generating enough income on its own, to meet its financial obligations on time and had to continue to depend on RMI government subsidies and capital contributions. Passenger revenue decreased by $820,030 in 2012 as compared to 2011, but increased by $77,790 in 2013 as compared to 2012. The decrease in 2012 was attributable mainly to the outing of the Dash 8 when it went AOG for exactly 23 months which began on September 13, 2011 and concluded on August 13, 2013, when the Dash 8 made its first flight after the D-check.

The graph below shows the main components of AMI's operating revenues from 2011 through to 2013.

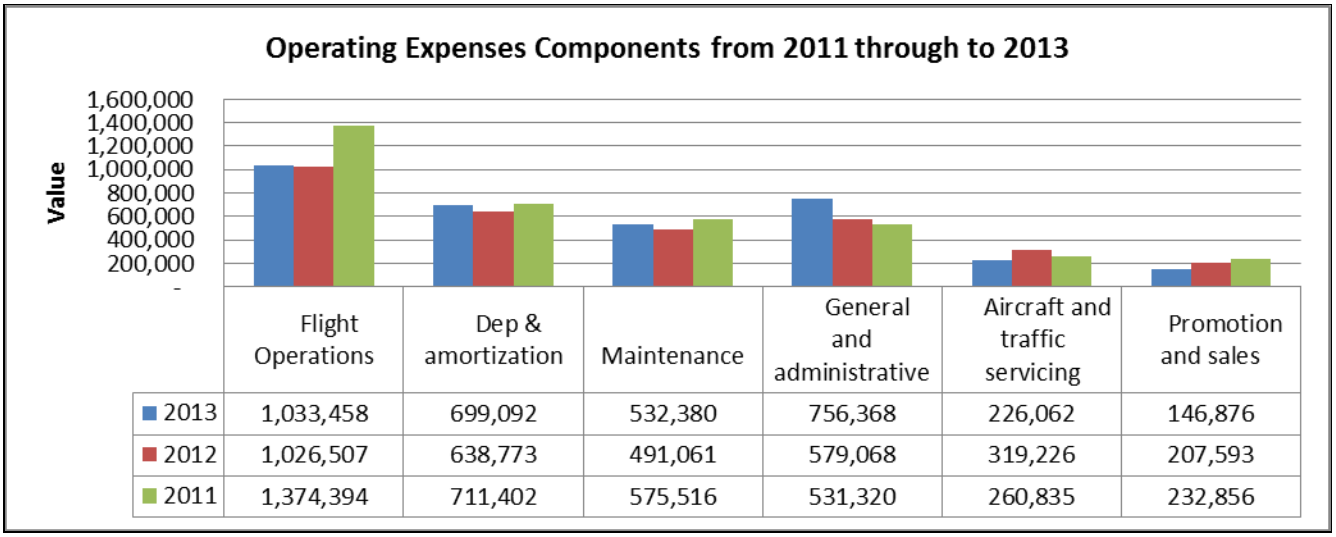


AMI's total operating revenues have generally been on an up-and-down trend. In 2011, the passenger revenue was the highest when it reached $1,874,290, then decreased to $1,054,260 in 2012, and increased again to $1,132,050 in 2013, and this was all due to the absence of the Dash 8 during those 23 months, and the drought in 2013 that required the use of chartered flights.

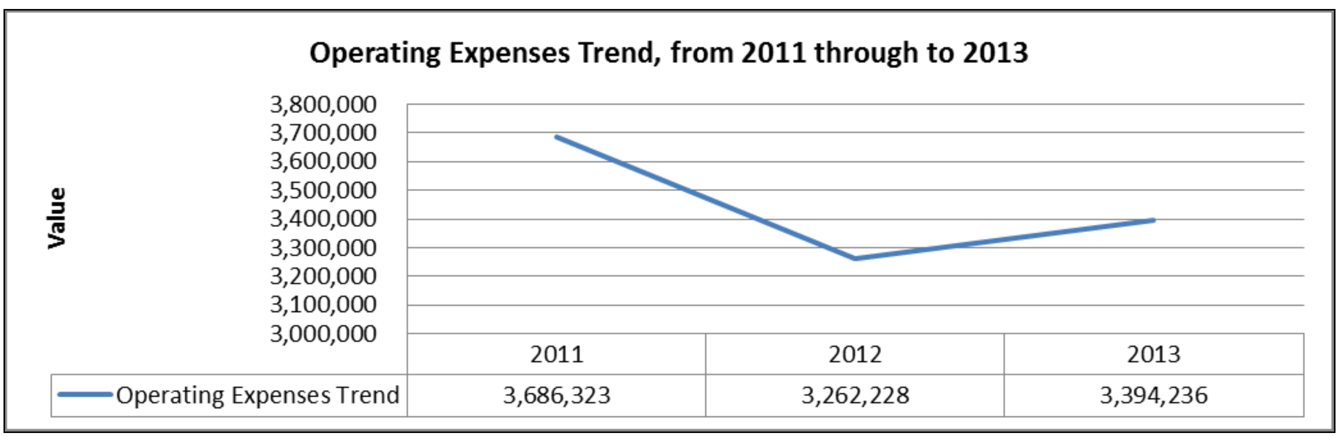


The pie graph shows that passenger revenue was the largest share of 48% of operating revenues followed by charter 29%; cargo 12%, and all others 11%, in 2013.

