

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

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2015 AND 2014

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

Years Ended September 30, 2015 and 2014
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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, 2015 and 2014, 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, 2015 and 2014 (stated at \$469,209 and \$470,142, respectively). Expendable parts enter materially into the determination of the results of operations for the years ended September 30, 2015 and 2014.

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 Air Marshall Islands, Inc. as of September 30, 2015 and 2014, 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

Going Concern

The accompanying financial statements have been prepared assuming that AMI will continue as a going concern. As discussed in Note 8 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 8 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 this matter.

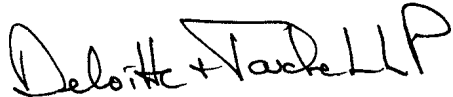
Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 to 12 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 August 11, 2016, 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.

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

August 11, 2016

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

Management's Discussion and Analysis
Years Ended September 30, 2015 and 2014

OVERVIEW

Presented herewith is AMI's management's discussion and analysis (MD&A) of the company's financial performance for the financial year ended 30th September 2015, to be read along with our financial statements and the accompanying notes to our financial statements in this report.

FINANCIAL HIGHLIGHTS

As at September 30, 2015, AMI obtained a net surplus of \$3,123,787, which eliminated the net deficit position of the airline from 2014 of \$1.05M to a net position of \$2.07M in 2015. The change was primarily due to the RepMar: subsidy of \$1,916,903 and capital contributions of \$2,219,661. Out of the total funding, RepMar paid \$943,373 directly to MIDB, \$300,000 directly to MISSA, \$1,900,000 was used in purchasing the new Dornier V7-1512, and \$290,422 used in purchasing equipment to support the ground handling services for Nauru Airlines.

The company continued to face operational difficulties and great challenges as it continued to experience frequent aircraft on ground (AOG) of the Dornier and the Dash 8 due to poor runway conditions of outer islands, lack of spare parts on shelves, delays in funding, and frequent interruption to the flight schedule.

The bad conditions of the airports in the outer islands continued to contribute significantly to the AOG of the company's aircraft leading to the disruption of the flight schedules.

Operating loss decreased from \$1.23 million in 2014 to \$0.85 million in 2015 as a result of increases in passenger, cargo, charter and other revenues that increased from \$2.14 million in 2014 to \$2.51 million in 2015 whereas total operating expenses slightly increased from \$3.33 million in 2014 to \$3.35 million in 2015.

Net surplus caused the total assets to exceed total liabilities by \$2.07 million in 2015 whereas in 2014 it was vice versa the total liabilities exceeded total assets by \$1.05 million.

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FINANCIAL ANALYSIS OF AMI

The table below provides a summary of AMI's net financial position, which is indicating that total assets decreased while total liabilities increased in 2015 over 2014 and 2013.

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Assets:			
Current and other assets	\$ 2,869,542	\$ 1,101,249	\$ 739,861
Capital assets	<u>6,946,025</u>	<u>6,478,160</u>	<u>6,936,827</u>
Total Assets	\$ <u>9,815,567</u>	\$ <u>7,579,409</u>	\$ <u>7,676,688</u>
Liabilities:			
Current and other liabilities	\$ 5,880,289	\$ 6,021,134	\$ 5,780,147
Long-term debt	<u>1,866,691</u>	<u>2,613,475</u>	<u>2,737,341</u>
Total Liabilities	<u>7,746,980</u>	<u>8,634,609</u>	<u>8,517,488</u>
Net Position:			
Net investment in capital assets	6,946,025	6,478,160	6,936,827
Unrestricted	<u>(4,877,438)</u>	<u>(7,533,360)</u>	<u>(7,777,627)</u>
Total Net Position	<u>2,068,587</u>	<u>(1,055,200)</u>	<u>(840,800)</u>
	\$ <u>9,815,567</u>	\$ <u>7,579,409</u>	\$ <u>7,676,688</u>

The total net position of 2015 indicates a positive amount which highlights the achievement of AMI. Whereas the total net position of 2014 and 2013 indicated that the company has been spending more than it has been generating as revenues to finance its operation, this has been made possible by continued government support relating to the importance of the service in the delivery of essential public services to the Marshallese people and communities residing on the outer islands.

In 2015, the Dornier and the Dash 8 continued to experience AOG due to bad airports in the outer islands, and lack of spare parts on shelves (an MEL) that continued to hamper (prevent) a "steady" flying schedule, thus continuing to prevent AMI from earning "consistent" income, or operating revenues (cash flows) that are very much needed to finance the ongoing operation itself.

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During 2015, the Cabinet provided to AMI the following subsidies and capital contributions, for the following purposes below:

	Amount	Date
For Subsidy:		
1. MISSA arrear payment	\$ 75,000	10/28/14
2. Subsidy	100,000	11/12/14
3. Subsidy	15,000	12/04/14
4. MISSA arrear payment	75,000	01/14/15
5. Subsidy	67,480	04/13/15
6. MISSA arrear payment	75,000	04/15/15
7. Subsidy	45,000	04/20/15
8. Subsidy	368,065	04/29/15
9. MISSA arrear payment	75,000	07/20/15
10. Subsidy	40,000	08/19/15
11. Moylan Insurance arrear payment	20,892	09/30/15
12. Moylan Insurance arrear payment	17,093	09/30/15
13. MIDB loan payment	201,229	09/30/15
14. MIDB loan payment	<u>742,144</u>	09/30/15
	<u>1,916,903</u>	
For Capital Contributions:		
1. New Dornier (Airflite)	1,900,000	11/21/14
2. Ground Service Equipment	290,422	11/24/14
3. Rotables (Bombardier)	13,417	12/31/14
4. Rotables (Pacific Turbine)	<u>15,822</u>	09/30/15
	<u>2,219,661</u>	
Grand Total	\$ <u>4,136,564</u>	

As indicated above, the government provided a total subsidy allocation of \$4,136,564 for AMI to meet some of its ongoing major financial obligations such as MISSA arrears (\$300,000), MIDB loan payment (\$943,373), purchase of new Dornier (\$1,900,000), purchase of ground support equipment (\$290,422) and others (\$702,769) in 2015.

The MISSA payment is part of the \$1.4 million owed by AMI to MISSA for past due contributions of employees to the social security program, and as agreed to between MISSA, the government, and AMI back in 2013. The government is to allocate and to provide \$300,000 on an annual basis (or \$75,000 per quarter) as a direct payment to MISSA on behalf of AMI, until the arrears are paid in full.

The Dash 8 has not been making money due to low utilization (averaging less than 25 percent per year since arrival from Australia) resulting from lack of an MEL (minimum equipment list) or lack of spare parts on shelves due to lack of money, and resulting from impact of the bad outer island airport runways, which continue to cause breakdown of the aircraft thus effectively preventing it from generating the income it needs in order to pay off its own loan, and help support the operation.

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The government guaranteed the MIDB loan and started paying it off on behalf of AMI in 2014 with the understanding that as soon as things get better for the company emanating from the foregoing discussion, the company will then start making payments towards the loan. Or the company will have to only turn around and sell the Dash 8, with government approval, in order to pay the loan off, and create an adequate MEL for the Dornier aircraft.

