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INTERNAL AUDIT DEPARTMENT

Audit No. 2237

October 7, 2002

TO: Vicki Wilson, Director
Public Facilities and Resources Department

SUBJECT: Limited Review of Lease Revenue for Newport Dunes Partnership
Parcel HA55B-101.21, 101.4, 101.51

We have performed a limited review of certain records and documents related to lease revenue for the year ended March 31, 2002, pertinent to the lease agreement (Agreement) between the County of Orange (County) and the Newport Dunes Partnership, a California general partnership (NDP), dated February 16, 1989, as amended and assigned. The Agreement is primarily to operate and maintain a public recreation facility including boat slips, boat launch, boat storage, recreation vehicle park and overnight camping, public swim beach, day use parking, restaurant, convenience store, beach concessions (such as snack stand and equipment rental), etc. NDP has subleased the marina operations to Webster Hotel Building, a California general partnership (Marina), and the equipment rental operations to Charles A. Berry, DBA Resort Watersports (Resort Watersports).

The primary purpose of our review was to determine whether gross receipts were properly reported to the County and adequately supported by NDP's records and the records of their sublessees. We also reviewed compliance with certain other provisions of the Agreement, such as accounting methods and payment procedures.

Based on our review, we find that NDP and its sublessees have retained sufficient documentation to adequately support monthly rent payments made to the County, except for certain documentation that helps ensure completeness of transactions at the Back Bay Café and Resort Watersports, as discussed further in item I. Additionally, we identified areas of non-compliance with the Agreement as presented below.

I. Record Keeping Deficiencies

A. Transaction Record Counter – Back Bay Café

Clause 16.A of the Agreement requires all retail sales to be recorded by means of cash registers which are "equipped with devices which lock in sales totals and other transaction records with counters which are not resettable and which record transaction numbers and sales details." The point of sale registers used at the Back Bay Café restaurant automatically generate a transaction number for each sale; however, these numbers do not appear to be in sequence. In addition, daily non-resettable control totals/counters are not generated. Therefore, system reports printed at the end of the day do not account for the continuity and completeness of sales transactions. NDP is currently working with its software vendor to determine how an acceptable transaction control can be implemented.

- Recommendation No. 1:** We recommend that PFRD require NDP to ensure their point of sale cashing system for the Back Bay Café complies with the Agreement and provides the means to ensure all transactions are accounted for.

PFRD Response: PFRD concurs with the recommendation. NDP has contacted software vendor for the point of sale system to comply with this recommendation.

B. Pre-Numbered Contracts for Special Events – Resort Watersports (sublease)

Clause 16.A of the Agreement requires the tenant to issue serially numbered tickets for each rental and to keep an adequate record of issued/unissued tickets. Resort Watersports prepares a contract for each special event. However, the contracts are not numbered or accounted for.

Recommendation No. 2: We recommend that PFRD require NDP and Resort Watersports to issue pre-numbered contracts for special events and to maintain an adequate record of issued/unissued contracts.

PFRD Response: PFRD concurs with the recommendation. NDP stated it would notify its subtenant, Resort Watersports, of this recommendation.

C. Time-Stamping Rental Times – Resort Watersports (sublease)

Resort Watersports issues pre-numbered rental agreements for each equipment rental. Rental out/in times are documented on the agreement, with the charge based on the total rental time. At the main rental location at Newport Dunes, rental out/in times are recorded using a time-stamp device. However, the remaining two rental locations manually document the rental time on the agreement. The manual notation can be more easily altered, resulting in possible underreporting of gross receipts.

Recommendation No. 3: We recommend that PFRD require NDP and Resort Watersports to utilize time-stamp machines at all rental locations to document rental out/in times.

PFRD Response: PFRD concurs with the recommendation. NDP stated it would notify its subtenant, Resort Watersports, of this recommendation.

D. Supporting Documentation – Newport Dunes Special Event Concessions

At certain special events, Newport Dunes offers food/beverage concessions to the public. We were informed these sales are recorded on auxiliary cash registers that are mobile and can be set-up at the event location. Newport Dunes maintains several registers to be used at these types of events, depending on need. During our testing, we noted that the daily detailed and close-out cash register tapes were not retained to support the concession sales made at these events, as required by Clause 16.A of the Agreement. These tapes should be retained.