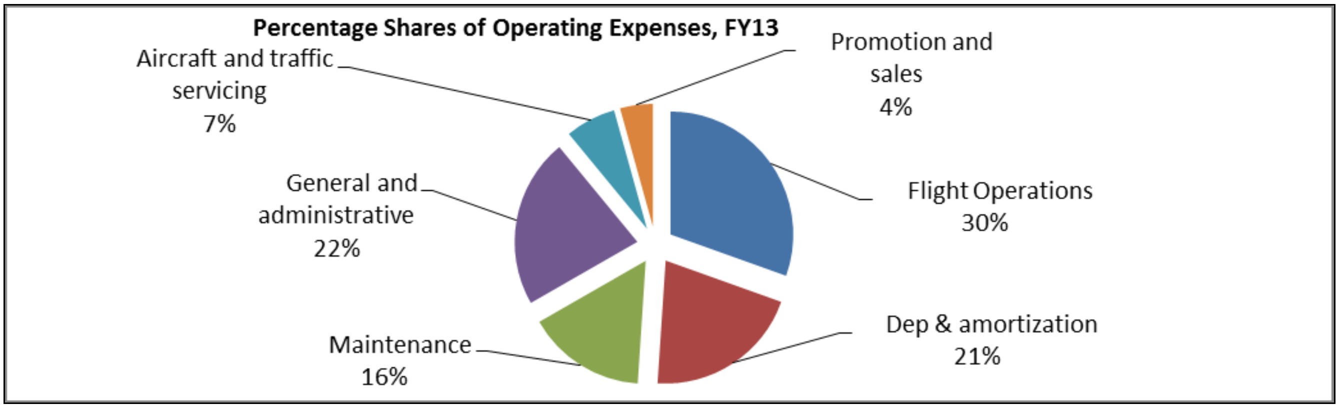
The following graph shows the major components of operating expenses during the reporting period, as follows:



As indicated by the above graph and the one below, they are both showing that AMI's operating expenses, on average, have been on a decreasing trend when expenses decreased from $3,686,323 in 2011 to $3,262,228 in 2012 and slightly increased to $3,394,236 in 2013.



In 2013, the expense components which contributed to the increase in operating expenses were mainly in depreciation and amortization, maintenance, and general administration.



The pie chart shows major component percentage shares of AMI's total operating expenses in 2013, indicating that flight operation was the largest share of 30%, followed by general administration, 22%; depreciation and amortization, 21%; maintenance, 16%; aircraft and traffic servicing, 7%; and promotion and sales, 4%. Fuel is an expense under flight operation and being the second largest cost after personnel, the reason for the largest share of operating expenses for flight operation.

CAPITAL ASSET AND DEBT

AMI's net capital assets in 2013 increased by $1,741,237 (or 34%) resulting from added value of repairs to aircraft and improvements for a total cost of $3,790,092 and for rotable spare parts for a cost of $222,444 less total depreciation for the year of $699,092. Kindly refer to note 4 to the accompanying financial statements in this report for more information on AMI's capital assets.

AMI incurred substantial new long-term debt when AMI obtained a $2.5 million loan from the Marshall Islands Development Bank in May 2013, to pay down the remaining cost of the Dash 8 D-check in Cairns Australia. Kindly refer to note 5 to the accompanying financial statements in this report for more information on AMI's long-term debt.

CASH FLOW

The net cash used for operating activities was $537,174 in 2013 as compared to net cash provided by operating activities in 2012 was $155,052, and net cash used for operating activities was $101,266 in 2011. The cash provided by operating revenues was entirely absorbed by AMI's operational activities. Government cash support to AMI were $1.18 million in 2013, $0.78 million in 2012, and $0.72 million in 2011, respectively, which were used as operating subsidies, and as direct payments from the RMI Government for AMI's outstanding prior year obligations, as alluded to earlier.

CURRENT ECONOMIC OUTLOOK

The Marshall Islands' economy is a small open economy that is highly susceptible to global events, and is dependent upon foreign funding to support a high domestic consumption, and to fuel major domestic activities.

In addition, the funding from the US Government through the Compact and federal programs account for up to 60% of the annual national budget of $130 million, and represent about one-third of the annual nominal GDP of $150 million. This has resulted in our national government being the driver of the economy, and not the private sector, which is supposed to be the engine of growth for the economy.

At the start of Compact II at the beginning of FY04, our economy enjoyed a comfortable growth of 3% to 5% per year until the global economic and energy crisis took place at end FY08/beginning FY09 that stopped the rapid world economic expansion as fuel and food prices skyrocketed and pushed global inflation to record levels.

Inflation in the RMI alone jumped from below 5% annually to 15% immediately following the onslaught of the FY08/09 global energy crisis that crushed real incomes, and dampened domestic demand. The price of jet fuel climbed over 100% as it went from around $2 a gallon in FY04 to more than $4 a gallon after the crisis. Right now, the price of jet fuel is hovering around $5 a gallon and with the ongoing instability in the Middle East, in Eastern Europe, and in other places around the world, we cannot simply expect the price of fuel to come down sooner, but rather we should brace for a possible further increase in fuel costs to perhaps around $6 or more per gallon; and that will be a very serious risk, and concern, to AMI's already dire and precarious financial situation. Henceforth, it is necessary for AMI to constantly keep a watchful eye on the horizon, and watch out for any looming troubles.