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

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Revenues:			
Net operating revenues	\$ 2,505,761	\$ 2,099,660	\$ 2,361,115
Non-operating revenues	1,916,903	887,901	1,177,040
Capital contributions	<u>2,219,661</u>	<u>311,672</u>	<u>76,767</u>
Total revenues	<u>6,642,325</u>	<u>3,299,233</u>	<u>3,614,922</u>
Expenses:			
Operating expenses	3,351,264	3,332,754	3,394,236
Non-operating expenses	<u>167,274</u>	<u>180,879</u>	<u>79,038</u>
Total expenses	<u>3,518,538</u>	<u>3,513,633</u>	<u>3,473,274</u>
Change in Net Position	\$ <u>3,123,787</u>	\$ <u>(214,400)</u>	\$ <u>141,648</u>

The above identifies the various revenue and expense items that contributed to AMI's change in net position.

The change in net position is the snapshot of the company's financial situation in those years therefore, if it goes up the situation is good, or it is not so good if it goes down.

Management's Discussion and Analysis for the year ended September 30, 2014 is set forth in AMI's report on the audit of financial statements, which is dated July 10, 2015. That Discussion and Analysis explains the major factors impacting the 2014 financial statements and can be obtained from the Company's General Manager at the address below.

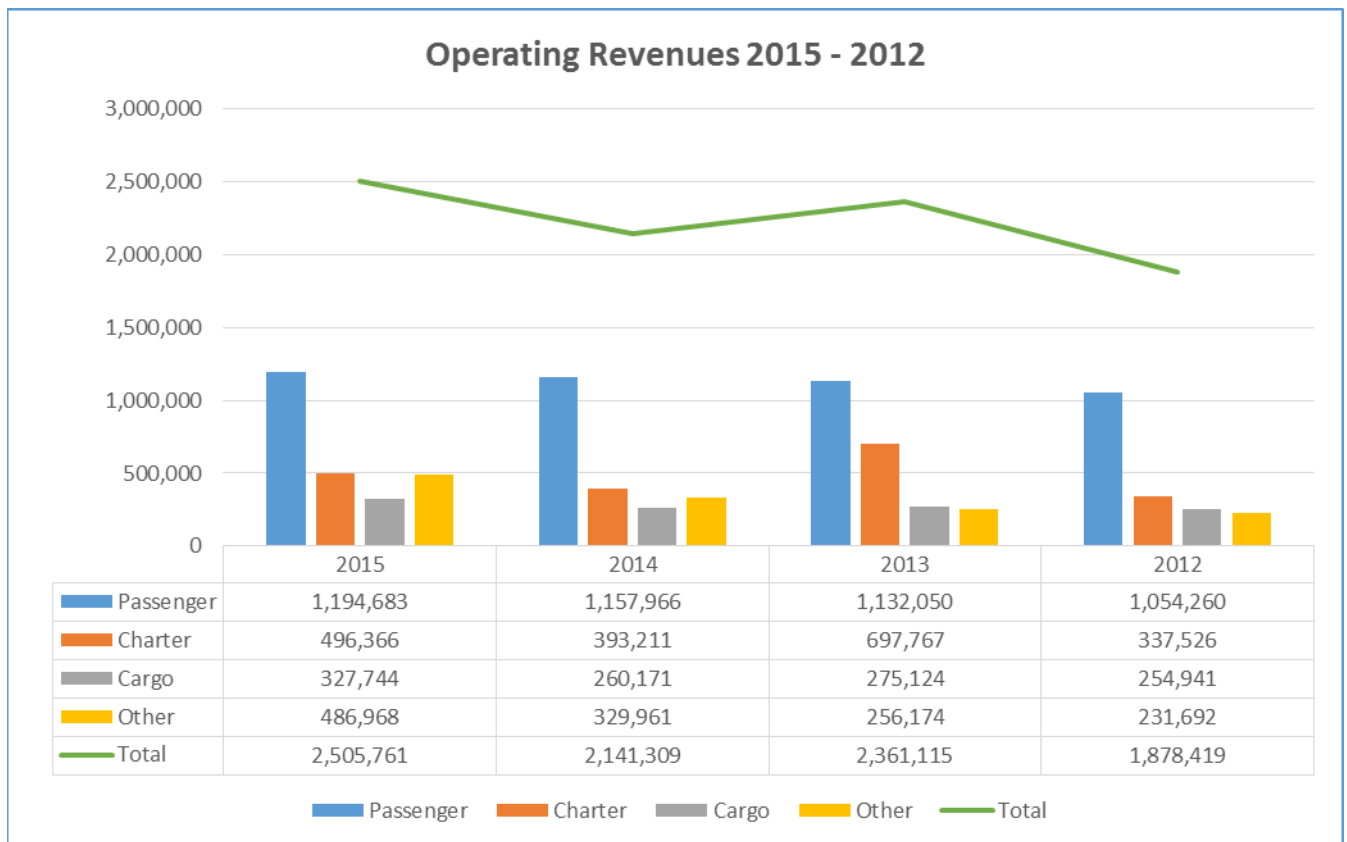
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Management's Discussion and Analysis
 Years Ended September 30, 2015 and 2014

The below graph shows the operating loss of AMI from 2015 through to 2012.



The graph below shows the main components of AMI's operating revenues from 2015 through to 2012.



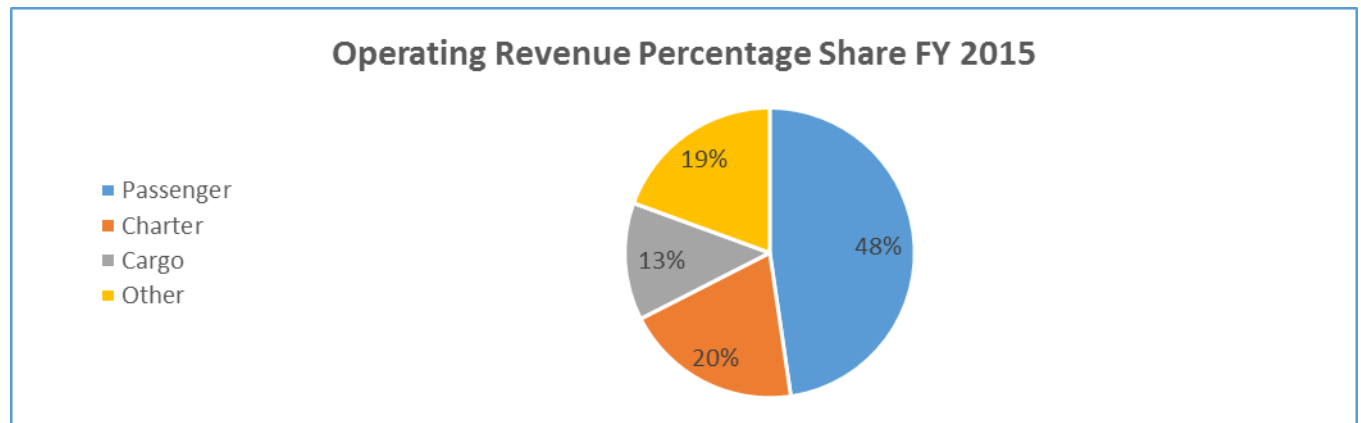
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Management's Discussion and Analysis
 Years Ended September 30, 2015 and 2014