In addition, NDP should account for the sequence of the control totals/counter numbers (z-out numbers) recorded on the close-out tape to ensure that all cash register activity is accounted for. Because many days or months may pass between events, this could be accomplished by recording the sequential control total/counter number on a log (along with the register number, date, and total sales amount) that is reviewed by a manager.

We also noted that these concession sales were the only type of sales not input into the HIS (Hotel Information System) computer system, the main accounting system used at Newport Dunes. To improve accountability, special event concession sales should be entered into the HIS computer system.

Recommendation No. 4: We recommend that PFRD require NDP to maintain detailed and close-out cash register tapes supporting special event concession sales.

PFRD Response: PFRD concurs with the recommendation. NDP explained that these tapes are maintained at its corporate accounting offices in San Diego.

Recommendation No. 5: We recommend that PFRD require NDP to monitor sales activity recorded on those mobile cash registers and the completeness of sales as evidenced by the sequential z-out numbers.

PFRD Response: PFRD concurs with the recommendation. NDP represented that it was in the process of developing a policy to implement a log system for mobile cash registers that will record the date and sequential control (z-out number) for each register.

Recommendation No. 6: We recommend that PFRD require NDP to record special event concession sales on the HIS system.

PFRD Response: The HIS is not a property-wide accounting system but is used primarily for the RV resort and related activities. The tenant will be advised that all special event concession sales are to be recorded on a cash register and that supporting documentation (e.g. register z-tapes, logs, etc.) are to be retained.

E. Gift Certificates – Resort Watersports (sublease)

Resort Watersports issues gift certificates on an occasional basis. The location manager prints the certificates on a personal computer, as needed, changing the sequential number each time a new certificate is printed. Because these certificates are printed using a computer, they are more subject to tampering which could result in unreported gross receipts. Gift certificate forms should be pre-numbered, controlled, and not easily reproduced.

Recommendation No. 7: We recommend that PFRD require NDP and Resort Watersports to issue pre-numbered gift certificate forms and to keep an adequate record of issued/unissued certificates.

PFRD Response: PFRD concurs with the recommendation. NDP stated it would work with Resort Watersports to comply with this recommendation.

II. Subsidiary Records System – Marina (sublease)

The Marina maintains a subsidiary record keeping system for tracking slip/storage rental accounting activity. We were told that several office staff have the ability to make adjustments to the accounting records (affecting amounts due or received) without supervisory approval being required. A few of these staff also have the responsibility of receiving and recording cash receipts onto the same subsidiary system. We were informed that the marina manager regularly performs a high-level review of account activity; however, this review is not documented. Duties of receiving cash, recording transactions, and reviewing/approving adjustments should be adequately segregated to help prevent concealment of errors and/or irregularities.

Recommendation No. 8: We recommend that PFRD require NDP and the Marina to maintain adequate segregation of key cash handling and record-keeping duties, and to record evidence of manager review of account activity.

PFRD Response: PFRD concurs with the recommendation. NDP represented that it would implement a control system that will include the Marine Facilities Director's review of all adjustments.

III. Reporting Monies Collected Instead of Recorded Sales

Clause 13.A of the Agreement states that gross receipts shall include "...the sales price of all goods, wares, merchandise, and products sold on or from the premises, whether for cash or credit and whether payment is actually made or not." NDP reported gross receipts based on cash receipts (i.e. actual monies collected) instead of sales recorded per the cash register reports. Based on a comparison of recorded sales to monies collected for the sample month of March 2002, we noted both positive and negative variances (cash shortages and overages). Some variances were as much as several hundred dollars. The variances resulted in rent being under and over paid to the County.

Recommendation No. 9: We recommend that PFRD require NDP to report gross receipts to the County based on the recorded sales amount and not on monies collected.

PFRD Response: PFRD concurs with the recommendation and will provide written notice to tenant further explaining the meaning of this recommendation.

