Limited Review of Bayshore Marina

FOR THE YEAR ENDED OCTOBER 31, 2003

REPORT DATE: October 20, 2004

Audit Number 2352

Audit Director:	**Peter Hughes, Ph.D., CPA**
Deputy Director:	**Eli Littner, CPA, CIA**
Audit Manager:	**Autumn McKinney, CPA, CIA**
In-Charge Auditor:	**Carol Swe, CPA, CIA**
Senior Auditor:	**Camille Gackstetter, CPA**

INTERNAL AUDIT DEPARTMENT

COUNTY OF ORANGE

Limited Review of Bayshore Marina

For the year ended October 31, 2004

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COUNTY OF ORANGE
INTERNAL AUDIT DEPARTMENT

OFFICE OF THE DIRECTOR

Integrity
Objectivity
Independence

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Transmittal Letter

Audit No. 2352

October 20, 2004

TO: Bryan G. Speegle, Director
Resources and Development Management Department

FROM: Peter Hughes, Ph.D., CPA, Director
Internal Audit Department

SUBJECT: Limited Review of Bayshore Marina
Parcel No. HA55D-20

We have completed our limited lease review of Bayshore Marina for the period sixteen months ended October 31, 2003. The final report is attached along with your responses to our recommendations. We also attached a Customer Survey of Audit Services. Please complete the survey and return it to Renee Aragon, Executive Secretary, Internal Audit Department. We appreciate the courtesy and cooperation of your staff during our review.

Attachment

Other recipients of this report:
Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Vicki Wilson, Deputy County Executive Officer
Kevin Thomas, Director, RDMD/Harbors, Beaches & Parks
Bob Hamilton, Manager, RDMD/HB&P/Program Management
Rich Adler, Chief, RDMD/HB&P/Lease Management
Mike Hentzen, Leasing Coordinator, RDMD/HB&P/Lease Management
Steve Danley, Director, RDMD/Management Services
Mary Fitzgerald, Manager, RDMD/Accounting Services
Brian Murphy, Chief, RDMD/Central Quality Assurance
Teri Marcoot, RDMD/Central Quality Assurance
Darlene J. Bloom, Clerk of the Board of Supervisors
Foreman, Grand Jury

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INTERNAL AUDITOR'S REPORT

Audit No. 2352

October 20, 2004

TO: Bryan G. Speegle, Director
Resources and Development Management Department

SUBJECT: Limited Review of Bayshore Marina
Parcel No. HA55D-20

We have performed a limited review of certain records and documents for sixteen months ended October 31, 2003, pertinent to the lease agreement (Agreement) between the County of Orange (County) and The Irvine Company, a West Virginia Corporation, dated August 13, 1974. The Agreement is primarily to maintain and operate a complete boat berthing facility at Bayshore Marina, Lower Newport Bay. The Irvine Company has retained BellPort Group, Inc. (BellPort) to maintain and operate Bayshore Marina on their behalf.

The primary purpose of our review was to determine whether The Irvine Company's and BellPort's records adequately supported their computation of monthly percentage rent payments to the County. We also reviewed compliance with certain other provisions of the Agreement, such as accounting methods and billing procedures.

Based on our review, we find that The Irvine Company and BellPort have retained sufficient documentation to adequately support monthly gross income reported to the County. However, we did identify rent owed, areas of non-compliance with the Agreement, and areas for improvement as presented below.

1. Unreported Gross Income
   During our review, we noted that The Irvine Company did not report gross income from the following activities:

   A. Utility Charges
      Marina customers are billed monthly for use of electricity at the boat slips. The Irvine Company did not report utility charges to the County in gross income during the review period; however, utility charges were reported at the time of our last audit for the year-ended February 28, 1992.

Clause 10 of the General Conditions of the Agreement defines gross income as "fees of any nature or kind charged by the Tenant. . ." We estimate unreported utility charges for fiscal year 2002/2003 to be approximately $21,445, resulting in $5,146.80 additional rent owed to the County.

The Irvine Company considers these charges to be a pass-through of costs and should not be reported as gross income. Per RDMD, The Irvine Company has not received approval to discontinue reporting utility charges.

Recommendation No. 1.A: We recommend that RDMD require The Irvine Company to pay $5,146.80 rent owed due for the period July 1, 2002 through June 30, 2003. We also recommend that RDMD require The Irvine Company to calculate and pay additional rent owed for utility charges for periods prior to July 1, 2002 and after June 30, 2003.