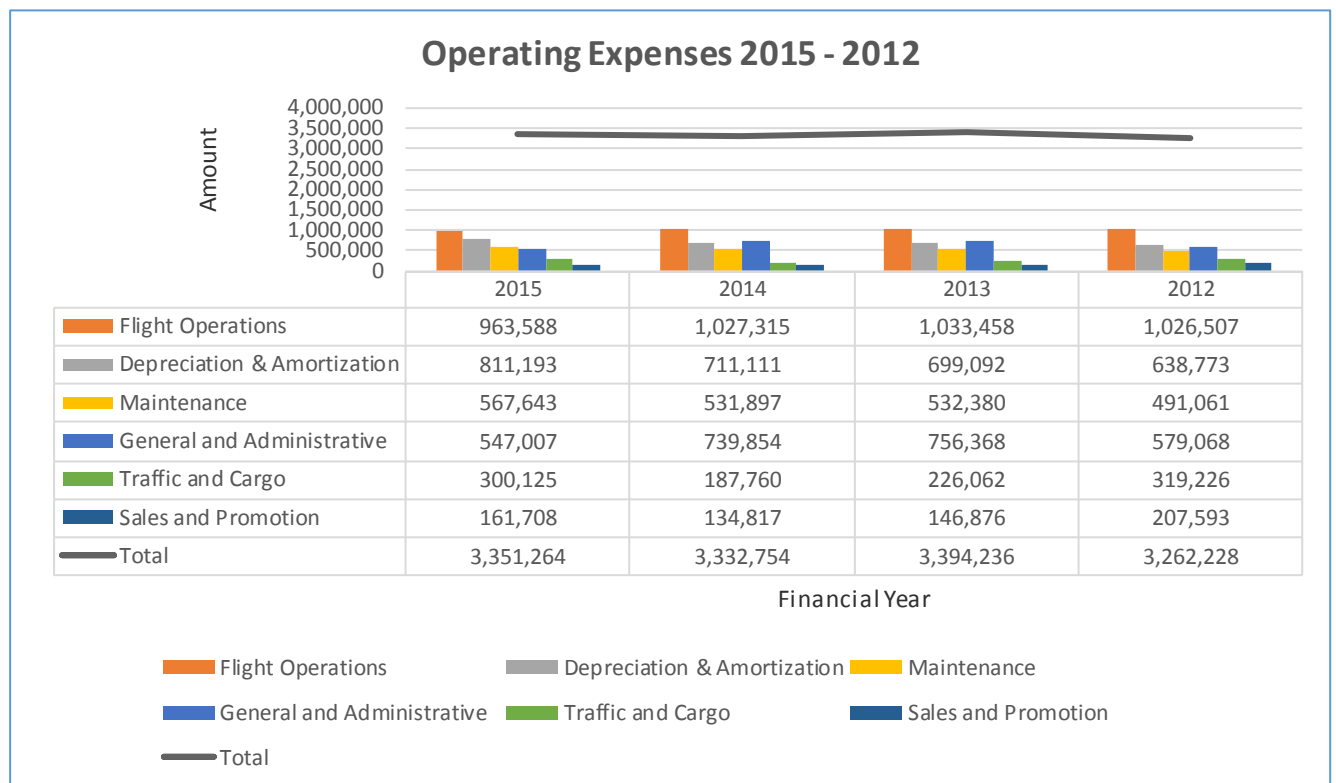
AMI's total operating revenues as indicated above have generally been on an up-and-down trend, with revenues from passengers, or from selling of air-tickets, was the largest source which continued to rise since 2012 due to increase passenger travel.

Charter is the second largest and it jumped almost 100 percent in 2013 simply because of the drought during the year which triggered the need for more charter flights.

Cargo went up in 2015 as compared to 2014, indicating a consistent trend over the years.



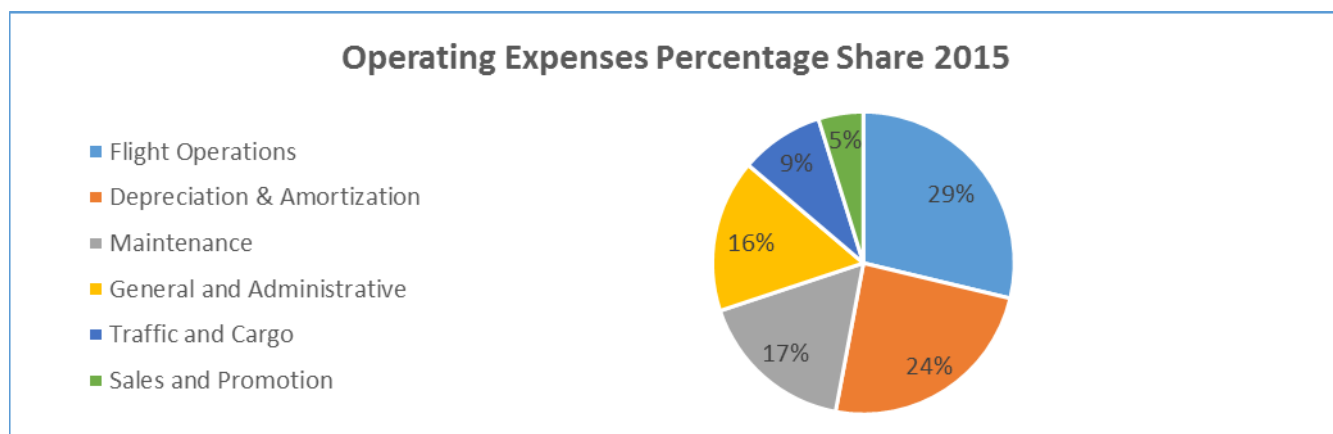
The above pie chart shows the distribution of each operating revenue source as a percentage of total operating revenues in which passenger was 48%, charter 20%, others 19%, and cargo/freight 13%.



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The above diagram shows the AMI's individual operating expenses with flight operation being the largest expense followed by depreciation and amortization, maintenance, general and administration, traffic and cargo and sales and promotion during the 2015 period.



The above pie chart shows major component percentage shares of AMI's total operating expenses in 2015, indicating flight operation with the largest share of 29%, followed by depreciation and amortization 24%, maintenance, 17%, general administration 16%, traffic and cargo servicing 9%; and sales & promotion 5%.

Fuel is an expense that comes under flight operation and being the second largest cost after personnel, therefore the reason flight operation represents the largest share of operating expenses.

CAPITAL ASSETS AND DEBT

AMI's net capital activities for 2015 increased by \$467,865 resulting from purchase of ground support equipment to support ground handling services of Nauru Airlines.

Every year, AMI spent an average of \$200,000 on Rotables spare parts for its two aircraft, although this could be way more depending on the need, but in 2015 the company spent \$339,237 which was more than the \$206,564 spent on the same during 2014.