IV. Entrance Gate Fees

Upon entering the Newport Dunes front gate, each customer is given a receipt upon payment of the parking fee. Certain customers, such as RV patrons, do not have to pay another fee to use the parking lot and are given a special hang-tag to denote an exemption. Upon exiting the gate, the customer must present to the gate attendant a receipt or hang-tag to indicate they have paid the appropriate fee or have an exemption. However, the same attendants authorizing guests to enter the lot may also perform this review upon exit. To ensure that all parking fees are appropriately collected and reported, an independent person should perform this review. This could be accomplished by an independent person observing the vehicle hang tags/receipts of the parked vehicles at various times throughout the day.

Recommendation No. 10: We recommend that PFRD require NDP to have an employee, independent of gate operations, periodically observe the vehicles in the parking lot to ensure each vehicle has an appropriate receipt/hang-tag displayed.

PFRD Response: PFRD concurs with the recommendation. NDP represented that regular patrols of the day use parking area would immediately be implemented.

Recommendation No. 11: We further recommend that PFRD advise NDP to post signs at the front gate instructing guests to place their receipt/hang-tag in clear view, to allow for verification.

PFRD Response: NDP has explained that there are numerous signs at the front gate and had reservations about adding another sign. In lieu of adding signage, PFRD will notify the tenant that it ensure that front gate personnel are informing guests that parking receipt/hang-tags must be displayed at all times. In addition PFRD will advise the tenant that PFRD will rely on the tenant's parking patrol to enforce this hang tag display regulation.

V. Reserves For Replacement

Clause 16.F of the Agreement requires the tenant to establish and maintain a Capital Replacement Fund to be used for replacement of furniture, fixtures, and equipment, and for capital repairs and renovations to improvements constructed within the premises. During our review, we found no evidence that NDP had established such a fund.

Recommendation No. 12: We recommend that PFRD require NDP to establish a Capital Replacement Fund that complies with the Agreement.

PFRD Response: PFRD concurs with the recommendation and an agreement has been reached regarding funds to be deposited into such a fund.

VI. Cash Register Receipts – Newport Dunes Marketplace

Clause 16.A of the Agreement requires that all retail sales be recorded by a cash register that displays the sales amount to the customer and “automatically issue a receipt.” We observed that the register at the grocery store automatically generated a receipt after each transaction; however, the cashier did not offer the receipt to the customer. A similar issue was noted in prior limited lease review letters dated June 13, 1991, and February 10, 2000.

Recommendation No. 13: We recommend that PFRD require NDP to offer register receipts to all customers.

PFRD Response: PFRD concurs with the recommendation. NDP has represented that it would retrain its grocery staff on its policy of providing receipts to guests.

VII. Interest Earned on Security/Advance Deposits

NDP accepts security deposits for boat storage and advance deposits for RV space rental and special events. These deposits are placed in an interest-bearing account. NDP does not report the interest earned on these deposits as gross receipts. In March 2002, advance/security deposits totaled almost \$600,000. This interest revenue is earned by NDP as a direct result of operations conducted on the premises.

Recommendation No. 14: We recommend that PFRD require NDP to report interest earned on security/advance deposits as gross receipts to the County.

PFRD Response: PFRD concurs with the recommendation and will so notify tenant in writing.

VIII. Security Deposit

Clause 17 of the Agreement requires NDP to provide the County with a security deposit, initially set at \$30,000. The Agreement provides for adjustments every five years based on the Consumer Price Index (CPI). Currently, the adjusted security deposit is \$40,000. Per PFRD, as a general policy, when a new lease is initiated, the security deposit amount is set to equal two to three months rental payments made to the County. For the audit period, this equals an amount between \$320,000 and \$480,000. PFRD should consider increasing the amount of the security deposit when there are future opportunities to amend the Agreement.

Recommendation No. 15: We recommend that PFRD address the issue of increasing the security deposit and revising the adjustment criteria in future Agreements/Amendments when the opportunity arises.

PFRD Response: PFRD concurs with the recommendation and will include a revision of the security deposit when the opportunity presents itself.

IX. Certification of Monthly Gross Receipts Statements

During our review we noted the monthly gross receipt statements submitted by NDP and Resort Watersports (sublease) were not signed by the tenant or responsible agent under penalty of perjury, as required by Clause 14.A of the Agreement.

Recommendation No. 16: We recommend that PFRD ensure monthly gross receipts statements submitted by NDP and Resort Watersports include the required certification under penalty of perjury.

