INTERNAL AUDIT DEPARTMENT
COUNTY OF ORANGE

Integrity
Objectivity
Independence

LIMITED REVIEW OF LEASE REVENUE FOR RANCHO BEACH HOUSE, INC.

For the Period
July 1, 2003 through June 30, 2004

AUDIT NUMBER: 2461 **REPORT DATE: MARCH 30, 2005**

Audit Director: Peter Hughes, Ph.D., CPA
Deputy Director: Eli Littner, CPA, CIA
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LIMITED REVIEW OF RANCHO BEACH HOUSE, INC.

For the Period from July 1, 2003 through June 30, 2004

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COUNTY OF ORANGE
INTERNAL AUDIT DEPARTMENT

OFFICE OF THE DIRECTOR

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Transmittal Letter

Audit No. 2461

March 30, 2005

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

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

SUBJECT: Limited Review of Rancho Beach House, Inc.

We have completed our limited review of Rancho Beach House, Inc. for the period from July 1, 2003 through June 30, 2004. The final report is attached along with your responses to our recommendations.

Please note, beginning with January 2005, we are implementing a more structured and rigorous follow-up audit process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). In the past, we followed-up on lease audit recommendations during a subsequent lease audit, which could be several years later. As a matter of policy, our first Follow-Up Audit will now begin at six months upon the official release of the report. The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our second Follow-Up Audit will now begin at 12 months from the release of the original report by which time all audit recommendations will have to be addressed or implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not addressed, resolved or implemented after our second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for their discussion.

In addition, as the Director of Internal Audit Department, effective December 14, 2004, I make a monthly audit status presentation to the BOS where I detail any significant and material audit findings released in reports during the prior month and the status of audit recommendation implementation as disclosed by Follow-Up Audits. Accordingly, the results of this review will be included in a future summary to the Board.

The Internal Audit Department is an independent audit function reporting directly to the Orange County Board of Supervisors.

Because of these visible changes to our follow-up process, the Internal Audit Department is available to partner with all departments and agencies so that they can successfully implement or address difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report, recommendations or follow-up process.

We have attached a Follow-Up Audit Tracking Document template. Your department should complete this template as our audit recommendations are implemented. When we perform our follow-up audit approximately six months from the date of this report, we will request the completed document to facilitate our review.

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 CEO, CEO/Infrastructure & Environmental Services
Kevin Thomas, Director, RDMD/Harbors, Beaches & Parks
Paul Lawrence, Manager, RDMD/HB&P/Dana Point Harbor Administration
Jackie Cadotte, Lease Compliance Specialist, RDMD/HB&P/Dana Point Harbor Admin.
Steve Danley, Director, RDMD/Administrative Services
Mary Fitzgerald, Manager, RDMD/Accounting Services
Brian Murphy, Chief, RDMD/Central Quality Assurance
Foreman, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

COUNTY OF ORANGE
INTERNAL AUDIT DEPARTMENT

OFFICE OF THE DIRECTOR

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INTERNAL AUDITOR'S REPORT

Audit No. 2461

March 30, 2005

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

SUBJECT: Limited Review of Rancho Beach House, Inc.
Parcel HA78H-24-001

We have performed a limited review of certain records and documents for the year ended June 30, 2004, pertinent to the lease agreement (Agreement) between the County of Orange (County) and Rancho Beach House, Inc., a California corporation, dated January 23, 2001. The Agreement is primarily for the operation of Rancho Beach House restaurant (RBH) located at Dana Point Harbor.

The primary purpose of our review was to determine whether RBH's records adequately supported their monthly gross receipts reported to the County. 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 RBH has retained sufficient documentation to adequately support monthly gross receipts reported to the County. However, we did identify areas of non-compliance with the Agreement and areas for improvement as presented below.

1. Banquets

   A. Pre-numbered Banquet Contracts and Orders
   Banquet contracts and banquet orders used by RBH were not pre-numbered. Clause 12.A of the Agreement requires RBH to use serially numbered documents for each admission or rental and to account for used and unused documents.

   Recommendation No. 1.A: We recommend that RDMD require RBH to use pre-numbered documents for banquet contracts and banquet orders, and to account for the sequential integrity of the documents.

The Internal Audit Department is an independent audit function reporting directly to the Orange County Board of Supervisors.