AMI incurred substantial long-term debt when AMI obtained a \$2.5 million loan from MIDB in May 2013, to pay down the remaining cost of the Dash 8 D-check in Cairns Australia, and the loan's collateral government started making payments in 2014 of \$191,092 and a payment of \$943,373 was made in 2015.

CASH FLOWS

AMI received from its customers \$2,501,868 in 2015 and \$2,090,063 in 2014, in cash, respectively.

During the year ended September 30, 2015, the company turned around and paid its vendors for goods and services and payroll for its employees in the amount \$1,247,980 and \$1,106,314, leaving a cash surplus of \$147,574 from operating activities, whereas in 2014 AMI had a cash deficit from operating activities of \$24,803. Additionally, the operating subsidies from the government in 2015 assisted in operations continuing "business as usual".

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Years Ended September 30, 2015 and 2014

CURRENT ECONOMIC OUTLOOK

The RMI is a small open and highly susceptible economy to world events, coupled with being highly dependent on funding from the US Government through the compact and federal funding.

With operating losses of \$0.85 million and \$1.23 million in 2015 and 2014, respectively, the annual subsidies and contributions from the central government to sustain the service and help keep the airline afloat will continue to be very important for the company in the short to medium-terms. Furthermore, with aging Dornier 228 and the Dash 8 aircraft which were built more than 20 years ago, coupled with the need for better airport runways and adequate MEL, etc., the need for serious action on such will be very important.

CHALLENGES

Outer Island Airstrips

Repair of runways are vital for success of AMI. This will significantly reduce our maintenance costs and broadens aircraft choice since the production of Dornier's has stopped and have become costly to support.

Parts

AOG situations arise because of the lead times in receiving of parts from vendor which is about 6 – 8 weeks from date of payment.

Dornier parts are very expensive and rarely available in the market due to non-production of Dornier aircrafts.

System

The current accounting system (Mas90) is no longer supported by vendor that means we are operating at a very high risk if the server or system fails we lose all the information.

AMI needs an Operations and a new Maintenance system, this will enable us to have e-ticket technology, better understanding of the operations and maintenance of aircraft and timely purchase of parts. Also this will lead to timely, relevant and ad hoc reports being available.

Renovation of hanger

The current hangar needs to be renovated and everyone to be relocated under one roof to enhance communication, monitoring and reduce the travel and rental expenses.

ROLE OF BOARD AND MANAGEMENT

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 change on operation if the following challenges and predicaments to the airline, continue to exist:

1. Deteriorated and dilapidated airport runways and ramps in the outer islands that continue to cause great and costly damages to the aircraft;
2. Insufficient MEL for the aircraft; and

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Years Ended September 30, 2015 and 2014

3. Deteriorating Hangar at the Majuro airport, which is urgently needed to house everyone under one roof, to increase efficiency and economy throughout the whole company which because the offices are so spread out as the Main Office is in Uliga while Maintenance and Spare Parts departments are at the hangar and Flight Operations and Traffic at the main terminal, hindering and efficient communication and timely response to problems between departments whenever they occur.

WAY FORWARD AND FUTURE SUSTAINABILITY

AMI created a strategic Business Plan (BP) which was supposed to be used as a compass to chart the company's future operating course.

In short, the BP's mission statement is two-fold:

- First, we want to transform Air Marshall Islands, Inc 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
- Second, we want to transform Air Marshall Islands, Inc into a financially viable national airline that is capable of taking part in the regional and international air service.

In order to achieve the above, the BP's 6 Rs has been altered to 5 Rs (five goals) as AMI relies on RMI subsidy funding, the 5 Rs must be implemented and these goals are:

- Goal 1: "Rebuild" our financial base;***
- Goal 2: "Reverse" our loss making";***
- Goal 3: "Restore" our service reliability;***
- Goal 4: "Renew" our operation; and***
- Goal 5: "Repair" of outer island airstrips.***

We strongly believe that implementation of these five goals through adequate support of the Cabinet and the Board would enable AMI, in spite of all abovementioned challenges, to achieve each individual goal and once achieved the 6th R – **Restrict reliance on state subsidy** can be implemented.

Therefore, achievement of success will depend very much on an unabated and continuous government support to the national airline (AMI) over the next few years.

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 2015, 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: gm@airmarshallislands.net

AIR MARSHALL ISLANDS, INC.
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Statements of Net Position
September 30, 2015 and 2014

<u>ASSETS</u>	<u>2015</u>	<u>2014</u>
Current assets:		
Cash	\$ <u>94,696</u>	\$ <u>102,750</u>
Receivables:		
Trade	468,047	457,724
Employees	196,557	187,750
Affiliates	<u>65,619</u>	<u>63,410</u>
	730,223	708,884
Less allowance for doubtful receivables	<u>(642,474)</u>	<u>(642,474)</u>
Receivables, net	<u>87,749</u>	<u>66,410</u>
Expendable parts (net of allowance for obsolescence of \$177,789 at September 30, 2015 and 2014)	<u>469,209</u>	<u>470,142</u>
Prepaid expenses and deposits	<u>43,006</u>	<u>41,406</u>
Total current assets	<u>694,660</u>	<u>680,708</u>
Capital assets:		
Nondepreciable capital assets	387,824	-
Depreciable capital assets, net of accumulated depreciation and amortization	6,558,201	6,478,160
Long-term deposits	<u>2,174,882</u>	<u>420,541</u>
	<u>9,120,907</u>	<u>6,898,701</u>
	\$ <u>9,815,567</u>	\$ <u>7,579,409</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Current liabilities:		
Current portion of long-term debt	\$ 919,283	\$ 1,132,367
Accounts payable	217,275	453,281
Social security taxes payable	1,126,541	1,233,118
Withholding taxes payable	542,323	452,197
Air traffic liability	90,410	72,964
Accrued expenses	268,062	300,279
Payable to affiliates	518,788	392,405
Advances from RepMar	<u>3,116,890</u>	<u>3,116,890</u>
Total current liabilities	6,799,572	7,153,501
Long-term debt, net of current portion	<u>947,408</u>	<u>1,481,108</u>
Total liabilities	<u>7,746,980</u>	<u>8,634,609</u>
Commitments and contingencies		
Net position:		
Net investment in capital assets	6,946,025	6,478,160
Unrestricted	<u>(4,877,438)</u>	<u>(7,533,360)</u>
Total net position	<u>2,068,587</u>	<u>(1,055,200)</u>
	\$ <u>9,815,567</u>	\$ <u>7,579,409</u>

See accompanying notes to financial statements.