RDMD Response: RDMD agrees with this recommendation and has discussed this finding with The Irvine Company. The Irvine Company was under the impression that a proposed amendment to allow the exclusion from gross receipts of direct pass-throughs for electrical charges was approved in the early '90s. However, for reasons that are unknown today, The Irvine Company elected not to proceed with the amendment, and the amendment was never sent to the Board of Supervisors for approval. The Irvine Company has paid the additional $5,146.80 rent owed as identified in the audit. In addition, as with some of the other findings in the audit, The Irvine Company has retained a CPA firm to examine its rental worksheets, utility charges, security deposits, prepaid rents and other documents affecting the gross revenues reported to the County and is committed to fulfilling its obligations under the terms of the lease (see attached letter). This work includes the periods prior to July 1, 2002 and after June 30, 2003, and is projected to be completed by the end of October 2004.

B. Security and Key Deposits

The Irvine Company has not reported net activity from security and key deposits to the County as gross income since fiscal year 2000/2001. As noted above, Clause 10 of the General Conditions of the Agreement defines all fees charged by the tenant to be considered as gross income. We calculated the net security and key deposits for fiscal years ended 2001/2002 (-$2,002) and 2002/2003 ($334). The cumulative difference of –$1,668 as of June 30, 2003, would result in a $400 credit to The Irvine Company. However, the actual amount and whether it remains a credit will depend on the cumulative difference as of the month this issue is corrected by the Irvine Company.

Recommendation No. 1.B: We recommend that RDMD require The Irvine Company to report as gross income all net security and key deposits collected. We also recommend that RDMD require The Irvine Company to calculate and pay rent owed, if any, as of the date of correction.

RDMD Response: RDMD agrees with the recommendation and has discussed this finding with The Irvine Company. This work is also included in the scope of work for the CPA firm that has been authorized by The Irvine Company to examine its rental worksheets, utility charges, security deposits, prepaid rents and other documents affecting the gross revenues reported to the County. Any credits or amounts due will be reconciled upon completion of this work, anticipated at the end of October 2004.

C. Prepaid Slip Rents

The Irvine Company did not report prepaid slip rents as gross income to the County during the review period; however, prepaid slip rent was reported as gross income as of the last audit for the year-ended February 28, 1992.

Clause 10 of the General Conditions of the Agreement states "The term *gross income*, upon which the rental is to be based, shall consist of all income generated from the operation of the facility . . .." We calculate unreported prepaid rent for fiscal year 2002/2003 to be $4,273.51, resulting in additional rent owed of $1,026. However, the actual amount owed will depend on the cumulative difference as of the month this issue is corrected by the Irvine Company.

Recommendation No. 1.C: We recommend that RDMD require The Irvine Company to report as gross income all prepaid rent collected. We also recommend that RDMD require The Irvine Company to calculate and pay rent owed for unreported prepaid rent as of the date of correction.

RDMD Response: RDMD agrees with the recommendation and has discussed this finding with The Irvine Company. This work is also included in the scope of work for the CPA firm that has been authorized by The Irvine Company to examine its rental worksheets, utility charges, security deposits, prepaid rents and other documents affecting the gross revenues reported to the County. Any additional rent due will be paid upon completion of this work, anticipated at the end of October 2004.

2. Financial Statements

The Irvine Company has not submitted the required financial statements since fiscal year 1997/1998.

Clause 12 of the General Conditions of the Agreement requires The Irvine Company to submit, on an annual basis, the following financial statements:

a. An income statement reflecting business transacted on or from the Project Area (Bayshore Marina) during the preceding accounting year. The income statement must be attested to that it is an accurate representation of The Irvine Company's records.

b. A statement certified as to accuracy (audited) by a certified public accountant wherein the total gross receipts are classified according to the categories of business conducted on or from the Project Area.

Per RDMD, The Irvine Company will be required to submit financial statements in compliance with the Agreement for fiscal year 2002/2003. Upon receipt and review of these financial statements, RDMD retains the right to request The Irvine Company to submit the financial statements in compliance with the Agreement for the prior years.

Recommendation No. 2: We recommend that RDMD require The Irvine Company to submit financial statements for fiscal year 2002/2003 in compliance with the Agreement and to reserve the right to require The Irvine Company to submit prior years financial statements if necessary.