PFRD Response: PFRD concurs with the recommendation and will provide the tenant with suggested language for such certification.

X. Written Authorization of Optional Uses

Clause 5.B of the Agreement states that NDP may provide additional services and uses, which are ancillary to and compatible with the required services and uses, subject to prior written approval from the County. Additionally, Clause 13.G of the Agreement states that NDP may rent space/facilities to non-profit organizations or public agencies for either no charge or for a nominal fee, upon prior written approval from the County. During our review, we noted two instances where prior written approval was not obtained:

1. A party pavilion tent has been set-up on the premises to be used as an additional rental facility;
2. Space/facility rental was provided for the Boy Scouts "Scout-a-Rama" special event (non-profit group)

Unauthorized services or uses of the leased premises may result in additional rent due to the County, because rent can be assessed at 100% for unauthorized/unapproved uses.

Recommendation No. 17: We recommend that PFRD require NDP to obtain prior written approval for ancillary services and uses and the category of rent due.

PFRD Response: PFRD concurs with the recommendation and has recently approved NDP's request to be allowed to use tents as ancillary catering space.

XI. Advance Deposits/Payments – Resort Watersports and Marina (subleases)

The Marina occasionally receives advance payments of rental fees. In addition, Resort Watersports periodically receives advance deposits for special events. These monies are reported as gross receipts to the County when the services are provided, rather than when the monies are received.

Clause 13. B of the Agreement states gross receipts shall include all charges made "...of any nature or kind whatsoever, whether for cash or credit, ...whether the services are actually performed or not." Advance deposits and payments should be reported as gross receipts when received.

Recommendation No. 18: We recommend PFRD require NDP, the Marina, and Resort Watersports to report advance payments and deposits when received.

PFRD Response: PFRD concurs with the recommendation. NDP has represented that it would work with its subtenants to ensure that advance payments and deposits are reported when received.

XII. Complimentary Services & Discounts

A. Employee Discounts – Resort Watersports (sublease)

Clause 13.F of the Agreement requires the fair rental value of facilities used by the tenant or its employees to be reported as gross receipts. Resort Watersports provided employees discounted equipment rentals. Only the discounted amount was reported to the County as gross receipts. Based on our review of sublessee records, the discounts were not excessive and the resulting amount of rent that would be owed to the County is very small.

Recommendation No. 19: We recommend that PFRD require NDP and Resort Watersports to report the fair market value of discounted services provided to employees as gross receipts to the County.

PFRD Response: PFRD concurs with the recommendation, but may consider allowing employee discounts within certain limitations and upon written authorization from the County.

B. Complimentary Certificates

NDP provided complimentary certificates, redeemable for various site and equipment rentals, to local charities as a fundraising opportunity. The fair market value of these complimentary certificates was not reported to the County as gross receipts. We were informed that these certificates were issued for a limited time during 2001; however, we were unable to obtain an estimate of the total value of the certificates issued.

Recommendation No. 20: We recommend that PFRD communicate to NDP the correct reporting of complimentary certificates.

PFRD Response: PFRD concurs with the recommendation and will notify the tenant in writing that redemption of the certificates is to be reported at full market value of the certificate.

C. Reduced Slip Rental Rates – Marina (sublease)

During our review, we noted that the Marina provided reduced slip rental rates to some customers. We were told the reduced rates were offered as incentives to join the marina or to accommodate temporary hardship situations. Only the reduced rate was reported to the County as gross receipts. Based on our review of Marina records, these reductions did not appear to be significant.

Recommendation No. 21: We recommend that PFRD communicate to NDP and the Marina the correct reporting of reduced rates charged to customers.

PFRD Response: PFRD concurs with the recommendation and will notify the tenant that reduced boat slip rentals are disallowed, unless prior written authorization has been given by the County.

XIII. Miscellaneous Revenue

Newport Dunes makes available various activities for their guests, such as arts & crafts projects, easter egg hunts, etc. Fees charged to the guests for these activities are not reported as gross receipts. Additionally, we were told that Newport Dunes sells Disneyland tickets as a convenience for their guests. The ticket sales are not reported as gross receipts. Clause 13.A of the Agreement states that gross receipts shall include "...the sales price of all goods, wares, merchandise, and products sold on or from the premises." Although the revenue generated from these services is minor, it should be reported as gross receipts.