As an ailing state-owned enterprise, AMI has not been able to generate enough or sufficient operating revenues on its own that are needed for AMI to cover its operating expenses. With operating losses of over $1 million every year, such as $1,033,121 in 2013 and $1,383,809 in 2012, respectively, the operating subsidy and the capital contributions from the RMI government will continue to be viewed as very important for the airline's operation and sustenance.

With aging capital assets and equipment such as the old Dornier 228 and the Dash 8 aircrafts, which were built more than 20 years ago, coupled with deteriorating conditions of the outer island airports, the support from the RMI government will remain essential for the airline's foreseeable future.

Over the years, AMI continued to face other great challenges such as the following:

1. Servicing a group of poor outer island communities which are part of AMI's community service obligation, CSO, which first and foremost must be subsidized by the RMI government;

2. Operating with a small and old fleet that shall be expanded and modernized if the airline is keen about creating a successful operation;

3. Providing a seasonal operation whereby the Summer and Christmas Seasons are the busiest while the Fall and Spring Seasons are slowest;

4. Continuing to experience disrupted flight schedule due to lack of adequate communication between various departments of the company, which is due mainly to their scattered office locations. The company therefore must remodel and renovate the Hangar at the airport, and move everyone to the Hangar to enhance communication and reduce the amount of time that is needed to go from one office to the next which are located miles from each other;

5. Operating as an SOE thus AMI is subject to political influence which can sometimes be contradictory to the Company's commercial objectives as it tries to operate like a commercial entity with government being the largest shareholder;

6. Continuing to use a "Dash System" computer system that is used to record and keep the company's aircraft spare parts inventory that has become old, and it is becoming obsolete and must be replaced as soon as practical;

7. Continuing to lack an adequate MEL for the Dash 8 so anytime the aircraft is in need of a spare part, the Company has to go out to buy it and cause days, or even weeks of delay while the aircraft is AOG;

8. Being located in a remote place like the RMI, which is far away from the international commercial lanes and global markets thus procuring spare parts from overseas and transporting them, including fuel, over long distances, is costly.

9. Continuing to fly to some of the world's worst airports, which are located in the outer islands, is not only becoming a great challenge, but also it is costing AMI millions of dollars in unnecessary damages to our aircrafts as they are hit by flying debris that are lying all over each airport in the outer islands. Such dirt and sand often gets into the aircraft's landing gears and puncture the tires, from the shock and awe, the screws inside the aircraft are loosen, the electrical and avionic system (the aircraft's nervous system) as the aircrafts continue to absorb hard shake and sharp bumps, it is thus only a matter of time, besides the millions of dollars in damages, before a major disaster could happen. It is now or never therefore, it is highly recommended that the RMI government take appropriate action now and begins the upgrade and improvement work on all outer island airports in the country.

AMI management and Board can only do so much in terms of streamlining operations and reining in costs and improving performance, but this will not create a much visible dent on operations without having upgraded and airworthy airports in the outer islands; sufficient MEL for both aircrafts; acquisition of new capital assets to replace the aging ones; and remodeling and upgrading of the Hangar at the airport with the main goal of housing everyone under one roof to increase communication and coordination, and continued RMI government preferential arrangements that the government can create in order to protect and grow the national airline.

If the "*status quo*" of little to no action from the RMI government continues then the whole air operation will cease to exist. It is thus in AMI's interest to continue to strongly lobby the RMI government to carry on the abovementioned to safeguard the national airline from the brink of collapse and eventual extinction.

WAY FORWARD AND FUTURE SUSTAINABILITY

One of the things AMI, through the support of its Board of Directors, has done was creating a new strategic Business Plan (BP) at the end of 2013 that is to be used as a compass to chart the company's future course.

In summary, AMI's business plan's mission is two-fold:

- First, we want Air Marshall Islands to be transformed into a modern and efficient airline that provides a domestic air service that is safe, reliable, and commercially viable for the benefit of the travelling public and in support of industries such as tourism that rely on air service for their success; and

- Finally, we want Air Marshall Islands to become a financially strong national airline capable of providing regional and international service as a flag carrier of our country.

The business plan has Six Major Goals (the *6 Rs*) that we must implement in order to achieve the above mission, and these goals are:

Goal 1: Rebuild our financial base;
Goal 2: Reverse loss making;
Goal 3: Restore service reliability;
Goal 4: Renew our operation;
Goal 5: Restrict reliance on state subsidy; and
Goal 6: Repair of outer island airstrips.

We strongly believe that by implementing these six goals, through adequate support of the Cabinet and the Board of Directors, we would be able to steer AMI in the midst of all these existing challenges that are confronting our national airline at the moment.

In the beginning, or during the first few years of implementation of the business plan, AMI will continue to require government subsidy as we move forward along and implement the business plan, together.

ADDITIONAL FINANCIAL AND OTHER INFORMATION

This MD&A was designed to provide AMI's customers and other stakeholders with an overview of the company's operations and financial condition as at 30th September 2013, and its vision for future sustainability. Should the readers have questions regarding the information provided in this report, or wish to request for additional financial information, kindly contact the AMI's General Manager & CEO at P.O. Box 1319, Majuro, Marshall Islands, MH 96960; Telephone (692) 625-3731; Fax (692) 625-3730; Email Address: jeffersonbarton@outlook.com

AIR MARSHALL ISLANDS, INC.