RDMD Response: RDMD concurs with Recommendation No. 1.A.

Action: RDMD will direct RBH to commence utilizing pre-numbered documents for banquet contracts and banquet orders. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

B. Banquet Deposits

RBH collects nonrefundable banquet deposits for banquet reservations. RBH reports the deposits to the County as gross receipts when the banquet is held, rather than when the deposit is received. Clause 9.F.(1) of the Agreement states security deposits shall be considered gross receipts when received by Tenant. RBH should report the banquet deposits as gross receipts to the County when received.

Recommendation No. 1.B: We recommend that RDMD require RBH to report banquet deposits as gross receipts to the County when received.

RDMD Response: RDMD concurs with Recommendation No. 1.B.

Action: RDMD will direct RBH to commence reporting banquet deposits as gross receipts when received by RBH. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

C. Miscellaneous Rental Fees

We reviewed a banquet held in June 2004 and noted that RBH charged the customer a rental fee for a dance floor and an arch obtained through an outside party. The rental fee charged to the customer was the same fee charged to RBH and there was no markup. RBH informed us that it provides these items as a courtesy to the customer and does not charge an additional fee.

Clause 9.B of the Agreement states gross receipts shall include charges made by Tenant for the sale or rendition on or from the Premises of services of any nature or kind whatsoever. Based on our discussions with RDMD, RBH should be disclosing these types of transactions as a separate line item on the monthly rent report to the County, with no percentage rent paid unless there is a mark-up (additional fee) assessed to the customer. If there is a mark-up assessed, RBH should pay percentage rent on the amount of the mark-up.

Recommendation No. 1.C: We recommend that RDMD require RBH to report pass through rental charges on the monthly rent report to the County and pay percentage rent on mark-up amounts, if any.

RDMD Response: RDMD concurs with Recommendation No. 1.C; noting additional requirements of the Agreement.

Action: In accordance with Section 5.C., optional services and uses are "subject to the prior written approval of the Director..." RDMD requires RBH to submit a written request for services provided by outside parties. In accordance with Section 5.D. "TENANT agrees not to... permit any other business activity within or from the Premises." In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

2. Gift Cards

A. Gift Card Redemptions

RBH properly reports gift card sales as gross receipts when the gift card is sold rather than when redeemed. However, upon redemption of the gift card, RBH also reports the sale as gross receipts. This may result in over reported gross receipts to the County.

RBH is allowed to make an adjustment to sales for gift card redemptions, but only if the gift card was sold at the Dana Point location. Adjustments are not allowed for gift cards sold at other locations or gift cards issued for promotional purposes because they are not reported as gross receipts to the County when issued/sold.

Recommendation No. 2.A: We recommend that RDMD communicate this potential over reporting of gift card redemptions to RBH so that it can be corrected in the future.

RDMD Response: RDMD concurs with Recommendation No. 2.A.

Action: By RBH receipt of this report, Audit Number 2461, RDMD notifies RBH that a potential for over reporting of gift card redemptions may exist.

B. Reconciling Gift Card Sales and Activations

RBH began selling gift cards (in lieu of gift certificates) in April 2004. Gift card sales are recorded in RBH's Point of Sale (POS) cashiering system. A separate electronic reader activates the gift card for the sold amount. We noted that RBH did not reconcile the amount activated on the reader to the amount recorded in the POS. This reconciliation will help ensure that all gift cards activated are recorded in the POS and then reported to the County.

Recommendation No. 2.B: We recommend that RDMD require RBH to reconcile gift cards sales in the POS with gift cards activated in the electronic reader.

RDMD Response: RDMD concurs with Recommendation No. 2.B.

Action: RDMD will direct RBH to commence reconciling gift card sales in the POS with gift cards activated in the electronic reader. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

C. Sequential Integrity of Gift Certificates/Cards

RBH maintains a manual log of gift certificates/cards issued. The log includes the certificate/card number, amount, type of transaction (e.g. cash, credit card, or promotion), date sold, and the employee's initials. We reviewed the log for February 2004 and noted there were gaps in the sequential numbers of the certificates and therefore, not all gift certificate activity was recorded on the log. The numerical sequence of gift certificates/cards issued should be accounted for.

Recommendation No. 2.C: We recommend that RDMD require RBH to account for the numerical sequence of gift cards issued by periodically reviewing the gift card log for completeness and sequential integrity.