Recommendation No. 22: We recommend that PFRD require NDP to report all miscellaneous revenue generated from ancillary services as gross receipts to the County.

PFRD Response: PFRD concurs with the recommendation and will advise the tenant in writing that the net difference between the receipts and expenses are to be included as gross receipts.

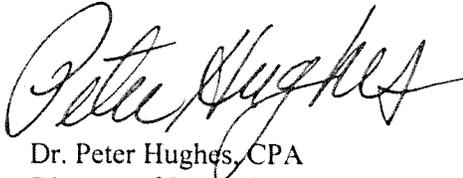
XIV. On-Site Employee Residences

Clause 9 of the Agreement allows for on-site employee residences, to be reported at fair market value as established by the PFRD/Real Estate Manager. Based on our review of the PFRD Real Estate files, the rates being reported by NDP were established in 1989 and appear to be below current fair market value.

Recommendation No. 23: We recommend that PFRD review the rates established for on-site employee residences to ensure they reflect current fair market value.

PFRD Response: PFRD concurs with the recommendation and has recently come to an agreement as to current fair market rent for the residences.

We appreciate the courtesy and cooperation extended to us by the personnel at NDP, the Marina, Resort Watersports, PFRD/Real Property, and PFRD/Accounting. If you have any questions regarding our limited review of lease revenue, please call me, Eli Littner, Deputy Audit Director, at (714) 834-5899, or Autumn McKinney, Audit Manager, at (714) 834-6106.



Dr. Peter Hughes, CPA
Director of Internal Audit

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Attachment – PFRD Response

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

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Attachment – PFRD Response



COUNTY OF ORANGE
PUBLIC FACILITIES & RESOURCES DEPARTMENT

Vicki L. Wilson, Director
300 N. Flower Street
Santa Ana, CA
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Santa Ana, CA 92702-4048
Telephone: (714) 834-2300
Fax: (714) 834-5188

DATE: September 23, 2002
TO: Peter Hughes, Ph.D., C.P.A., Director, Internal Audit Department
FROM: Vicki L. Wilson, Director
Public Facilities & Resources Department
SUBJECT: Response to Limited Review of Lease Revenue for Newport Dunes Partnership
Parcel HA55B-101.21, 1010.4, 101.51
Audit 2237

INTERNAL AUDIT
OCT 07 2002
P E R F R D

The Public Facilities and Resources Department (PFRD) has reviewed Internal Audit Department's Limited Review of Lease Revenue for Newport Dunes Partnership (NDP) for the year ended March 31, 2002, pertinent to the Lease between the County of Orange (County) and NDP, dated February 16, 1989. (Note: Effective as of August 1, 2002, NDP's interest in the Lease was assigned to Tahoe Shores, Ltd., and Newport Dunes Marina, LLC.)

For the most part the auditors found that that NDP and its sublessees retained sufficient documentation to adequately support monthly rent payments made to the County. However, they identified areas where documentation is needed to help ensure completeness of certain transactions. In addition, they identified areas of non-compliance with the Lease.

Following are the auditor's findings as well as PFRD's response to Internal Audit Department's recommendations:

I. Record Keeping Deficiencies

A. Transaction Record Counter – Back Bay Café

Clause 16.A of the Lease requires all retail sales to be recorded by means of cash registers which are "equipped with devices which lock in sales totals and other transaction records with counters which are not resettable and which record transaction numbers and sales details." The point of sale registers used at the Back Bay Café restaurant automatically generate a transaction number for each sale; however, these numbers do not appear to be in sequence. In addition, daily non-resettable control totals/counters are not generated. Therefore, system reports printed at the end of the day do not account for the continuity and completeness of sales transactions. NDP is currently working with its software vendor to determine how an acceptable transaction control can be implemented.

Recommendation No. 1: Internal Audit recommends that PFRD require NDP to ensure their point of sale cashiering system for the Back Bay Café complies with the Lease and provides the means to ensure all transactions are accounted for.