Statements of Net Position
September 30, 2013 and 2012

ASSETS	2013	2012 (As Restated)
Current assets:		
Cash	$ 113,882	$ 4,582
Receivables:		
Trade	367,756	320,496
Employees	217,006	239,989
Affiliates	105,967	54,464
	690,729	614,949
Less allowance for doubtful receivables	(600,825)	(600,825)
Receivables, net	89,904	14,124
Expendable parts (net of allowance for obsolescence of $177,789 at September 30, 2013 and 2012)	485,702	498,662
Prepaid expenses and deposits	50,373	129,578
Total current assets	739,861	646,946
Capital assets:		
Nondepreciable capital assets	-	1,572,207
Capital assets, net of accumulated depreciation	6,936,827	3,623,383
	$ 7,676,688	$ 5,842,536
LIABILITIES AND NET POSITION		
Current liabilities:		
Current portion of long-term debt	$ 755,588	$ 467,628
Accounts payable	214,796	319,083
Contract payable - aircraft overhaul	-	430,597
Air traffic liability	106,055	211,825
Accrued expenses	200,350	120,293
Payable to affiliates	2,142,056	2,158,668
Advances from RepMar	3,116,890	3,116,890
Total current liabilities	6,535,735	6,824,984
Long-term debt, net of current portion	1,981,753	-
Total liabilities	8,517,488	6,824,984
Commitments and contingencies		
Net position:		
Net investment in capital assets	6,936,827	5,195,590
Deficiency	(7,777,627)	(6,178,038)
Total net position	(840,800)	(982,448)
	$ 7,676,688	$ 5,842,536

See accompanying notes to financial statements.

AIR MARSHALL ISLANDS, INC.

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2013 and 2012

	2013	2012 (As Restated)
Operating revenues:		
Passenger	$ 1,132,050	$ 1,054,260
Cargo	275,124	254,941
Charter	697,767	337,526
Other	256,174	195,109
Total operating revenues	2,361,115	1,841,836
Recovery of doubtful accounts	-	36,583
Total net operating revenues	2,361,115	1,878,419
Operating expenses:		
Flight operations	1,033,458	1,026,507
Depreciation and amortization	699,092	638,773
Maintenance	532,380	491,061
General and administrative	756,368	579,068
Aircraft and traffic servicing	226,062	319,226
Promotion and sales	146,876	207,593
Total operating expenses	3,394,236	3,262,228
Operating loss	(1,033,121)	(1,383,809)
Nonoperating revenues (expenses):		
RepMar subsidy	1,177,040	772,872
Interest expense	(79,038)	(91,890)
Total nonoperating revenues (expenses) , net	1,098,002	680,982
Capital contributions from RepMar	76,767	1,495,598
Change in net position	141,648	792,771
Net position at beginning of year	(982,448)	(1,775,219)
Net position at end of year	$ (840,800)	$ (982,448)

See accompanying notes to financial statements.

AIR MARSHALL ISLANDS, INC.

Statements of Cash Flows
Years Ended September 30, 2013 and 2012

		2013		2012 (As Restated)
Cash flows from operating activities:				
Cash received from customers	$	2,179,565	$	2,043,092
Cash payments to suppliers for goods and services		(1,741,291)		(882,545)
Cash payments to employees for services		(975,448)		(1,005,495)
Net cash provided by (used for) operating activities		(537,174)		155,052
Cash flows from noncapital financing activities:				
Operating subsidy received from RepMar		1,177,040		772,872
Cash flows from capital and related financing activities:				
Acquisition of property and equipment		(2,870,926)		(1,633,224)
Capital contribution from RepMar		76,767		1,495,598
Proceeds from long-term debt		2,500,000		-
Principal repayments of long-term debt		(230,287)		(706,841)
Interest paid on long-term debt		(6,120)		(91,890)
Net cash used for capital and related financing activities		(530,566)		(936,357)
Net change in cash		109,300		(8,433)
Cash at beginning of year		4,582		13,015
Cash at end of year	$	113,882	$	4,582
Reconciliation of operating loss to net cash provided by (used for) operating activities:				
Operating loss	$	(1,033,121)	$	(1,383,809)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:				
Depreciation and amortization		699,092		638,773
Recovery of doubtful accounts		-		(36,584)
(Increase) decrease in assets:				
Receivables:				
Trade		(47,260)		117,702
Employees		22,983		(19,348)
Affiliates		(51,503)		48,841
Expendable parts		12,960		(24,064)
Prepaid expenses and deposits		79,205		48,295
Increase (decrease) in liabilities:				
Accounts payable		(104,287)		90,262
Air traffic liability		(105,770)		54,062
Accrued expenses		84,771		58,488
Payable to affiliates		(94,244)		562,434
Net cash provided by (used for) operating activities	$	(537,174)	$	155,052
Summary disclosure of noncash activities:				
Construction in progress	$	-	$	(234,188)
Contract payable-aircraft overhaul		-		234,188
	$	-	$	-

See accompanying notes to financial statements.

(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, 2012, 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, Government of the Republic of Marshall Islands (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 seven-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.

GASB 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*, 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 position categories:

- Net investment in capital assets; capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.

- Unrestricted; net position that is not subject to externally imposed stipulations. Unrestricted net position 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.

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 position. 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 are 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.