RDMD Response: RDMD agrees with the recommendation and has discussed the finding with The Irvine Company. This work also is included in the scope of work for the CPA firm that has been authorized by The Irvine Company to examine its rental worksheets, utility charges, security deposits, prepaid rents and other documents affecting the gross revenues reported to the County. The Irvine Company has agreed to submit financial statements for fiscal year 2002/2003 and all future years in accordance with the terms of the lease.

3. Records and Documentation

Clause 12 of the General Conditions of the Agreement states, "TENANT shall, at all times during the term of this agreement, keep or cause to be kept, true and complete books, records, and accounts of all financial transactions in the operation of all business activities..." We noted the following areas where documentation supporting gross income was inaccurate or not retained as required by the Agreement:

A. Reconciliation

The Irvine Company performs a monthly reconciliation of customer charges between the Yardie Accounting System (used for billing) and the Marina Manager System (used to maintain tenant information) to ensure completeness and accuracy of customer billings; however, this reconciliation is not documented. Documentation of the reconciliation provides assurance that a reconciliation between the two systems is performed and that discrepancies are identified and properly resolved. Without a reconciliation, there is more risk customers may not be charged or may be charged incorrectly, increasing the risk of loss for the County.

Recommendation No. 3.A: We recommend that RDMD require The Irvine Company to maintain documentation of the monthly reconciliation between the Yardie Accounting System and the Marina Manager System.

RDMD Response: RDMD agrees with the recommendation and has discussed this finding with The Irvine Company. The Irvine Company has agreed to retain copies of any future reconciliations.

B. Inaccurate Documentation

During our review, we found four instances (out of eleven customer files tested) of inaccurate information in the customer file or the Marina Manager System (used to maintain tenant information).

In two instances, the customers were billed incorrectly, resulting in undercharges of $986 and $187 during the review period; however, only $717 affects fiscal year 2002/2003. The remaining $456 represents billing errors subsequent to 6/30/03 that should be corrected by The Irvine Company before reporting gross income for next fiscal year 2003/2004. As a result of these errors, rent was underpaid for fiscal year 2002/2003 by approximately $172.

For the other two instances, we noted incorrect information in the customers' files that did not affect gross income reported to the County. In addition, we were provided a schedule of transient/sub-tenants that was incomplete.

A documented periodic physical inventory of the boats and a comparison to the Marina Manager System would help ensure completeness and accuracy of records.

Recommendation No. 3.B: We recommend that RDMD require The Irvine Company to pay $172 additional rent owed as a result of billing errors. We also recommend that RDMD require The Irvine Company to perform and document a periodic physical inventory of the boats and reconcile to the customer files and the Marina Manager System.

RDMD Response: RDMD agrees with the recommendation and has discussed the recommendation with The Irvine Company. After discussion with The Irvine Company, however, two key facts came to light: 1) all accounting documentation and billing is done through the Yardie Accounting System which is a complete stand alone accounting system, and 2) the Marina Manager system is only used as an internal tool by on-site staff to show prospective boat slip tenants the location of vacant slips and is not used for accounting or billing purposes. As such, The Irvine Company does not reconcile the two systems for tenant information. However, the CPA firm retained to review the records will be reviewing the accounting records for any errors and, if any additional amounts are identified, they will be paid to the County.

Auditor Comment: We concur the Yardie Accounting System and the Marina Manager System are stand-alone systems used for specific purposes. The monthly billings are based on the slip and/or boat length. Therefore, a periodic comparison between the physical inventory of the boats with system-produced billings is important to help ensure accuracy of boat/slip lengths used in the rent calculation. RDMD informed us that the CPA hired by The Irvine Company will include a physical inventory comparison in their review of the accounting records.

4. Certification of the Percentage Rental Worksheet

The Percentage Rental Worksheet submitted by The Irvine Company for the Bayshore Marina Project Area (used to report annual gross income and percentage rent due to the County) does not include a statement that it is signed under penalty of perjury.

Clause 11.C of the General Conditions of the Agreement requires the statement to be signed by The Irvine Company or responsible agent under penalty of perjury.

Recommendation No. 4: We recommend that RDMD require The Irvine Company to submit an annual Percentage Rental Worksheet signed under penalty of perjury.