Attachment – PFRD Response (con't)

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PFRD Response: PFRD concurs with the recommendation. NDP has contacted software vendor for the point of sale system to comply with this recommendation.

B. Pre-Numbered Contracts for Special Events – Resort Watersports (sublease)

Clause 16.A of the Lease requires the tenant to issue serially numbered tickets for each rental and to keep an adequate record of issued/unissued tickets. Resort Watersports prepares a contract for each special event. However, the contracts are not numbered or accounted for.

Recommendation No. 2: Internal Audit recommends that PFRD require NDP and Resort Watersports to issue pre-numbered contracts for special events and to maintain an adequate record of issued/unissued contracts.

PFRD Response: PFRD concurs with the recommendation. NDP stated it would notify its subtenant, Resort Watersports, of this recommendation.

C. Time-Stamping Rental Times – Resort Watersports (sublease)

Resort Watersports issues pre-numbered rental agreements for each equipment rental. Rental out/in times are documented on the agreement, with the charge based on the total rental time. At the main rental location at Newport Dunes, rental out/in times are recorded using a time-stamp device. However, the remaining two rental locations manually document the rental time on the agreement. The manual notation can be more easily altered, resulting in possible underreporting of gross receipts.

Recommendation No. 3: Internal Audit recommends that PFRD require NDP and Resort Watersports to utilize time-stamp machines at all rental locations to document rental out/in times.

PFRD Response: PFRD concurs with the recommendation. NDP stated it would notify its subtenant, Resort Watersports, of this recommendation.

D. Supporting Documentation – Newport Dunes Special Event Concessions

At certain special events, Newport Dunes offers food/beverage concessions to the public. The auditor was informed these sales are recorded on auxiliary cash registers that are mobile and can be set-up at the event location. Newport Dunes maintains several registers to be used at these types of events, depending on need. During its testing, Internal Audit noted that the daily detailed and close-out cash register tapes were not retained to support the concession sales made at these events, as required by Clause 16.A of the Lease. These tapes should be retained.

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In addition, NDP should account for the sequence of the control totals/counter numbers (z-out numbers) recorded on the closeout tape to ensure that all cash register activity is accounted for. Because many days or months may pass between events, this could be accomplished by recording the sequential control totals/counter number on a log (along with the register number, date, and total sales amount) that is reviewed by a manager.

The auditors also noted that these concession sales were the only type of sales not input into the HIS (Hotel Information System) computer system, the main accounting system used at Newport Dunes. To improve accountability, special event concession sales should be entered into the HIS computer system.

Recommendation No. 4: Internal Audit recommends that PFRD require NDP to maintain detailed and close-out cash register tapes supporting special event concession sales.

PFRD Response: PFRD concurs with the recommendation. NDP explained that these tapes are maintained at its corporate accounting offices in San Diego.

Recommendation No. 5: Internal Audit recommends that PFRD require NDP to monitor sales activity recorded on those mobile cash registers and the completeness of sales as evidenced by the sequential z-out numbers.

PFRD Response: PFRD concurs with the recommendation. NDP represented that it was in the process of developing a policy to implement a log system for mobile cash registers that will record the date and sequential control (z-out number) for each register.

Recommendation No. 6: Internal Audit recommends that PFRD require NDP to record special event concession sales on the HIS system.

PFRD Response: The HIS is not a property-wide accounting system but is used primarily for the RV resort and related activities. The tenant will be advised that all special event concession sales are to be recorded on a cash register and that supporting documentation (e.g. register z-tapes, logs, etc.) are to be retained.

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IV. Entrance Gate Fees

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PFRD Response: NDP has explained that there are numerous signs at the front gate and had reservations about adding another sign. In lieu of adding signage, PFRD will notify the tenant that it ensure that front gate personnel are informing guests that parking receipt/hang-tags must be displayed at all times. In addition PFRD will advise the tenant that PFRD will rely on the tenant's parking patrol to enforce this hang tag display regulation.

V. Reserves For Replacement

Clause 16.F of the Lease requires the tenant to establish and maintain a Capital Replacement Fund to be used for replacement of furniture, fixtures, and equipment, and for capital repairs and renovations to improvements constructed within the premises. During its review, Internal Audit found no evidence that NDP had established such a fund.