AIR MARSHALL ISLANDS, INC.
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Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2015 and 2014

	2015	2014
Operating revenues:		
Passenger	\$ 1,194,683	\$ 1,157,966
Cargo	327,744	260,171
Charter	496,366	393,211
Other	486,968	329,961
Total operating revenues	2,505,761	2,141,309
Bad debt expense	-	(41,649)
Net operating revenues	2,505,761	2,099,660
Operating expenses:		
Flight operations	963,588	1,027,315
Depreciation and amortization	811,193	711,111
Maintenance	567,643	531,897
General and administrative	547,007	739,854
Aircraft and traffic servicing	300,125	187,760
Promotion and sales	161,708	134,817
Total operating expenses	3,351,264	3,332,754
Operating loss	(845,503)	(1,233,094)
Nonoperating revenues (expenses):		
RepMar subsidy	1,916,903	887,901
Interest expense	(167,274)	(180,879)
Total nonoperating revenues, net	1,749,629	707,022
Capital contributions from RepMar	2,219,661	311,672
Change in net position	3,123,787	(214,400)
Net position at beginning of year	(1,055,200)	(840,800)
Net position at end of year	\$ 2,068,587	\$ (1,055,200)

See accompanying notes to financial statements.

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Statements of Cash Flows
Years Ended September 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Cash flows from operating activities:		
Cash received from customers	\$ 2,501,868	\$ 2,090,063
Cash payments to suppliers for goods and services	(1,247,980)	(1,096,612)
Cash payments to employees for services	<u>(1,106,314)</u>	<u>(1,018,254)</u>
Net cash provided by (used for) operating activities	<u>147,574</u>	<u>(24,803)</u>
Cash flows from noncapital financing activities:		
Operating subsidy received from RepMar	<u>673,530</u>	<u>396,809</u>
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(1,104,160)	(227,294)
Payment of long-term deposit	-	(134,019)
Capital subsidy received from RepMar	290,422	-
Principal repayments of long-term debt	(4,640)	-
Interest paid	<u>(10,780)</u>	<u>(21,825)</u>
Net cash used for capital and related financing activities	<u>(829,158)</u>	<u>(383,138)</u>
Net change in cash	(8,054)	(11,132)
Cash at beginning of year	<u>102,750</u>	<u>113,882</u>
Cash at end of year	\$ <u><u>94,696</u></u>	\$ <u><u>102,750</u></u>
Reconciliation of operating loss to net cash provided by (used for) operating activities:		
Operating loss	\$ (845,503)	\$ (1,233,094)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	811,193	711,111
Bad debt expense	-	41,649
(Increase) decrease in assets:		
Receivables:		
Trade	(10,323)	(89,968)
Employees	(8,807)	29,256
Affiliates	(2,209)	42,557
Expendable parts	933	15,560
Prepaid expenses and deposits	(1,600)	8,967
Increase (decrease) in liabilities:		
Accounts payable	(236,006)	238,485
Social security taxes payable	193,423	175,067
Withholding taxes payable	90,126	99,412
Air traffic liability	17,446	(33,091)
Accrued expenses	12,518	8,101
Payable to affiliates	<u>126,383</u>	<u>(38,815)</u>
Net cash provided by (used for) operating activities	\$ <u><u>147,574</u></u>	\$ <u><u>(24,803)</u></u>
Summary disclosure of noncash activities:		
RepMar subsidy	\$ 1,243,373	\$ 491,092
Long-term debt	(742,144)	(123,866)
Social security taxes payable	(300,000)	(300,000)
Interest expense	<u>(201,229)</u>	<u>(67,226)</u>
	<u>\$ -</u>	<u>\$ -</u>
Capital contributions from Repmar	\$ 1,929,239	\$ 311,672
Long-term deposits	(1,900,000)	(286,522)
Property and equipment	<u>(29,239)</u>	<u>(25,150)</u>
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements
September 30, 2015 and 2014

(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, 2014, AMI operated a fleet of a single Dornier Do228 aircraft and a single de Havilland Canada Dash 8 (DHC-8) Series 100 aircraft. During AMI's initial operating year, the 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, deferred outflows of resources, liabilities, and deferred inflows of resources 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 position. 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.

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

Notes to Financial Statements
September 30, 2015 and 2014

(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, 2015 and 2014, the carrying amounts of cash were \$94,696 and \$102,750, respectively, and the corresponding bank balances were \$123,892 and \$124,848, respectively. As of September 30, 2015 and 2014, bank balances in the amount of \$110,972 and \$112,175, 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:

	<u>Estimated Useful Lives</u>
Building 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

AIR MARSHALL ISLANDS, INC.
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Notes to Financial Statements
September 30, 2015 and 2014

(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, 2015 and 2014, the accumulated vacation leave liability amounted to \$47,392 and \$51,670, 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.

AIR MARSHALL ISLANDS, INC.
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Notes to Financial Statements
September 30, 2015 and 2014

(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, deferred outflows of resources, liabilities, and deferred inflows of resources 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, 2015, AMI implemented the following pronouncements:

- GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which revise and establish new financial reporting requirements for most governments that provide their employees with pension benefits. The implementation of these statements did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The provisions in Statement 72 are effective for fiscal years beginning after June 15, 2015. Management believes that the implementation of this statement only requires additional disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques and will not have a material effect on the financial statements of AMI.

AIR MARSHALL ISLANDS, INC.
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Notes to Financial Statements
September 30, 2015 and 2014

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The provisions in Statement No. 76 are effective for fiscal years beginning after June 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements of AMI.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. 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.
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Notes to Financial Statements
September 30, 2015 and 2014

(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) Long-Term Deposits

A summary of other assets as of September 30, 2015 and 2014, follows:

	<u>2015</u>	<u>2014</u>
Deposit on acquisition of Dornier 228-212	\$ 2,100,000	\$ 200,000
Deposit on acquisition of rotatable parts	<u>74,882</u>	<u>220,541</u>
	<u>\$ 2,174,882</u>	<u>\$ 420,541</u>

(5) Property and Equipment

Capital asset activities for the years ended September 30, 2015 and 2014, were as follows:

	2015			September 30, 2015
	October 1, 2014	Additions	Retirements/ Transfers	
Aircraft and improvements	\$ 17,981,771	\$ 177,644	\$ -	\$ 18,159,415
Rotable spare parts	5,874,659	339,237	-	6,213,896
Plant and equipment	439,655	301,323	-	740,978
Office furniture and equipment	716,416	9,706	-	726,122
Motor vehicles	205,244	58,758	-	264,002
Building improvements	<u>13,314</u>	<u>4,566</u>	-	<u>17,880</u>
	25,231,059	891,234	-	26,122,293
Less accumulated depreciation and amortization	<u>(18,752,899)</u>	<u>(811,193)</u>	-	<u>(19,564,092)</u>
	6,478,160	80,041	-	6,558,201
Construction in progress	<u>-</u>	<u>387,824</u>	-	<u>387,824</u>
	<u>\$ 6,478,160</u>	<u>\$ 467,865</u>	<u>\$ -</u>	<u>\$ 6,946,025</u>

AIR MARSHALL ISLANDS, INC.
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Notes to Financial Statements
September 30, 2015 and 2014