(2) Summary of Significant Accounting Policies, Continued

Cash, Continued

For purposes of the statements of net position and cash flows, cash is defined as cash on hand and cash held in demand and savings accounts. As of September 30, 2013 and 2012, the carrying amounts of cash were $113,882 and $4,582, respectively, and the corresponding bank balances were $143,527 and $17,782, respectively. As of September 30, 2013 and 2012, bank balances in the amount of $137,407 and $14,944, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance with the remainder maintained in non-FDIC insured financial institutions. Accordingly, these deposits are exposed to custodial credit risk. AMI does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

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 receivables that may become uncollectible based on evaluations of the collectability of these receivables and prior collection experience. The allowance is established through a provision for losses on receivables 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.

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:

	Estimated Useful Lives
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

(2) Summary of Significant Accounting Policies, Continued

Property and Equipment, Continued

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 lower.

Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. AMI has no items that qualify for reporting in this category.

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 non-vesting accumulating rights to receive sick pay benefits. As of September 30, 2013 and 2012, the accumulated vacation leave liability amounted to $46,232 and $45,321, respectively, and is included within the statements of net position as accrued expenses.

Deferred Inflows of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. AMI has no items that qualify for reporting in this category.

Revenue Recognition

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 non-operating.

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

(2) Summary of Significant Accounting Policies, Continued

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.

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.

New Accounting Standards

During the year ended September 30, 2013, AMI implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, which improved financial reporting for governmental entities by amending the requirements of Statements No. 14, The Financial Reporting Entity, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which enhanced the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement No. 62 superseded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of AMI.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of AMI.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of AMI.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 70 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of AMI.

(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 activities for the years ended September 30, 2013 and 2012, were as follows:

	2013			
	October 1, 2012	Additions	Retirements/ Transfers	September 30, 2013
Aircraft and improvements	$ 14,194,817	$ 3,786,954	$ -	$ 17,981,771
Rotable spare parts	5,445,651	222,444	-	5,668,095
Plant and equipment	439,655	-	-	439,655
Office furniture and equipment	713,278	3,138	-	716,416
Motor vehicles	159,364	-	-	159,364
Building improvements	13,314	-	-	13,314
	20,966,079	4,012,536	-	24,978,615
Less accumulated depreciation and amortization	(17,342,696)	(699,092)	-	(18,041,788)
	3,623,383	3,313,444	-	6,936,827
Construction in progress	1,572,207	-	(1,572,207)	-
	$ 5,195,590	$ 3,313,444	$ (1,572,207)	$ 6,936,827

	2012			
	October 1, 2011	Additions	Retirements/ Transfers	September 30, 2012
Aircraft and improvements	$ 14,054,830	$ 139,987	$ -	$ 14,194,817
Rotable spare parts	5,296,793	148,858	-	5,445,651
Plant and equipment	439,655	-	-	439,655
Office furniture and equipment	706,918	6,360	-	713,278
Motor vehicles	159,364	-	-	159,364
Building improvements	13,314	-	-	13,314
	20,670,874	295,205	-	20,966,079
Less accumulated depreciation and amortization	(16,703,923)	(638,773)	-	(17,342,696)
	3,966,951	(343,568)	-	3,623,383
Construction in progress	-	1,572,207	-	1,572,207
	$ 3,966,951	$ 1,228,639	$ -	$ 5,195,590

(5) Long-Term Debt

A schedule of AMI's long-term debt as of September 30, 2013 and 2012, is as follows:

	2013	2012
Note payable to bank, due on November 28, 2014, interest at 13.5% per annum, payable in monthly installments of $31,500, including interest, collateralized by AMI's aircraft.	$ -	$ 230,287
Note payable to RMI Ports Authority, due on March 30, 2013, interest at 8% per annum, payable in monthly installments of $11,560, including interest. This note is uncollateralized.	237,341	237,341
Note payable to Marshall Islands Development Bank, due on May 30, 2018, interest at 6.5% per annum, payable in monthly installments of $51,100, including interest. The loan is collateralized by the Dash 8 aircraft.	2,500,000	-
	$ 2,737,341	$ 467,628

Future repayment commitments are as follows:

Year Ending September 30	Principal	Interest	Total
2014	$ 755,588	$ 249,642	$ 1,005,230
2015	500,645	112,508	613,153
2016	533,701	79,452	613,153
2017	568,940	44,213	613,153
2018	378,467	8,756	387,223
	$ 2,737,341	$ 494,571	$ 3,231,912

Changes in long-term liabilities for the year ended September 30, 2013, were as follows:

	Balance October 1, 2012	Additions	Reductions	Balance September 30, 2013	Due Within One Year
Notes payable	$ 467,628	$ 2,500,000	$ (230,287)	$ 2,737,341	$ 755,588

(5) Long-Term Debt, Continued

Changes in long-term liabilities for the year ended September 30, 2012, were as follows:

	Balance October 1, 2011	Additions	Reductions	Balance September 30, 2012	Due Within One Year
Notes payable	$ 1,174,469	$ -	$ (706,841)	$ 467,628	$ 467,628

(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.

During the years ended September 30, 2013 and 2012, AMI received operating subsidies from RepMar, totaling $1,177,040 and $772,872, respectively. In addition, AMI received $76,767 and $1,495,598 in capital contributions from RepMar during the years ended September 30, 2013 and 2012, respectively, relating to payments made for Dash 8 aircraft overhaul costs.