RDMD Response: RDMD agrees with the recommendation and has discussed this finding with The Irvine Company. The Irvine Company has agreed to submit the annual Percentage Rental Worksheet signed under penalty of perjury.

5. Clarification of the Agreement

We understand that the Agreement is up for renewal later this year. During our review, we identified the following areas of the Agreement that RDMD may want to consider for clarification or revision:

a. Simplifying the annual percentage rent calculation.
b. Clarification of reporting requirements for utility charges, security deposits, and prepaid rent.
c. Security deposit amount of $6,000 appears inadequate.
d. Late charge of $20 per month for delinquent payments appears low. The Irvine Company currently charges a $50 late fee plus a 10% finance charge to customers for delinquent payments.

No specific recommendation is made at this time.

RDMD Response: Although no specific recommendation was made, all of the above items are being addressed in the new lease currently under negotiation between RDMD and The Irvine Company. All items will reflect current County standards for real estate leases.

We appreciate the courtesy and cooperation extended to us by the personnel of BellPort Group, Inc., The Irvine Company, RDMD/HB&P/Lease Development and Management, and RDMD/Accounting Services. 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.

Peter Hughes, Ph.D., CPA
Director of Internal Audit

Audit Team
Eli Littner, Deputy Director, CPA, CIA
Autumn McKinney, Audit Manager, CPA, CIA
Carol Swe, Senior Auditor II, CPA, CIA
Camille Gackstetter, Senior Auditor II, CPA

Attachment – RDMD Response

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:
Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Vicki Wilson, Deputy County Executive Officer
Kevin Thomas, Director, RDMD/Harbors, Beaches & Parks
Bob Hamilton, Manager, RDMD/HB&P/Program Management
Rich Adler, Chief, RDMD/HB&P/Lease Management
Mike Hentzen, Leasing Coordinator, RDMD/HB&P/Lease Management
Steve Danley, Director, RDMD/Management Services
Mary Fitzgerald, Manager, RDMD/Accounting Services
Brian Murphy, Chief, RDMD/Central Quality Assurance
Teri Marcoot, RDMD/Central Quality Assurance
Darlene J. Bloom, Clerk of the Board of Supervisors
Foreman, Grand Jury

COUNTY OF ORANGE

RESOURCES & DEVELOPMENT MANAGEMENT DEPARTMENT

Bryan Speegle, Director
300 N. Flower Street
Santa Ana, CA

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Final Response

RECEIVED
INTERNAL AUDIT DEPARTMENT
2004 OCT 12 PM 4:13

October 6, 2004

TO: Peter Hughes, Director, Internal Audit Department

FROM: Bryan Speegle, Director
Resources and Development Management Department

SUBJECT: Response to Limited Review Audit No. 2352 – Bayshore Marina – Lower Newport Bay (HA55D-20)

The Resources and Development Management Department (RDMD) has reviewed the draft letter of the Internal Audit Department's Limited Review of the lease between the County of Orange and The Irvine Company for a 16-month period ending October 2003. During that period, TIC operated under the terms and conditions of a lease agreement dated August 13, 1974 ("the Agreement"). The Agreement is primarily to maintain and operate a complete boat berthing facility at Bayshore Marina in Lower Newport Bay. During the audit period, The Irvine Company had retained BellPort Group, Inc. (BellPort) to maintain and operate Bayshore Marina on their behalf. It should be noted that recently The Irvine Company decided to manage their marinas with in-house resources and has terminated their management agreement with BellPort.

Bayshore Marina consists of 96,895 square feet of County tidelands and approximately 40,000 square feet of adjoining tidelands and uplands owned by The Irvine Company. Gross receipts from marina operations were $1,208,875 for FY 03-04 with $247,434 paid in rent to the County. Other than the minimum rent of $23,439 being paid at the beginning of the fiscal year, all other rent is paid annually in arrears on a fiscal year basis.

We understand the primary purpose of Internal Audit's review was to determine whether The Irvine Company's and BellPort's records adequately supported their computation of percentage rent payments made to the County. We understand that Internal Audit also reviewed compliance with certain other provisions of the Agreement, such as accounting methods and payment procedures.

The audit concluded that The Irvine Company and BellPort retained sufficient documentation to adequately support rent payments made to the County; however, the audit identified additional rent owed, areas of non-compliance with the Agreement and areas for improvements. The audit made a total of five recommendations.