Recommendation No. 12: Internal Audit recommends that PFRD require NDP to establish a Capital Replacement Fund that complies with the Lease.

PFRD Response: PFRD concurs with the recommendation and an agreement has been reached regarding funds to be deposited into such a fund.

Attachment – PFRD Response (con't)

Peter Hughes
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VI. Cash Register Receipts – Newport Dunes Marketplace

Clause 16.A of the Lease requires that all retail sales be recorded by a cash register that displays the sales amount to the customer and "automatically issue a receipt." The auditors observed that the register at the grocery store automatically generated a receipt after each transaction; however, the cashier did not offer the receipt to the customer. A similar issue was noted in prior limited lease review letters dated June 13, 1991, and February 10, 2000.

Recommendation No. 13: Internal Audit recommends that PFRD require NDP to offer register receipts to all customers.

PFRD Response: PFRD concurs with the recommendation. NDP has represented that it would retrain its grocery staff on its policy of providing receipts to guests.

VII. Interest Earned on Security/Advance Deposits

NDP accepts security deposits for boat storage and advance deposits for RV space rental and special events. These deposits are placed in an interest-bearing account. NDP does not report the interest earned on these deposits as gross receipts. In March 2002, advance/security deposits totaled almost \$600,000. This interest revenue is earned by NDP as a direct result of operations conducted on the premises.

Recommendation No. 14: Internal Audit recommends that PFRD require NDP to report interest earned on security/advance deposits as gross receipts to the County.

PFRD Response: PFRD concurs with the recommendation and will so notify tenant in writing.

VIII. Security Deposit

Clause 17 of the Lease requires NDP to provide the County with a security deposit, initially set at \$30,000. The Lease provides for adjustments every five years based on the Consumer Price Index (CPI). Currently, the adjusted security deposit is \$40,000. Per PFRD, as a general policy, when a new lease is initiated, the security deposit amount is set to equal two to three months rental payments made to the County. For the audit period, this equals an amount between \$320,000 and \$480,000. PFRD should consider increasing the amount of the security deposit when there are future opportunities to amend the Lease.

Recommendation No. 15: Internal Audit recommends that PFRD address the issue of increasing the security deposit and revising the adjustment criteria in future Agreements/Amendments when the opportunity arises.

PFRD Response: PFRD concurs with the recommendation and will include a revision of the security deposit when the opportunity presents itself.

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IX. Certification of Monthly Gross Receipts Statements

During its review Internal Audit noted the monthly gross receipt statements submitted by NDP and Resort Watersports (sublease) were not signed by the tenant or responsible agent under penalty of perjury, as required by Clause 14.A of the Lease.

Recommendation No. 16: Internal Audit recommends that PFRD ensure monthly gross receipts statements submitted by NDP and Resort Watersports include the required certification under penalty of perjury.

PFRD Response: PFRD concurs with the recommendation and will provide the tenant with suggested language for such certification.

X. Written Authorization of Optional Uses

Clause 5.B of the Lease states that NDP may provide additional services and uses, which are ancillary to and compatible with the required services and uses, subject to prior written approval from the County. Additionally, Clause 13.G of the Lease states that NDP may rent space/facilities to non-profit organizations or public agencies for either no charge or for a nominal fee, upon prior written approval from the County. During its review, Internal Audit noted two instances where prior written approval was not obtained:

1. A party pavilion tent has been set-up on the premises to be used as an additional rental facility;
2. Space/facility rental was provided for the Boy Scouts "Scout-a-Rama" special event (non-profit group)

Unauthorized services or uses of the leased premises may result in additional rent due to the County, because rent can be assessed at 100% for unauthorized/unapproved uses.

Recommendation No. 17: Internal Audit recommends that PFRD require NDP to obtain prior written approval for ancillary services and uses and the category of rent due.

PFRD Response: PFRD concurs with the recommendation and has recently approved NDP's request to be allowed to use tents as ancillary catering space.

XI. Advance Deposits/Payments – Resort Watersports and Marina (subleases)

The Marina occasionally receives advance payments of rental fees. In addition, Resort Watersports periodically receives advance deposits for special events. These monies are reported as gross receipts to the County when the services are provided, rather than when the monies are received.