A summary of related party transactions as and for the years ended September 30, 2013 and 2012, is as follows:

	2013			
	Receivables	Revenues	Payables	Expenses
RepMar	$ 89,180	$ 351,524	$ 360,269	$ 9,520
RMIPA	-	-	396,710	525
Marshall Islands Social Security Administration	-	-	1,358,051	80,576
Marshall Islands National Telecommunications Authority	-	802	2,330	28,579
Marshalls Energy Company, Inc.	-	-	24,137	53,546
Other	16,787	2,435	559	-
	105,967	$ 354,761	$ 2,142,056	$ 172,746
Less allowance for doubtful receivables	(55,684)			
	$ 50,283			

(6) Related Party Transactions, Continued

	2012			
	Receivables	Revenues	Payables	Expenses
RepMar	$ 38,885	$ 184,241	$ 606,987	$ 274,955
RMIPA	-	-	355,991	96,915
Marshall Islands Social Security Administration	-	-	1,411,985	194,312
Marshall Islands National Telecommunications Authority	-	-	2,305	24,721
Marshalls Energy Company, Inc.	-	-	66,843	84,762
Marshall Island Development Bank	-	-	36,993	-
Other	15,579	45,774	1,914	-
	54,464	$ 230,015	$ 2,483,018	$ 675,665
Less allowance for doubtful receivables	(42,295)			
	$ 12,169			

A summary of advances from RepMar as of September 30, 2013 and 2012, follows:

	2013	2012
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 are currently under negotiation.	988,574	988,574
Funding assistance in accordance with Cabinet Minute C.M. 118 (2007), no interest and on reimbursable basis.	128,316	128,316
	$ 3,116,890	$ 3,116,890

At September 30, 2013 and 2012, AMI is liable for payroll taxes, totaling $352,785 and $280,297, respectively. The additional payroll taxes for 2013 and 2012 exclude the related penalties and interest.

At September 30, 2013 and 2012, AMI is liable to the Marshall Islands Social Security Administration (MISSA) for certain delinquent employee and employer contributions, totaling $1,358,051 and $1,411,985, respectively, which includes related penalties and interest. On December 28, 2010, AMI entered into a promissory note with MISSA in the amount of $1,059,068 associated with these delinquent contributions. The note bears interest at 12% per annum with monthly payments of $15,000 commencing January 10, 2011. In addition, a $50,000 payment is due on or before January 31, 2011 and another on or before April 30, 2011. On September 23, 2011, MISSA filed suit against AMI for defaulting on the above promissory note. On November 30, 2012, the High Court entered judgment against AMI in favor of MISSA for $1,411,985, inclusive of penalties relating to delinquent contributions.

(7) Commitments and Contingencies

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, 2013, 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.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the continuation of AMI as a going concern. AMI sustained substantial operating losses during the years ended September 30, 2013 and 2012 of $1,033,121 and $1,383,809, respectively, and used a substantial amount of working capital in its operations resulting in a working capital deficiency of $5,795,874 at September 30, 2013. Furthermore, at September 30, 2013, total liabilities exceeded total assets by $840,800. 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.

In view of these matters, realization of a major portion of the assets in the accompanying statement of net position at September 30, 2013, is dependent upon continued operations of AMI, which, in turn, is dependent upon AMI's ability to provide reliable service to its customers and the success of future operations. Management believes that actions presently being undertaken to revise AMI's operating requirements, including the repair and rehabilitation of its aircraft, generating cash flows through possible disposal of assets, improving flight schedules, increasing cargo and other services, and negotiating to secure electronic ticketing capability, provide the opportunity for AMI to continue as a going concern.

(8) Restatement

Subsequent to the issuance of AMI's 2012 financial statements, AMI management determined that accrued withholding taxes were overstated by $324,350. As a result of this determination, payable to affiliates and related general and administrative expenses have been restated from the amounts previously reported as follows:

	As Previously Reported	As Restated
At September 30:		
Current Liabilities:		
Payable to affiliates	$ 2,483,018	$ 2,158,668
Net position	$ (6,502,388)	$ (6,178,038)
Total net position	$ (1,306,798)	$ (982,448)

(8) Restatement, Continued

	Reported	As Restated
For the year ended September 30		
Operating Expenses:		
General and administrative	$ 903,418	$ 579,068
Operating loss	$ (1,708,159)	$ (1,383,809)
Change in net position	$ 468,421	$ 792,771
Net position at the end of year	$ (1,306,798)	$ (982,448)

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Chairman
Board of Directors
Air Marshall Islands, Inc.:

We have audited, in accordance with the 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, the financial statements of Air Marshall Islands, Inc. (AMI), which comprise the statement of net position as of September 30, 2013, statements of revenues, expenses and changes in net position and of cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated July 17, 2014. Our report was qualified for the inadequacy of accounting records over expendable parts and included emphasis-of-matter paragraphs regarding a restatement for correction of an error and a going concern uncertainty.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered AMI's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of AMI's internal control. Accordingly, we do not express an opinion on the effectiveness of AMI's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, maternal weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Responses we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* 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 *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2013-001 through 2013-004 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether AMI's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

AMI's Responses to Findings

AMI's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. AMI's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the AMI's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the AMI's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

July 17, 2014

Finding No. 2013-001

Reconciliation of Balances

Criteria: Balances per the general ledger (GL) should be timely reconciled with balances per subsidiary ledgers (SL).

Condition: Certain GL accounts did not reconcile with SL balances:

GL Account Name	GL Balance Over (Under) SL Balance
Due from Affiliates	(67,821)
Inventory	3,818
AP System	84,530
Unearned Revenue	(35,919)

In addition, we noted unlocated difference presented under reconciliation report.