(5) Property and Equipment, Continued

	2014			September 30, 2014
	October 1, 2013	Additions	Retirements/ Transfers	
Aircraft and improvements	\$ 17,981,771	\$ -	\$ -	\$ 17,981,771
Rotable spare parts	5,668,095	206,564	-	5,874,659
Plant and equipment	439,655	-	-	439,655
Office furniture and equipment	716,416	-	-	716,416
Motor vehicles	159,364	45,880	-	205,244
Building improvements	<u>13,314</u>	<u>-</u>	<u>-</u>	<u>13,314</u>
	24,978,615	252,444	-	25,231,059
Less accumulated depreciation and amortization	<u>(18,041,788)</u>	<u>(711,111)</u>	<u>-</u>	<u>(18,752,899)</u>
	<u>\$ 6,936,827</u>	<u>\$ (458,667)</u>	<u>\$ -</u>	<u>\$ 6,478,160</u>

(6) Long-Term Debt

A schedule of AMI's long-term debt as of September 30, 2015 and 2014, is as follows:

	2015	2014
Note payable to RMI Ports Authority (RMIPA), due on March 30, 2013, interest at 8% per annum, payable in monthly installments of \$11,560, including interest. This note is uncollateralized.	\$ 237,701	\$ 237,341
Note payable to Marshall Islands Development Bank (MIDB), 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.	<u>1,628,990</u>	<u>2,376,134</u>
	<u>\$ 1,866,691</u>	<u>\$ 2,613,475</u>

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

Notes to Financial Statements
September 30, 2015 and 2014

(6) Long-Term Debt, Continued

Future repayment commitments are as follows:

<u>Year Ending September 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 919,283	\$ 233,847	\$ 1,153,130
2017	568,940	44,213	613,153
2018	<u>378,468</u>	<u>8,756</u>	<u>387,224</u>
	<u>\$ 1,866,691</u>	<u>\$ 286,816</u>	<u>\$ 2,153,507</u>

Changes in long-term liabilities for the year ended September 30, 2015, were as follows:

	Balance October 1, <u>2014</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2015</u>	Due Within <u>One Year</u>
Notes payable:					
RMIPA	\$ 237,341	\$ -	\$ 360	\$ 237,701	\$ 237,701
MIDB	<u>2,376,134</u>	-	<u>(747,144)</u>	<u>1,628,990</u>	<u>681,582</u>
	<u>\$ 2,613,475</u>	\$ -	<u>\$ (746,784)</u>	<u>\$ 1,866,691</u>	<u>\$ 919,283</u>

Changes in long-term liabilities for the year ended September 30, 2014, were as follows:

	Balance October 1, <u>2013</u>	<u>Additions</u>	<u>Reductions</u>	Balance September <u>30, 2014</u>	Due Within <u>One Year</u>
Notes payable:					
RMIPA	\$ 237,341	\$ -	\$ -	\$ 237,341	\$ 237,341
MIDB	<u>2,500,000</u>	-	<u>(123,866)</u>	<u>2,376,134</u>	<u>895,026</u>
	<u>\$ 2,737,341</u>	\$ -	<u>\$ (123,866)</u>	<u>\$ 2,613,475</u>	<u>\$ 1,132,367</u>

(7) 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.
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Notes to Financial Statements
September 30, 2015 and 2014

(7) Related Party Transactions, Continued

During the years ended September 30, 2015 and 2014, AMI received cash operating subsidies from RepMar of \$673,530 and \$396,809, respectively, as well as non-cash operating subsidies of \$1,243,373 and \$491,092, respectively. Non-cash operating subsidies represent payments made by RepMar on behalf of AMI for debt settlement on loan payable to MIDB of \$943,373 and \$191,092, respectively, and delinquent contributions to MISSA of \$300,000 and \$300,000, respectively.

On August 19, 2014, AMI entered into a purchase agreement to acquire a used Dornier 228-212 at a purchase price of \$2,100,000. On September 2, 2014, RepMar paid \$200,000 on behalf of AMI in accordance with the purchase agreement. The remaining \$1,900,000 was paid by RepMar on behalf of AMI during the year ended September 30, 2015. In addition, RepMar provided AMI with capital subsidies of \$391,661 and \$111,672, respectively, during the years ended September 30, 2015 and 2014. Of these amounts, RepMar made payments of \$29,239 and \$111,672, respectively, to vendors on behalf of AMI.

A summary of related party transactions as and for the years ended September 30, 2015 and 2014, is as follows:

	2015			
	<u>Receivables</u>	<u>Revenues</u>	<u>Payables</u>	<u>Expenses</u>
RepMar	\$ 41,512	\$ 461,479	\$ 37,698	\$ 20,774
RMIPA	-	-	472,283	36,206
Marshall Islands National Telecommunications Authority	-	2,199	2,854	32,840
Marshalls Energy Company, Inc.	-	104	2,704	35,567
Other	<u>24,107</u>	<u>-</u>	<u>3,249</u>	<u>3,410</u>
	65,619	\$ <u>463,782</u>	\$ <u>518,788</u>	\$ <u>128,797</u>
Less allowance for doubtful receivables	<u>(53,820)</u>			
	<u>\$ 11,799</u>			
	2014			
	<u>Receivables</u>	<u>Revenues</u>	<u>Payables</u>	<u>Expenses</u>
RepMar	\$ 46,380	\$ 322,670	\$ 53,414	\$ 8,107
RMIPA	-	-	319,402	-
Marshall Islands National Telecommunications Authority	-	-	6,419	31,089
Marshalls Energy Company, Inc.	-	-	11,918	55,468
Other	<u>17,030</u>	<u>8,713</u>	<u>1,252</u>	<u>15,000</u>
	63,410	\$ <u>331,383</u>	\$ <u>392,405</u>	\$ <u>109,664</u>
Less allowance for doubtful receivables	<u>(42,766)</u>			
	<u>\$ 20,644</u>			

AIR MARSHALL ISLANDS, INC.
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Notes to Financial Statements
September 30, 2015 and 2014

(7) Related Party Transactions, Continued

A summary of advances from RepMar as of September 30, 2015 and 2014, follows:

	<u>2015</u>	<u>2014</u>
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.	<u>128,316</u>	<u>128,316</u>
	<u>\$ 3,116,890</u>	<u>\$ 3,116,890</u>

At September 30, 2015 and 2014, AMI is liable for payroll taxes, totaling \$542,323 and \$452,197, respectively. Payroll taxes for 2015 and 2014 exclude related penalties and interest.

At September 30, 2015 and 2014, AMI is liable to the Marshall Islands Social Security Administration (MISSA) for certain delinquent employee and employer contributions, totaling \$1,126,541 and \$1,233,118, 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. During the years ended September 30, 2015 and 2014, RepMar made payments to MISSA on behalf of AMI of \$300,000 associated with this court judgment.

During the years ended September 30, 2015 and 2014, AMI purchased plant and equipment, motor vehicles and training services in the amount of \$385,263 and \$20,256, respectively, from a related party.

(8) 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, 2015, AMI has not been repaid the pre-delivery payments and has recorded a provision for uncollectible advances of \$2,100,000.

AIR MARSHALL ISLANDS, INC.
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Notes to Financial Statements
September 30, 2015 and 2014

(8) Commitments and Contingencies, Continued

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 operating losses during the years ended September 30, 2015 and 2014 of \$845,503 and \$1,233,094, respectively, and used a substantial amount of working capital in its operations resulting in a working capital deficiency of \$6,104,912 at September 30, 2015. 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, 2015, 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.

