

MAJURO RESORT, INC.

INDEPENDENT AUDITORS' REPORT ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED DECEMBER 31, 2002



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
BASED UPON THE AUDIT PERFORMED IN ACCORDANCE  
WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors  
Majuro Resort, Inc.:

We have audited the financial statements of Majuro Resort, Inc. (MRI) for the year ended December 31, 2002, and have issued our report thereon dated January 31, 2003. We conducted our audit 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.

Compliance

As part of obtaining reasonable assurance about whether MRI's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings (pages 3 through 6) as items 2002-1 through 2002-3.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered MRI's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted one matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect MRI's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Findings as item 2002-4.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not consider the reportable condition described above to be a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to management in a separate letter dated January 31, 2003.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte & Touche*

January 31, 2003

MAJURO RESORT, INC.

Schedule of Findings  
Year Ended December 31, 2002

Local Noncompliance

Finding No. 2002-1

Criteria: Section 5 of the Republic of the Marshall Islands (RepMar) Income Tax Act of 1989, as amended, states that the employer shall, once every four weeks or thirteen times per year, pay taxes withheld under Section 4 of the Act.

Condition: At December 31, 2002, MRI owed RepMar \$43,960 in income tax withholdings from employee wages. Of this amount, approximately \$33,707 is represented by income tax withheld from employee wages for the period from January 2001 through August 2001.

Cause: The cause of the above condition is unknown.

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

Recommendation: We recommend that management comply with the Income Tax Act of 1989, as amended.

Prior Year Status: Noncompliance with the Income Tax Act of 1989, as amended, was reported as a finding in the audits of MRI for fiscal years 1998 through 2001.

Auditee Response and Corrective Action Plan: We agree with amounts provided, and the following action has been implemented to address this amount. On December 10, 2002, balance of 1999 and all taxation for year 2000 were paid, a total amount of \$60,356.81. The hotel entered into a verbal agreement for payment of taxation for period from January 2001 to August 2001 to be paid monthly in installments with current taxes. The back tax will be cleared by August 2003.

MAJURO RESORT, INC.

Schedule of Findings, Continued  
Year Ended December 31, 2002

Local Noncompliance

Finding No. 2002-2

Criteria: Section 153 of the Republic of the Marshall Islands (RepMar) Income Tax Act of 1989, as amended, states that there shall be assessed a tax of eight percent of the daily room rate on hotel and resort facilities in the Marshall Islands. The tax shall be collected by the owner of the room and forwarded to RepMar on a monthly basis.

Condition: At December 31, 2002, MRI owed RepMar \$330,639 in hotel tax. This amount is represented by unpaid RepMar hotel tax for the months of July 1999 through December 2002.

Cause: The cause of the above condition is unknown.

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

Recommendation: We recommend that management comply with the Income Tax Act of 1989, as amended.

Prior Year Status: Noncompliance with the Income Tax Act of 1989, as amended, was reported as a finding in the audits of MRI for fiscal years 1998 through 2001.

Auditee Response and Corrective Action Plan: OMR management will formally request receiving this amount as a subsidy for FY2003, which will offset the taxation payment. As OMR has not generated sufficient funds to meet all of its financial obligations, the owners need to issue a subsidy, which would assist the hotel meets its financial obligations. This is commensurate with the 2001 audit response. We will also request that the hotel be given an exemption from this tax for five (5) years beginning January 1, 2003.

MAJURO RESORT, INC.

Schedule of Findings, Continued  
Year Ended December 31, 2002

Local Noncompliance

Finding No. 2002-3

Criteria: The Republic of the Marshall Islands (RepMar) Income Tax Act of 1989, as amended by the Income Tax (Amendment) Act of 1991, states that there shall be assessed a tax of three percent of the gross revenues earned by every business operating in the Marshall Islands. The tax is due on or before the last day of the month following the close of each calendar year quarter. MRI was granted an exemption from this tax for a period of five years from commencement of its business operations. This exemption terminated in August 2001.

Condition: At December 31, 2002, MRI owed RepMar \$112,517 in gross receipts tax. This amount is represented by unpaid RepMar gross receipts tax for the months of August 2001 through December 2002.

Cause: The cause of the above condition is unknown.

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

Recommendation: We recommend that management comply with the Income Tax Act of 1989, as amended.

Auditee Response and Corrective Action Plan: The hotel was exempt for five (5) years from this tax. As OMR has not generated sufficient funds to meet all of its financial obligations, and the owners have not issued a subsidy, we will formally request that this amount be considered a subsidy and request an exemption from such tax for another five years beginning January 2003.

MAJURO RESORT, INC.

Schedule of Findings, Continued  
Year Ended December 31, 2002

Revenue/Cash Receipts

Finding No. 2002-4

Criteria: An effective system of internal control includes policies and procedures to ensure that food and beverage sales are properly recorded.

Condition: Of twenty-five food and beverage sales tickets tested (amounting to \$46,114), an audit trail from the food and beverage reconciliation worksheet, prepared by the night auditor, to the general ledger could not be determined for fifteen sales tickets. The fifteen items include tickets selected from the following dates: January 9, 23, 26 and 28; April 4 and 18; May 14; June 13; July 16 and 20; August 7; September 9 and 21; October 16; and December 6, all in calendar year 2002. Variances between the food and beverage reconciliation worksheet and the general ledger were not properly identified and summarized on the reconciliation worksheet.

Cause: The cause of the above condition is an incomplete audit trail of daily sales tickets to the food and beverage reconciliation worksheet, and to the general ledger, and the lack of proper supervision over the compilation of sales tickets to the food and beverage reconciliation worksheet.

Effect: The effect of the above condition is the loss of a proper audit trail.

Recommendation: We recommend that management implement appropriate policies and procedures for proper compilation and review of recording sales tickets to the food and beverage reconciliation worksheet.

Auditee Response and Corrective Action Plan: Management took corrective action in late December to address this issue. The actions include:

- Daily checking of all dockets issued against meals served and posted to F&B reconciliation worksheet
- Follow-up of missing, voided and non sequential docket numbers
- Approval of voided dockets by approved management personnel
- Daily reviews of voided dockets
- Disciplinary procedures for non adherence to these policies in both Marshallese and English

MAJURO RESORT, INC.

Unresolved Prior Year Comments  
Year Ended December 31, 2002

The status of unresolved prior year findings are disclosed within the Schedule of Findings section (pages 3 through 6) of this report.