RDMD Response: RDMD concurs with Recommendation No. 2.C.

Action: RDMD will direct RBH to commence accounting for numerical sequence of gift certificates/cards issued. In accordance with Section 12.A. Tenant "shall keep an adequate record of said tickets, both issued and not issued." In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

3. Minor Clerical Errors in Compiling and Reporting Monthly Gross Receipts

RBH's accounting records (general ledger) are not "closed" by the time the monthly rent report is due to the County. Therefore, gross receipts reported to the County are based on the monthly reports from RBH's point of sale (POS) cashiering system, adjusted as necessary. For gift certificates/cards, the amount reported to the County is based on an adding machine tape of amounts from the daily POS reports.

For the sample months of February 2004 and June 2004, RBH made minor clerical errors when compiling the monthly gross receipts reported to the County. The following discrepancies were noted:

- For June 2004, gift certificate sales were under reported to the County by $280. The adding machine tape supporting the amount of gift certificate sales reported to the County was not retained by RBH.

- For February 2004, banquet deposits were reported in the gift certificates sold category and vice versa.

- For June 2004, reported gross receipts for food, beverage/bar, and room charges did not agree to RBH's general ledger, resulting in a net difference of $278 being over reported to the County. Part of the difference resulted from a $307 gratuity tax reported as gross receipts.

Recommendation No. 3.A: We recommend that RDMD require RBH to establish procedures to help ensure reported gross receipts are accurate. This should include a

comparison of sales reported to the County with sales recorded on RBH's monthly general ledger. Any necessary corrections could be reported to the County in the following month.

RDMD Response: RDMD concurs with Recommendation No. 3.A.

Action: RDMD will direct RBH to establish procedures to help ensure reported gross receipts are accurate. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

Recommendation No. 3.B: We also recommend that RDMD require RBH to retain adding machine tapes or other manual records prepared that support gift certificates and adjustments to gross receipts reported to the County.

RDMD Response: RDMD concurs with Recommendation No. 3.B.

Action: RDMD will direct RBH to retain adding machine tapes or other manual records prepared that support gift certificates/cards and adjustments to gross receipts reported to the County. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

4. Financial Statements

Clause 12.C of the Agreement requires RBH to submit annual financial statements to the County, attest under penalty of perjury the accuracy of the financial statements, and submit a gross receipts statement compiled by a Certified Public Accountant (CPA). The following areas of non-compliance were noted:

- For the years ended 12/31/01 and 12/31/02, RBH did not submit a gross receipts statement compiled by a CPA or annual financial statements prepared by RBH.

- For the year ended 12/31/03, RBH did submit a gross receipt statement prepared by a CPA. However, the CPA did not prepare an Accountants' Standard Report on Compilation required by the professional standards – Statements on Standards for Accounting and Review Services (SSARS).

- For the year ended 12/31/03, RBH did submit monthly financial statements with year-to-date amounts. However, RBH did not attest as to the accuracy of the statements under penalty of perjury.

Recommendation No. 4: We recommend that RDMD require RBH to submit financial statements that comply with Clause 12.C of the Agreement.

RDMD Response: RDMD concurs with Recommendation No. 4.

Action: RDMD will direct RBH to submit the required documents outlined above. RDMD has previously sent, by certified mail - return receipt requested, a demand for the required reports on August 19, 2004 and again on September 7, 2004. Although documents were

received by RDMD from RBH on August 23, 2004 and a letter from RBH's accountant on September 14, 2004, those documents were not submitted in accordance with the requirements of the Agreement. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

5. Internet Sales

We noted that RBH maintains an internet website where merchandise and gift certificates are sold for all of their restaurant locations including Dana Point. RBH informed us that the internet sales are managed by a separate business entity of RBH. The internet sales are not reported to the County as gross receipts. RDMD should determine whether any of the internet sales should be reported as gross receipts to the County.

Recommendation No. 5: We recommend that RDMD review and determine the appropriate reporting of RBH's internet website sales.

RDMD Response: RDMD concurs with Recommendation No. 5.

Action: RDMD has determined that internet sales conducted from a location other than Dana Point would not result in percentage rent owed to the County, EXCEPT in the sale of gift certificates/cards as addressed in Item 2 of this report where gift certificates sold at a location other than Dana Point must be reported when redeemed in Dana Point. Gift certificates/cards sold at another location and redeemed at Dana Point will result in percentage rent owed to the County.