GL Account Name	Unlocated Amount
AR – System	3,247
Advances to Employees	(1,800)
Uncleared Checks	(1,683)
AP – System	4,669

Cause: The cause of this condition is the lack of established policies and procedures pertaining to timely reconciliation of GL and SL balances, resolution of reconciling items, and independent reviews.

Effect: The effect of the above condition is a misstatement of account balances and errors not being timely detected.

Recommendation: We recommend that management establish policies and procedures over timely reconciliation of account balances, resolution of reconciling items, and independent reviews to minimize opportunity for unreconciled differences.

Prior Year Status: Lack of established policies and procedures pertaining to timely reconciliation of GL balances against SL balances, resolution of reconciling items, and independent reviews was reported as a finding in the audits of AMI for fiscal years 2011 and 2012.

Auditee Response and Corrective Action Plan: Management agrees with the finding and will soon hire a Chief Accountant to supervise and review reconciliation of balances on a regular basis; and will require the CA and the Accounting office to at least produce Quarterly Reconciliation Reports as a means to detect—in advance—any differences in balances between the General Ledger (Trial Balance) and the Subsidiary Ledgers. Therefore, the immediate hiring of the CA is key for this and other important accounting functions alluded to above and also from FY12 management responses.

Finding No. 2013-002

Journal Entries

Criteria: Adequate accounting controls necessitate that journal entries and recorded adjustments be appropriately approved and documented. Furthermore, an independent review of journal vouchers should be performed.

Condition: Journal vouchers do not contain a signature of an independent reviewer.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures over processing journal entries.

Effect: The effect of the above condition is a potential for unauthorized journal entries.

Recommendation: We recommend that management adopt policies and procedures to evidence review and approval of journal entries.

Prior Year Status: Lack of established policies and procedures pertaining to independent review and approval of journal entries was reported as a finding in the audit of AMI for fiscal year 2012.

Auditee Response and Corrective Action Plan: Management agrees with the finding and will require the Revenue Supervisor to always provide to the Chief Accountant or to the GM in the absence of the CA, any journal entries and recorded adjustments to review and approve before such entries and adjustments are posted in the system. Thus, the timely recruitment of the CA is key for this and other important accounting functions alluded to above and also from FY12 management response.

Finding No. 2013-003

Inventories

Criteria: Adequate accounting controls necessitate that inventories be appropriately recorded, monitored and valued based on the existing accounting policy. Information maintained by the accounting department and the inventory management system at the spares department should be reconciled. Furthermore, an independent review of inventory valuation report should be performed.

Condition:

1. Of eighteen (18) samples tested, the following exceptions were noted:

Item #	Part #	Quantity per Audit at 9/30/13	Quantity per Valuation Report at 9/30/12	Unit Cost	Difference
1	AVL-OFRA	1	6	$ 270	$ 1,350

For item presented above, it was counted per piece instead as one (1) set per confirmation with the inventory clerk.

Furthermore, we noted the following unit cost exceptions:

		Valuation Report			Difference Over (Under)	
Item #	Part #	Quantity	Unit Cost	Unit Cost per Audit	Unit Cost	Extended Amount
1	A-262330A09B	6	$ 3,092.00	$ 168.91	$ 2,923.09	$ 17,538.54
2	CA3420-4-C22	4	2,844.00	28.44	2,815.56	11,262.24
3	A-735801A08B	6	273.23	219.65	53.58	321.48
4	RA18-4	78	41.45	0.41	41.04	3,200.77
5	RB14-14	45	62.95	0.63	62.32	2,804.40

Items presented above were incorrectly valued based on the latest transaction, misapplication of unit cost, and an error in entering unit costs in the valuation report.

2. Signing the logsheet for issued items is not frequently followed.

Cause: It appears that there is lack of a review process of the inventory valuation report that resulted in erroneous movements and incorrectly updated unit costs. Furthermore, it appears that inventory management did not maintain adequate documents supporting inventory issuances.

Effect: The effect of the condition is a possible misstatement of inventory and consumable expenses and report modification concerning expendable parts.

Recommendation: Management should adopt and implement appropriate internal control policies over recording, monitoring, and valuation of inventories.

Prior Year Status: Lack of reconciliation between accounting and inventory departments was reported as a finding in the audits of AMI for fiscal years 2006 through 2012.

Finding No. 2013-3, Continued

Inventories, Continued

Auditee Response and Corrective Action Plan: Management acknowledges this finding and has already undertaken a complete review of all data entries for the current inventory to ensure correctness of these entries for quantities and values. This project will also identify redundant and obsolete inventory items for disposal through sale or other means as deemed appropriate for each item identified in accordance with published manufacturer and/or industry guidance. Policies and procedures will be developed and implemented for the independent review of inventory transaction data entries to ensure complete and correct information; for the liquidation and/or disposal of existing inventory deemed redundant or obsolete; and to better coordinate with administrative accounting staff for the complete, correct and timely delivery of inventory transaction information, and as long as the hiring of the Chief Accountant continues to be delayed, then the problem with coordination between the two offices will continue to hamper the above attempted effort.

Finding No. 2013-004

Revenue

Criteria: Adequate accounting controls necessitate that revenues be appropriately reviewed, documented, and recorded.