(9) Subsequent Events

On December 3, 2015, the High Court entered an additional judgment in favor of MISSA against AMI for \$367,836 (inclusive of penalties, court costs and attorney's fees) for non-payment of delinquent employee and employer contributions.

On December 1, 2015, the Dornier 228-212 arrived in Majuro and commenced operations on December 10, 2015.

**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 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, 2015, and the 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 August 11, 2016. Our report was qualified for the inadequacy of accounting records over expendable parts and included an emphasis-of-matter paragraph regarding 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.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items 2015-001 through 2015-004, that we consider to be material weaknesses.

Compliance and Other Matters

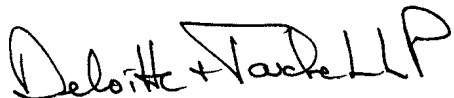
As part of obtaining reasonable assurance about whether AMI's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2015-005 through 2015-007.

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.

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

August 11, 2016

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

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No. 2015-001

Reconciliation of Balances

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

Condition: We noted unlocated difference amounting to \$77,820 presented under reconciliation report of AP-system.

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 review.

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 through 2014.

Auditee Response and Corrective Action Plan: Management agrees with the finding as stated in the FY2015 audit, and the CFO is looking into the respective ongoing finding. The unreconciled differences have accumulated over the years and this would need time to reconcile.

The corrective action plan will be to implement a new accounting and inventory system as the current MAS90 is no longer supported by the vendor, limited usage and most of the options in the respective modules are disabled as the renewal subscriptions has not been paid for a long time and the system has been used offline.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-002

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:

Of twelve items tested, the following exceptions were noted:

<u>Item #</u>	<u>Part #</u>	<u>Quantity per Audit at 9/30/15</u>	<u>Quantity per Valuation Report at 9/30/15</u>	<u>Unit Cost</u>	<u>Difference</u>
1	119003-01	0	3	\$1,050	\$3,150

Furthermore, we noted the following unit cost exceptions:

<u>Item #</u>	<u>Part #</u>	<u>Valuation Reports</u>		<u>Unit Cost per Audit</u>	<u>Difference Over (Under)</u>	
		<u>Quantity</u>	<u>Unit Cost</u>		<u>Unit Cost</u>	<u>Extended Amount</u>
1	3103235-11	20	\$ 826.00	\$ 82.60	\$ 743.40	\$ 14,868.00
2	RA18-4	75	41.45	0.41	41.04	3,077.66
3	A-531000B14W	1	3,826.16	8,193.00	(4,366.84)	(4,366.84)

The above items were incorrectly valued based on the latest transaction, because of a misapplication of unit cost, or because of an error in entering unit costs in the valuation report.

Cause: It appears that there is lack of a review of inventory valuation reports that resulted in erroneous movements which 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 a 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 2014.

Auditee Response and Corrective Action Plan: Management agrees with the finding as stated in the FY2015 audit, and the CFO is looking into the respective ongoing finding. An error was made by the stock clerk whilst entering unit costs in the valuation report and the stock clerk has been cautioned on his roles and responsibilities.

The corrective action plan will be to implement an inventory system that can be centralized where accounting department has constant access to inventory records.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-003

Revenue

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

Condition:

1. Of fifty-seven passenger tickets tested, we noted the following:

Collections for the following tickets were not timely deposited:

<u>Ticket Number</u>	<u>Fare Sales Report</u>	<u>Payment Date/ Invoice Date</u>	<u>Deposit Date</u>	<u>No. of Working Days Delayed</u>
42002531841	\$ 153	11/06/2014	12/29/2014	35
42002745713	297	01/16/2015	01/20/2015	2
5500252086	255	01/21/2015	01/23/2015	2
42002532530	209	01/06/2015	01/23/2015	13
42002545631	128	01/27/2015	01/30/2015	3
42002534991	152	01/13/2015	01/16/2015	3
42002539283	193	02/05/2015	02/11/2015	4
42002546143	148	02/03/2015	02/06/2015	3
42002546246	148	02/10/2015	02/18/2015	6
42002555000	256	05/13/2015	05/18/2015	3
42002570831	128	05/19/2015	05/21/2015	2
42002586356	418	07/08/2015	07/14/2015	4
42002576626	209	06/23/2015	06/26/2015	3
42002557332	156	06/13/2015	06/19/2015	5
44000514563	17	09/16/2015	09/18/2015	2
44000532936	160	09/24/2015	09/28/2015	2
44000518682	271	08/21/2015	08/27/2015	4

2. Of nine freight tickets tested, we noted the following:

- a. Two evidenced an error in the computation of the amount charged resulting in an \$80 overstatement.

- b. Proceeds for the following freight tickets were not timely deposited:

<u>Airway Bill Number</u>	<u>Airway Bill Amount</u>	<u>Date Collected</u>	<u>Date Deposited</u>	<u>No. of Working Days Delayed</u>
104729	1,080.00	10/21/2014	10/23/2014	2
105484	79.40	12/04/2014	12/08/2014	2
105870	117.50	12/29/2014	01/02/2015	2
106398	340.00	01/16/2015	01/23/2015	5
106617	263.00	02/02/2015	02/05/2015	3

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-003, Continued

Revenue, Continued

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

a. Five cash sale tickets were not timely deposited.

<u>Ticket Number</u>	<u>Amount</u>	<u>Date Collected</u>	<u>Date Deposited</u>	<u>No. of Working Days Delayed</u>
34402	\$ 132.00	10/21/2014	10/23/2014	2
35108	234.30	12/04/2014	12/08/2014	4
37035	331.20	09/19/2015	09/22/2015	2
34957	1,987.70	01/03/2015	01/06/2015	2
35532	214.80	06/23/2015	06/29/2015	4

4. Of 23 charter flights tested, we noted the following:

a. The following collections were not timely deposited:

<u>Receipt Number</u>	<u>Amount</u>	<u>Date Collected</u>	<u>Date Deposited</u>	<u>No. of Working Days Delayed</u>
93730	\$ 9,300.00	11/14/2014	11/18/2014	2
94843	9,760.00	05/12/2015	05/14/2015	2

b. One flight request form revealed an error in the computation of the amount charged resulting in a \$450 overstatement.

c. Nine flight request forms revealed errors and inconsistencies in block time computations resulting in a \$10,270 net overstatement.

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 audits of AMI for fiscal years 2013 and 2014.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-003, Continued

Revenue, Continued

Auditee Response and Corrective Action Plan: Management agrees with the finding as stated in the FY2015 audit, and the CFO is looking into the respective ongoing finding. Timely deposit is an issue faced by AMI as tickets are sold at Downtown Office, Airport Office and Outer Islands, sales of Outer Islands are an issue since trips to respective islands are once a week which does cause delay in deposits. The errors and inconsistencies in block time computations will be closely looked into.

