

May 12, 2009

Mr. William Weza  
General Manager  
Majuro Resort, Inc. dba Marshall Islands Resort  
P.O. Box 3279  
Majuro, MH 96960

Dear Mr. Weza:

In planning and performing our audit of the financial statements of Majuro Resort, Inc. (MRI) as of and for the year ended September 30, 2008 (on which we have issued our report dated May 12, 2009), 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, we considered MRI's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MRI's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MRI's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to MRI's internal control over financial reporting and other matters as of September 30, 2008 that we wish to bring to your attention.

MRI's responses to the deficiencies identified in our audit are described in the accompanying Appendix I. We did not audit MRI's responses and, accordingly, we express no opinion on them.

We have also issued a separate report to the Board of Directors, also dated May 12, 2009, on our consideration of MRI'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 definition of a deficiency is also set forth in the attached Appendix I.

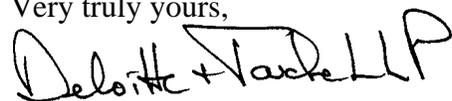
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of the management, others within the organization, and the Office of the Auditor-General and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of MRI for their cooperation and assistance during the course of this engagement.

Very truly yours,



## SECTION I – CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving MRI's internal control over financial reporting as of September 30, 2008 that we wish to bring to your attention:

### 1. Cash in Bank

Observation: One bank cash account includes \$4,170 of prior year credit card collections that have not yet cleared the bank.

Recommendation: We recommend that management timely monitor all reconciling items to identify and resolve long-outstanding items which have not yet cleared the bank.

Auditee Response: This long outstanding credit card receivable is still unresolved to date. The unsettled credit card sales of \$4,170 resulted during the prior period when the direct settlement facility through Bank of Marshall Islands (BOMI) was terminated. The unpaid amounts were properly communicated to BOMI and all supporting documents have been forwarded to support the claim. The amount of \$4,170 is fully covered with allowance for doubtful accounts. Management will consider write-off of the account after seeking approval from the Executive Management.

### 2. Housebanks

Observation: In verification of the housebanks account, we noted the following:

- a. Cash count documents for the cash count performed on September 30, 2008 were not available.
- b. In 2008, the housebanks cash balance was short by \$870 and \$569 of which was directly charged to earnings.

Recommendation: We recommend that all cash count documentation be fully accounted for and be kept on file to support recorded housebank balances. Further, to better establish cash accountability, management should implement stricter access to the cash register such that only cashiers logged into the system have access. Also, a more stringent policy on cash shortages may be necessary as this appears to be a recurring matter.

Auditee Response: There have been surprise cash counts performed on a regular basis and the results of the counts have been documented. However, the cash count documents for September 30, 2008 were not available. The documents for the cash count conducted on October 28, 2008 were used as the basis in recording the change in housebank balances. We have discussed this with our General Cashier and we will ensure that all documents are kept on file intact and in order. On the other hand, the cash count performed in 2008 revealed an actual shortage of \$870 of which \$301 was charged to employees who were found to be accountable, and the remaining \$569 was charged to earnings as the reason for shortage has not been determined at the time of recording. Further investigation is needed in order to properly account for the shortage.

### 3. Credit Card Charges

Observation: In verification of other receivables, we noted the following:

- a. Prior year credit card finance charges of \$10,267 are recorded and charged to current year earnings.

**SECTION I – CONTROL DEFICIENCIES, Continued**

- b. Unrecorded prior year credit card purchases of \$7,285 are recorded and charged to current year earnings.
- c. An estimated \$3,280 credit card payable is unaccounted for as of September 30, 2008.

Recommendation: We recommend that management perform timely reconciliations of credit card purchases and charges. To effectively monitor outstanding payables, we recommend that management consider making direct payments to the credit card institution rather than to the individual who is holding the card.

Auditee Response: The lack of documents to support the credit card purchases and charges in prior years has caused the delay in recording the transactions in the General Ledger.

4. Allowance for Doubtful Accounts

Observation: An allowance analysis is not periodically performed. Further, approximately 84% of September 30, 2008 receivables are greater than ninety days old.

Recommendation: We recommend that management periodically monitor the aging of accounts receivable to ensure that an appropriate allowance is recorded.

Auditee Response: Collection of receivables has been very challenging as outstanding accounts are mainly from the government and government-related agencies in which we are experiencing a slow turnover over the past years. We are continually in search for ways to improve our collection efforts. We have currently designated a special collector to assist in the collection of receivables particularly those long outstanding delinquent accounts. Moreover, our aging of accounts receivables is a useful device for reviewing the condition of the accounts. As of September 30, 2008, we have an Allowance for Doubtful Accounts of \$120,001 which we believe is adequate to absorb currently estimated bad debts in the account balance.

5. Fixed Assets

Observation: Fixed assets are not tagged and inventoried. Also, purchases of assets occurred in the current year to replace existing assets; however, no corresponding disposal was recorded. There is no current process whereby the accounting department is notified of disposals. Furthermore, there is no documentation or procedure in place to document that assets have been received and have been placed in use. This is also a prior year comment.

Recommendation: We recommend that fixed assets be tagged and inventoried. Disposals should be approved, documented and recorded. Documentation to evidence that assets are received and in place should be available for review.