Conditions:

1. Of seventy-five (75) passenger ticket samples tested, we noted the following:

   a. One sample misapplied a new fare rate resulting in undercharging of the ticket sale.
   b. One ticket sales deposit revealed an error in reconciliation resulting in a variance of $48.11.
   c. One ticket dated November 2, 2011 was erroneously included in FY13 due to an error entering the data in the Dash Revenue system.
   d. The following tickets were not timely deposited:

Ticket Number	Fare Sales Report	Payment Date/ Invoice Date	Deposit Date	No. of Working Days Delayed
5500255151	$ 152	8/29/2013	9/5/2013	5
5500249618	77	12/6/2012	12/17/2012	7
5500253812	171	5/4/2013	5/8/2013	3
5500251312	90	1/2/2013	1/4/2013	2
5500255292	290	7/19/2013	7/23/2013	2
5500248053	122	11/5/2012	11/7/2012	2
5500254812	51	6/28/2013	7/4/2013	4
5500251236	294	2/29/2012	12/31/2012	2
5500248094	122	12/12/2012	12/14/2012	2
5500252561	114	7/5/2013	7/15/2013	6
5500256472	85	8/17/2013	8/23/2013	6
5500254539	171	6/7/2013	6/17/2013	6
5500254508	145	6/1/2013	6/5/2013	3
5500248858	15	10/11/2012	10/19/2012	6
5500250939	118	1/22/2013	1/24/2013	2
5500254909	171	6/17/2013	6/20/2013	3
5500247227	171	10/11/2012	10/19/2012	6
5500250662	145	12/17/2012	12/21/2012	4
5500247858	123	12/24/2012	12/28/2012	4
5500245619	134	3/8/2013	3/15/2013	5
5500251656	114	1/25/2013	2/1/2013	5
5500252929	191	7/8/2013	7/26/2013	14
5500254741	171	6/17/2013	6/20/2013	3
5500253848	85	9/3/2013	9/10/2013	5
5500256287	51	9/26/2013	9/30/2013	2
5500255095	152	7/4/2013	7/8/2013	2
5500250974	95	4/2/2013	4/4/2013	2
4200273901	39	9/16/2013	9/18/2013	2

Finding No. 2013-004, Continued

Revenue, Continued

2. Of six freight ticket samples tested, we noted the following:

    a. One freight ticket did not indicate route information. Thus, we were not able to validate the rate charged the shipper.
    b. One ticket incorrectly charged excess baggage rate instead of the freight charge.
    c. The following tickets were not timely deposited:

Ticket Number	Ticket Amount	Date Collected	Date Deposited	No. of Working Days Delayed
313831	1,586.30	12/24/2012	12/28/2012	3
104542	1,049.60	1/10/2013	1/16/2013	4
104677	1,029.15	1/20/2013	1/24/2013	4
105174	2,285.85	2/7/2013	4/8/2013	3
107174	497.30	9/2/2013	9/9/2013	5

3. Of three excess baggage tickets tested, we noted the following:

    a. One sample was unsupported with an actual ticket. Thus, we were not able to validate shipper information and ticket charged.
    b. One cash sale ticket was not timely deposited.

Ticket Number	Amount	Date Collected	Date Deposited	No. of Working Days Delayed
91280	$ 571.70	9/10/2013	9/13/2013	3

4. Of 25 charter flight samples tested, we noted the following:

    a. Flight requests are not properly dated. Thus, we were unable to verify the flight date.
    b. Flight requests are not properly signed by sales personnel that evidence review and complete documentation.
    c. One flight request form was dated beyond the flight date. Thus, it appears that the process of securing approval prior to actual flight is not followed.
    d. One flight request form did not indicate the type of aircraft. Thus, we were not able to validate the passenger fare.
    e. Five flight request forms did not match existing landing fees resulting in a $800 understatement of revenue.
    f. Seven flight request forms revealed errors in block time computations resulting in a $344 net understatement of charges.
    g. One flight request form did not provide sufficient information on the flight route resulting in difficulty of verifying the charge.
    h. One flight request form was not properly billed and recorded as revenue as of September 30, 2013.

Finding No. 2013-004, Continued

Revenue, Continued

i. The following tickets were not timely deposited:

Flight Request Number	Amount	Date Collected	Date Deposited	No. of Working Days Delayed
1365	$ 7,781.50	5/22/2013	5/24/2013	2
1421	$ 900.00	9/26/2013	9/30/2013	2

Cause: The above condition appears to be due to control policies that do not allow for monitoring and filing of documents, independent review of reports, and inadequate coordination and communication between personnel.

Effect: The above condition may result in misstatements and may adversely impact financial information.

Recommendation: Management should adopt and strengthen control policies over management coordination, independent review of reports, timely deposits of collections, and proper filing, reconciliation, and maintenance of documents.

Prior Year Status: Recommendation concerning control policies and procedures over monitoring and filing of documents, independent review of reports to provide accurate financial information, and coordination and communication among departments was reported as a finding in the audit of AMI for fiscal year 2012.

Auditee Response and Corrective Action Plan: Management agrees with this finding and will require the Ticketing Manager to always make sure any fare rates given out that are either above or below the approved fare rates, are supported by a prior approved and signed memorandum by the General Manager and that every cash revenue received by the airline, must be deposited in the bank on a timely basis. To enhance and strengthen this safeguard, the immediate hiring of the CA cannot be delayed anymore.

Unresolved Prior Years' Findings
Year Ended September 30, 2013

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses section of this report.