The corrective action plan for the block time, CFO to verify the computations with the Sales, Reservation & Route Manager and for timely deposit no easy solution can be implemented at this time.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-004

Purchase of Dornier 228-212

Criteria: Asset appraisals or valuations should be performed in the determination of the appropriateness of capital asset acquisition.

Condition: An independent asset appraisal or valuation associated with the purchase of the Dornier 228-212 at a cost of \$2,100,000 did not appear to occur.

Cause: The cause of the above condition is the lack of an apparent independent asset appraisal or valuation associated with the purchase of the Dornier 228-212.

Effect: The effect of the above condition is potential noncompliance with RepMar procurement laws and regulations.

Recommendation: We recommend that management consider an independent appraisal or valuation performed of the Dornier 228-212 in order to ascertain the appropriateness of the aircraft's purchase price.

Prior Year Status: Recommendation concerning management to have an independent appraisal or valuation performed of the Dornier 228-212 in order to ascertain the appropriateness of the aircraft's purchase price was reported as a finding in the audit of AMI for fiscal year 2014.

Auditee Response and Corrective Action Plan: Management's response to FY2014 audit report stated that the decision to purchase the aircraft came from the government so management kindly refers this to the board of directors, the chairman and the cabinet.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-005

Local Noncompliance

Criteria: 48 MIRC Chapter 1, Income Tax Act of 1989, Section 105, states that the employer shall once every four (4) weeks or thirteen times per year, pay taxes withheld under Section 104 under Chapter 1. The employer shall, along with the taxes, within two (2) weeks following the preceding four (4) week period make a full, true and correct return showing all wages and salaries paid by the employer to the employees during the preceding four (4) week period and showing the tax due and withheld thereon as provided in Section 104 of the Chapter.

Condition: AMI filed and paid income taxes withheld for the year ended September 30, 2015 in a manner inconsistent with the criteria. Specifically, withholding taxes in the amount of \$108,107 for the year ended September 30, 2015 were not timely remitted. In addition, income taxes withheld in the amount of \$452,197 for PPE 1/20/09 through 9/24/14 have not been paid.

Cause: The cause of the above condition is the lack of policies and procedures to monitor timely filing of returns and payment of withheld income taxes.

Effect: The effect of the above condition is noncompliance with RepMar Income Tax Act of 1989, as amended.

Recommendation: We recommend that management establish policies and procedures to comply with the RepMar Income Tax Act of 1989, as amended.

Prior Year Status: Recommendation concerning management establish policies and procedures to comply with the RepMar Income Tax Act of 1989, as amended, was reported as a finding in the audit of AMI for fiscal year 2014.

Auditee Response and Corrective Action Plan: Management's response to FY2014 audit report stated management does agree with the finding and indicates that AMI and Division of Revenue and Taxation have entered into an agreement and AMI is complying with the agreed.

The corrective action plan is to ensure that AMI files the withholding taxes as per RepMar Income Tax Act of 1989 and the payroll supervisor has been reminded on the required.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-006

Local Noncompliance

Criteria: Sections 131 and 215 of the RepMar Social Security Act of 1990 and the Social Security Health Fund Act of 1991, respectively, state that no later than the tenth day after the end of each quarter, every employer shall submit to the Social Security Administrator a report of the wages and salaries paid by the employer, and the contributions due from the employer, under Sections 129 and 130, 213 and 214, respectively, and pay into the Fund the contributions due.

Condition: AMI filed and paid social security contributions for the year ended September 30, 2015 in a manner inconsistent with the criteria. Specifically, employee and employer contributions for the year ended September 30, 2015 were not timely remitted and/or paid as follows:

<u>Quarter Ended</u>	<u>Date Filed</u>	<u>Tax Due</u>	<u>Penalties Interest Due</u>	<u>Amount Paid</u>	<u>Amount Unpaid</u>
9/30/2014	10/27/2014	\$ 43,132	\$ 3,811	\$ 36,500	\$ 10,443
12/31/2014	1/21/2015	42,090	3,688	-	45,778
3/31/2015	4/9/2015	41,916	2,462	-	44,378
6/30/15	9/1/2015	41,916	1,206	-	43,122
9/30/2015	10/13/2015	<u>48,142</u>	<u>-</u>	<u>-</u>	<u>48,142</u>
		<u>\$ 217,196</u>	<u>\$ 11,167</u>	<u>\$ 36,500</u>	<u>\$ 191,863</u>

Cause: The cause of the above condition is the lack of policies and procedures to monitor timely filing of returns and payment of social security taxes.

Effect: The effect of the above condition is noncompliance with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991.

Recommendation: We recommend that management comply with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991.

Auditee Response and Corrective Action Plan: Management agrees with the finding as stated in the FY2015 audit and indicate that AMI and MISSA have entered into an agreement and AMI is complying with the agreed.

The corrective action plan is to ensure that AMI files social security contributions as per RepMar Social Security Act of 1990 and the payroll supervisor has been reminded on the required.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-7

Local Noncompliance

Criteria: RepMar's Procurement Code states the following:

- (a) Section 124 – unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.
- (b) Section 127 – procurement of goods and services not exceeding \$25,000 may be made in accordance with small purchase procedures promulgated by RepMar's Policy Office. Small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000. RepMar's Ministry of Finance has previously declared that if small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.
- (c) Section 128 – a contract may be awarded for supply, service, or construction item without completion when it is determined in writing that there is only one source for the required supply, service, or construction item.

Condition: AMI does not have a formal procurement policy requiring documentation indicating the history of procurement to be maintained on file. For the following items, supporting documentation was inadequate to evidence the procurement process:

<u>Check # / Wire #</u>	<u>Date</u>	<u>Amount</u>
053849/053506	01/31/15	\$ 3,600
054337/054199	08/26/15	\$ 2,214
054337/054199	10/06/15	\$ 4,539

In addition, the following exceptions were noted:

- (a) No price quotations or ticket cost comparison related to airline tickets (check # 053181) for two passengers from Majuro to Nepal amounting to \$20,558.
- (b) Competitive sealed bidding was not performed in relation to contracts awarded to a related party (check #s 053216 and 053665) amounting to \$292,789 and \$29,088, respectively.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures requiring documentation of procurement procedures to support compliance with RepMar's Procurement Code.

Effect: The effect of the above condition is noncompliance with RepMar's Procurement Code.

Recommendation: We recommend that management establish adequate internal control policies and procedures to conform with RepMar's Procurement Code.

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

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-7, Continued

Local Noncompliance, Continued

Auditee Response and Corrective Action Plan:

Management agrees with most of the findings stated in the FY2015 audit, with exceptions as explained in the following:

- (a) Due to only one travel agency on the Island that is Pacific Unique Travel (PUT), ticket cost comparison is a challenge to achieve, AMI at times does purchase tickets via credit card whilst comparing cost with PUT and in the mentioned case the amount exceeded the credit card limit of \$20,000.
- (b) Management of AMI kindly refers this to the board of directors and the chairman since it was a decision made by the board of AMI.

AIR MARSHALL ISLANDS, INC.

Unresolved Prior Years' Findings
Year Ended September 30, 2015

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