RDMD staff provided The Irvine Company with a copy of Audit No. 2352 and discussed with The Irvine Company the findings, RDMD's responses to the findings and any required actions.

RDMD hereby provides the following "Responses" to the Internal Audit Department's "Findings" and "Recommendations":

INTERNAL AUDIT FINDING NO. 1

1. Unreported Gross Income

During our review, we noted that The Irvine Company did not report gross income from the following activities:

A. Utility Charges

Marina customers are billed monthly for use of electricity at the boat slips. The Irvine Company did not report utility charges to the County in gross income during the review period; however, utility charges were reported at the time of our last audit for the year-ended February 28, 1992.

Clause 10 of the General Conditions of the Agreement defines gross income as "fees of any nature or kind charged by the Tenant. . ." We estimate unreported utility charges for fiscal year 2002/2003 to be approximately $21,445, resulting in $5,146.80 additional rent owed to the County.

The Irvine Company considers these charges to be a pass-through of costs and should not be reported as gross income. Per RDMD, The Irvine Company has not received approval to discontinue reporting utility charges.

Recommendation No. 1.A: We recommend that RDMD require The Irvine Company to pay $5,146.80 rent owed due for the period July 1, 2002 through June 30, 2003. We also recommend that RDMD require The Irvine Company to calculate and pay additional rent owed for utility charges for periods prior to July 1, 2002 and after June 30, 2003.

RDMD Response: *RDMD agrees with this recommendation and has discussed this finding with The Irvine Company. The Irvine Company was under the impression that a proposed amendment to allow the exclusion from gross receipts of direct pass-throughs for electrical charges was approved in the early '90s. However, for reasons that are unknown today, The Irvine Company elected not to proceed with the amendment, and the amendment was never sent to the Board of Supervisors for approval. The Irvine Company has paid the additional $5,146.80 rent owned as identified in the audit. In addition, as with some of the other findings in the audit, The Irvine Company has retained a CPA firm to examine its rental worksheets, utility charges, security deposits, prepaid rents and other documents affecting the gross revenues reported to the County and is committed to fulfilling its obligations under the terms of the lease (see attached letter). This work includes the periods prior to July 1, 2002 and after June 30, 2003, and is projected to be completed by the end of October 2004.*

B. Security and Key Deposits

The Irvine Company has not reported net activity from security and key deposits to the County as gross income since fiscal year 2000/2001. As noted above, Clause 10 of the General Conditions of the Agreement defines all fees charged by the tenant to be considered as gross income. We calculated the net security and key deposits for fiscal

years ended 2001/2002 (-$2,002) and 2002/2003 (+$334). Based on the percentage rent formula, the cumulative difference (-$1,668) as of June 30, 2003 would result in a $400 credit to The Irvine Company. However, the actual amount and whether it remains a credit will depend on the cumulative difference as of the month this issue is corrected by the Irvine Company.

Recommendation No. 1.B: We recommend that RDMD require The Irvine Company to report as gross income all net security and key deposits collected. We also recommend that RDMD require The Irvine Company to calculate and pay rent owed, if any, as of the date of correction.

RDMD Response: *RDMD agrees with the recommendation and has discussed this finding with The Irvine Company. This work is also included in the scope of work for the CPA firm that has been authorized by The Irvine Company to examine its rental worksheets, utility charges, security deposits, prepaid rents and other documents affecting the gross revenues reported to the County. Any credits or amounts due will be reconciled upon completion of this work, anticipated at the end of October 2004.*

C. Prepaid Slip Rents

The Irvine Company did not report prepaid slip rents as gross income to the County during the review period; however, prepaid slip rent was reported as gross income as of the last audit for the year-ended February 28, 1992.

Clause 10 of the General Conditions of the Agreement states "The term *gross income*, upon which the rental is to be based, shall consist of all income generated from the operation of the facility." We calculate unreported prepaid rent for fiscal year 2002/2003 to be $4,273.51, resulting in additional rent owed of $1,026. However, the actual amount owed will depend on the cumulative difference as of the month this issue is corrected by the Irvine Company.

Recommendation No. 1.C: We recommend that RDMD require The Irvine Company to report as gross income all prepaid rent collected. We also recommend that RDMD require The Irvine Company to calculate and pay rent owed for unreported prepaid rent as of the date of correction.