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Clause 13.B of the Lease states gross receipts shall include all charges made "...of any nature or kind whatsoever, whether for cash or credit, ...whether the services are actually performed or not." Advance deposits and payments should be reported as gross receipts when received.

Recommendation No. 18: Internal Audit recommends that PFRD require NDP, the Marina, and Resort Watersports to report advance payments and deposits when received.

PFRD Response: PFRD concurs with the recommendation. NDP has represented that it would work with its subtenants to ensure that advance payments and deposits are reported when received.

XII. Complimentary Services & Discounts

A. Employee Discounts – Resort Watersports (sublease)

Clause 13.F of the Lease requires the fair rental value of facilities used by the tenant or its employees to be reported as gross receipts. Resort Watersports provided employees discounted equipment rentals. Only the discounted amount was reported to the County as gross receipts. Based on the review of sublessee records, the discounts were not excessive and the resulting amount of rent that would be owed to the County is very small.

Recommendation No. 19: Internal Audit recommends that PFRD require NDP and Resort Watersports to report the fair market value of discounted services provided to employees as gross receipts to the County.

PFRD Response: PFRD concurs with the recommendation, but may consider allowing employee discounts within certain limitations and upon written authorization from the County.

B. Complimentary Certificates

NDP provided complimentary certificates, redeemable for various site and equipment rentals, to local charities as a fundraising opportunity. The full market value of these complimentary certificates was not reported to the County as gross receipts. The auditors were informed that these certificates were issued for a limited time during 2001; however, they were unable to obtain an estimate of the total value of the certificates issued.

Recommendation No. 20: Internal Audit recommends that PFRD communicate to NDP the correct reporting of complimentary certificates.

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PFRD Response: PFRD concurs with the recommendation and will notify the tenant in writing that redemption of the certificates is to be reported at full market value of the certificate.

C. Reduced Slip Rental Rates – Marina (sublease)

During the review, the auditors noted that the Marina provided reduced slip rental rates to some customers. They were told the reduced rates were offered as incentives to join the marina or to accommodate temporary hardship situations. Only the reduced rate was reported to the County as gross receipts. Based on the auditors' review of Marina records, these reductions did not appear to be significant.

Recommendation No. 21: Internal Audit recommends that PFRD communicate to NDP and the Marina the correct reporting of reduced rates charged to customers.

PFRD Response: PFRD concurs with the recommendation and will notify the tenant that reduced boat slip rentals are disallowed, unless prior written authorization has been given by the County.

XIII. Miscellaneous Revenue

Newport Dunes makes available various activities for their guests, such as arts & crafts projects, Easter egg hunts, etc. Fees charged to the guests for these activities are not reported as gross receipts. Additionally, the auditors were told that Newport Dunes sells Disneyland tickets as a convenience for their guests. The ticket sales are not reported as gross receipts. Clause 13.A of the Lease states that gross receipts shall include "...the sales price of all goods, wares, merchandise, and products sold on or from the premises." Although the revenue generated from these services is minor, it should be reported as gross receipts.

Recommendation No. 22: Internal Audit recommends that PFRD require NDP to report all miscellaneous revenue generated from ancillary services as gross receipts to the County.

PFRD Response: PFRD concurs with the recommendation and will advise the tenant in writing that the net difference between the receipts and expenses are to be included as gross receipts.

XIV. On-Site Employee Residences

Clause 9 of the Lease allows for on-site employee residences, to be reported at fair market value as established by the PFRD/Real Estate Manager. Based on the auditors' review of the PFRD Real Estate files, the rates being reported by NDP were established in 1989 and appear to be below current fair market value.

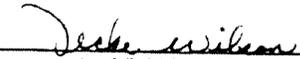
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Recommendation No. 23: Internal Audit recommends that PFRD review the rates established for on-site employee residences to ensure they reflect current fair market value.

PFRD Response: PFRD concurs with the recommendation and has recently come to an agreement as to current fair market rent for the residences.

As noted above, many of the recommendations have been implemented since the completion of Internal Audit's review. PFRD will follow-up with the new tenants to ensure that they are aware of the recommended actions that apply to aquatic park operations from this point forward.



Vicki L. Wilson

ja

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