Auditee Response: A physical property count was not performed since the opening of the Hotel. Further, our capital assets are also not tagged. The cost and benefit to conduct property count will be properly considered. Certain capital equipments were purchased during the year to replace damaged equipments due to wear and tear. The net book values of these assets were zero at the time of replacement and we opted not to relieve the cost and accumulated depreciation in the Lapsing Schedule for future reference. But we properly considered to adhere to the appropriate accounting standards. All newly acquired capital equipments are immediately put into use. Thus, the need to document the use of these assets is deemed not necessary.

**SECTION I – CONTROL DEFICIENCIES, Continued**

6. Reconciliation between Subsidiary Ledger and General Ledger

Observation: A difference of \$2,234, \$3,101 and \$2,868, respectively, was noted between the AR Direct Bill, AR Houseguest, and AR City subsidiary ledgers and general ledger accounts; while a difference of \$16,978 was noted between the AP trade subsidiary ledger and the general ledger. The difference was discussed with the Financial Controller, who indicated that the differences may be due to timing differences.

Recommendation: We recommend that reconciliations between the general ledger and subsidiary ledger be performed every month-end to ensure that differences are timely resolved.

Auditee Response: Based on our review of the variances, the differences between the Subsidiary Ledger and the General Ledger is due to timing differences in posting collections or payments and adjustments in the Accounts Receivable and Accounts Payable modules of the System. In addition, certain entries affecting the Accounts Receivable and the Accounts Payable modules were made through the General Ledger module. Ideally, all entries for Accounts Receivable and Accounts Payable should be made to the appropriate modules so that the balances between the General Ledger and the Subsidiary Ledgers are in agreement. This is now being carefully observed as well as the monthly reconciliation to ensure that entries are properly posted to the appropriate modules and any adjustments are reflected in the proper period.

7. Payroll Expense

Observation: The following was noted during tests of payroll expenses:

- a. A \$5 average overpayment per pay period was received by 13 employees based on a sample of 26 employees tested. It appears that deducted withholding taxes were less than required resulting in the \$5 average difference. The reason for the incorrect computation is unknown.
- b. Three of 26 timecards tested did not contain indication of supervisor approval.

Recommendation: Management may want to discuss the matter of the discrepancies in net payroll, after consideration of cost and benefit, with the service provider to understand the cause of the observation and its resolution. Further, management should ensure that all timecards are approved by the appropriate level of management.

Auditee Response: The difference between the manual and the system computation of the employee's withholding taxes has been discussed with the payroll software provider. We are now waiting for the feedback from the system provider. On the other hand, we have communicated to the Payroll In-Charge the observation regarding timecards. We will ensure that all timecards are properly approved by the appropriate level of management.

## SECTION I – CONTROL DEFICIENCIES, Continued

### 8. Food and Beverage Revenue

Observation: 24 of 34 Food and Beverage Revenue transactions tested contained unaccounted for variances between the F&B reconciliation reports and the Hotel posting journals. Management believes that such variances are a result of timing difference, i.e., other open transactions are included in the F&B reconciliation report of the next business day.

Recommendation: Timely review and reconciliation of the F&B reconciliation report and the Hotel posting journal should be performed to ensure that reconciliation is properly prepared and revenues are completely recorded. In addition, adequate documentation trail as to the timing differences should be prepared to facilitate accurate review of transactions.

Auditee Response: The hotel has already implemented a procedure for reconciliation of the F&B Reconciliation Report and the Hotel Posting Journal as part of the Night Auditor's work. All front desk clerks have also initiated review of their shift audit as part of their daily task. The Night Auditor reviews the Hotel Posting Journal before finally closing the Hotel Audit for the day. Another level of review is performed by the Rooms Division Manager to ensure that their work is properly performed as expected.

## SECTION II — OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention at this time are as follows:

### 1. Right of Offset

Observation: One fixed asset transaction tested was settled by an offset of a receivable from a vendor; however, written evidence authorizing the offset was not available.

Recommendation: A general principle of accounting requires that offset of assets and liabilities occur only when a right of offset exists. MRI should obtain written evidence authorizing the right of offset. Otherwise, the verbal agreement between the parties may not be enforceable.

Auditee Response: There has been a verbal offsetting arrangements made between MIR management and two (2) of our suppliers. We will consider obtaining a written agreement for these offsetting arrangements.

### 2. National Government Tax

Observation: In May 2007, Management suspended imposing taxes on hotel rooms pending finalization of a MOA between RepMar and PII. However, there may still be a risk regarding non-payment of national government taxes as MRI does not have a formal agreement with RepMar. This is also a prior year comment.

Recommendation: A Memorandum of Agreement between PII and RepMar should be finalized to understand the terms and conditions to be implemented by MRI.

**SECTION I – CONTROL DEFICIENCIES, Continued**

Auditee Response: Discussions have been held for the past years to finalize the agreement between PII and RepMar. After a series of meetings chaired by the Chief Secretary in 2005, the final agreement has been submitted to Cabinet for action. We have not received any development yet after that. Meanwhile, the Management has suspended the imposition of local tax on hotel rooms pending the final negotiation of the MOA between RepMar and PII.

**SECTION III – DEFINITIONS**

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* 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 deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

## **MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING**

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

### **Management's Responsibility**

MRI's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

### **Objectives of Internal Control over Financial Reporting**

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

### **Inherent Limitations of Internal Control over Financial Reporting**

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.