RDMD Response: *RDMD agrees with the recommendation and has discussed this finding with The Irvine Company. This work is also included in the scope of work for the CPA firm that has been authorized by The Irvine Company to examine its rental worksheets, utility charges, security deposits, prepaid rents and other documents affecting the gross revenues reported to the County. Any additional rent due will be paid upon completion of this work, anticipated at the end of October 2004.*

INTERNAL AUDIT FINDING NO. 2

2. Financial Statements

The Irvine Company has not submitted the required financial statements since fiscal year 1997/1998.

Clause 12 of the General Conditions of the Agreement requires The Irvine Company to submit, on an annual basis, the following financial statements:

a. An income statement reflecting business transacted on or from the Project Area (Bayshore Marina) during the preceding accounting year. The income statement must be attested to verify that it is an accurate representation of The Irvine Company's records.

b. A statement certified as to accuracy (audited) by a certified public accountant wherein the total gross receipts are classified according to the categories of business conducted on or from the Project Area.

Per RDMD, The Irvine Company will be required to submit financial statements in compliance with the Agreement for fiscal year 2002/2003. Upon receipt and review of these financial statements, RDMD retains the right to request The Irvine Company to submit the financial statements in compliance with the Agreement for the prior years.

Recommendation No. 2: We recommend that RDMD require The Irvine Company to submit financial statements for fiscal year 2002/2003 in compliance with the Agreement and to reserve the right to require The Irvine Company to submit prior years financial statements if necessary.

RDMD Response: *RDMD agrees with the recommendation and has discussed the finding with the Irvine Company. This work also is included in the scope of work for the CPA firm that has been authorized by The Irvine Company to examine its rental worksheets, utility charges, security deposits, prepaid rents and other documents affecting the gross revenues reported to the County. The Irvine Company has agreed to submit financial statements for fiscal year 2002/2003 and all future years in accordance with the terms of the lease.*

INTERNAL AUDIT FINDING NO. 3

3. Records and Documentation

Clause 12 of the General Conditions of the Agreement states, "TENANT shall, at all times during the term of this agreement, keep or cause to be kept, true and complete books, records, and accounts of all financial transactions in the operation of all business activities..." We noted the following areas where documentation supporting gross income was inaccurate or not retained as required by the Agreement:

A. Reconciliation

The Irvine Company performs a monthly reconciliation of customer charges between the Yardie Accounting System (used for billing) and the Marina Manager System (used to maintain tenant information) to ensure completeness and accuracy of customer billings; however, this reconciliation is not documented. Documentation of the reconciliation provides assurance that reconciliation between the two systems is performed and that discrepancies are identified and properly resolved. Without reconciliation, there is more risk customers may not be charged or may be charged incorrectly, increasing the risk of loss for the County.

Recommendation No. 3.A: We recommend that RDMD require The Irvine Company to maintain documentation of the monthly reconciliation between the Yardie Accounting System and the Marina Manager System.

RDMD Response: *RDMD agrees with the recommendation and has discussed this finding with The Irvine Company. The Irvine Company has agreed to retain copies of any future reconciliations.*

B. Inaccurate Documentation

During our review, we found four instances (out of eleven customer files tested) of inaccurate information in the customer file or the Marina Manager System (used to maintain tenant information).

In two instances, the customers were billed incorrectly, resulting in undercharges of $986 and $187 during the review period; however, only $717 affects fiscal year 2002/2003. The remaining $456 represents billing errors subsequent to 6/30/03 that should be corrected by The Irvine Company before reporting gross income for next fiscal year 2003/2004. As a result of these errors, rent was underpaid for fiscal year 2002/2003 by approximately $172.

For the other two instances, we noted incorrect information in the customers' files that did not affect gross income reported to the County. In addition, we were provided a schedule of transient/sub-tenants that was incomplete.

A documented periodic physical inventory of the boats and a comparison to the Marina Manager System would help ensure completeness and accuracy of records.

Recommendation No. 3.B: We recommend that RDMD require The Irvine Company to pay $172 additional rent owed as a result of billing errors. We also recommend that RDMD require The Irvine Company to perform and document a periodic physical inventory of the boats and reconcile to the customer files and the Marina Manager System.

RDMD Response: *RDMD agrees with the recommendation and has discussed the recommendation with The Irvine Company. After discussion with The Irvine Company, however, two key facts came to light: 1) all accounting documentation and billing is done through the Yardie Accounting System which is a complete stand alone accounting system, and 2) the Marina Manager system is only used as an internal tool by on-site staff to show prospective boat slip tenants the location of vacant slips and is not used for accounting or billing purposes. As such, The Irvine Company does not reconcile the two systems for tenant information. However, the CPA firm retained to review the records will be reviewing the accounting records for any errors and, if any additional amounts are identified, they will be paid to the County.*

INTERNAL AUDIT FINDING NO. 4

4. Certification of the Percentage Rental Worksheet

The Percentage Rental Worksheet submitted by The Irvine Company for the Bayshore Marina Project Area (used to report annual gross income and percentage rent due to the County) does not include a statement that it is signed under penalty of perjury.

Clause 11.C of the General Conditions of the Agreement requires the statement to be signed by The Irvine Company or responsible agent under penalty of perjury.

Recommendation No. 4: We recommend that RDMD require The Irvine Company to submit an annual Percentage Rental Worksheet signed under penalty of perjury.

RDMD Response: *RDMD agrees with the recommendation and has discussed this finding with The Irvine Company. The Irvine Company has agreed to submit the annual Percentage Rental Work sheet signed under penalty of perjury.*

5

INTERNAL AUDIT FINDING NO. 5

5. Clarification of the Agreement

We understand that the Agreement is up for renewal later this year. During our review, we identified the following areas of the Agreement that RDMD may want to consider for clarification or revision:

a. Simplifying the annual percentage rent calculation.
b. Clarification of reporting requirements for utility charges, security deposits, and prepaid rent.
c. Security deposit amount of $6,000 appears inadequate.
d. Late charge of $20 per month for delinquent payments appears low. The Irvine Company currently charges a $50 late fee plus a 10% finance charge to customers for delinquent payments.

No specific recommendation is made at this time.

RDMD Response: *Although no specific recommendation was made, all of the above items are being addressed in the new lease currently under negotiation between RDMD and The Irvine Company. All items will reflect current County standards for real estate leases.*

Thank you for allowing us the opportunity to respond to your draft letter. If you have any questions or need additional information, please feel free to contact Mike Hentzen of my staff at (714) 834-6286.

Sincerely,

Bryan Speegle

Attachment

cc: *James D. Ruth, County Executive Officer*
Vicki Wilson, Deputy County Executive Officer
Kevin Thomas, Director, RDMD/Harbors, Beaches & Parks
Bob Hamilton, Manager, RDMD/HBP/Program Management
Rich Adler, Chief, RDMD/HBP/Lease Management
Mike Hentzen, Leasing Coordinator, RDMD/HBP/Lease Management
Steve Danley, Director, RDMD/Management Services
Mary Fitzgerald, Manager, RDMD/Accounting Services
Brian Murphy, Chief, RDMD/Central Quality Assurance
Autumn, McKinney, Internal Audit
Carol L. Swe, Internal Audit

6

THE IRVINE COMPANY
RESORT PROPERTIES

July 15, 2004

Mr. Richard Adler
Harbors, Beaches and Parks/Lease Management
Resources Development Management Department
P.O. Box 4048
Santa Ana, CA 90702-4048

Mr. Michael Hentzen
Harbors, Beaches and Parks/Lease Management
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P.O. Box 4048
Santa Ana, CA 90702-4048

Re: Bayshore Marina Lease and Audit (Parcel No. HA55D-20)

Dear Rich and Mike:

Pursuant to your request enclosed please find a check in the amount of $5,146.80 representing rental payment for Bayshore Marina electrical utility charges for the 2002/2003 lease year. This sum is paid pursuant to item 1A of the County Audit.

Also, this letter will confirm that The Irvine Company is currently in the process of having relevant Marina records reviewed for accuracy pursuant to the directive of the County audit.

As we discussed in our June 10, 2004 meeting, our goal is to provide the County the information it request in the audit, and to ensure we have met our obligation under the terms of the existing lease. Accordingly, we have retained a qualified firm to examine our rental worksheets, utility charges, security deposits, prepaid rents and other documents potentially affecting the Marina gross income.

I expect that this process will be completed within four to six weeks, and greatly appreciate your understanding in this regard. In the interim, please feel free to contact Mike Recupero or me if we can answer any questions regarding this process. I look forward to continuing to work together toward our mutual objectives.

Sincerely,

Greg Sinks
Director, Operations

enclosure

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