6. Valet Parking

RBH contracts with a private company to provide valet parking service. RBH informed us that it does not receive a share of the revenue from the valet company, and there is no written contract or service agreement. Lease Clause 5.C of the Agreement states that RBH may provide additional restaurant related services and uses subject to prior approval from the Director of RDMD.

Recommendation No. 6: We recommend that RDMD review and determine the appropriate reporting of the valet parking activity.

RDMD Response: RDMD concurs with Recommendation No. 6.

Action: RDMD has determined that valet services are a service provided by an outside company. In accordance with Section 5.C., optional services and uses are "subject to the prior written approval of the Director..." RDMD requires RBH to submit a written request for services provided by outside parties. In accordance with Section 5.D. "TENANT agrees not to... permit any other business activity within or from the Premises." In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

7. Signed Monthly Rent Reports

We reviewed the monthly rent reports submitted to the County for July 1, 2003, through June 30, 2004, and noted that the monthly rent report was not signed by RBH for 5 of the 12 months. Clause 10.A of the Agreement requires RBH to sign the monthly rent reports under penalty of perjury.

Recommendation No. 7: We recommend that RDMD require RBH to sign each monthly rent report under penalty of perjury.

RDMD Response: RDMD concurs with Recommendation No. 7.

Action: RDMD directs RBH sign all monthly reports certifying their accuracy under penalty of perjury.

We appreciate the courtesy and cooperation extended to us by the personnel at Rancho Beach House, Inc., RDMD/HB&P/Dana Point Harbor Administration, 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, Internal Audit

Audit Team
Eli Littner, Deputy Director, CPA, CIA
Autumn McKinney, Audit Manager, CPA, CIA
Carol Swe, Senior Auditor II, CPA, CIA
Lily Chin, 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 Mauk, County Executive Officer
Vicki Wilson, Deputy CEO, CEO/Infrastructure & Environmental Services
Kevin Thomas, Director, RDMD/Harbors, Beaches & Parks
Paul Lawrence, Manager, RDMD/HB&P/Dana Point Harbor Administration
Jackie Cadotte, Lease Compliance Specialist, RDMD/HB&P/Dana Point Harbor Admin.
Steve Danley, Director, RDMD/Administrative Services
Mary Fitzgerald, Manager, RDMD/Accounting Services
Brian Murphy, Chief, RDMD/Central Quality Assurance
Foreman, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

Attachment – RDMD Management Responses:

COUNTY OF ORANGE

RESOURCES & DEVELOPMENT MANAGEMENT DEPARTMENT

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

P.O. Box 4048
Santa Ana, CA 92702-4048

Telephone: (714) 834-2300
Fax: (714) 834-5188

DATE: March 28, 2005

TO: Peter Hughes, Director, Internal Audit Department

FROM: Bryan Speegle, Director
Resources & Development Management Department

SUBJECT: Response to Limited Review of Revenue for Rancho Beach House, Inc.
Parcel HA78H-24-001 (Audit No. 2461)

RECEIVED
INTERNAL AUDIT DEPARTMENT
2005 MAR 30 PM 1:11

The Resources & Development Management Department (RDMD) has received and reviewed the Internal Audit Department's Limited Review of Revenue for Rancho Beach House, Inc., (RBH) in draft form for the 12 month period ending June 30, 2004, pertinent to the lease agreement (Agreement) between the County of Orange (County) and RBH dated January 23, 2001. The Agreement is primarily for the operation of Rancho Beach House restaurant located at Dana Point Harbor.

The primary purpose of the Internal Audit Department's review was to determine whether RBH's records adequately supported their gross receipts reported to the County. Internal Audit Department also reviewed compliance with certain other provisions of the Agreement, such as accounting methods and payment procedures.

It was found that RBH has retained sufficient records to support gross receipts reported to the County; however, areas of non-compliance with the Agreement were identified and areas for improvement were presented to RDMD.

Submitted below are RDMD's responses to the Limited Review:

1. **Banquets:**

   A. Pre-numbered Banquet Contracts and Orders

   Internal Audit reported that banquet contract and banquet orders used by RBH were not pre-numbered. Clause 12.A of the Agreement requires RBH to use serially numbered documents for each admission or rental and to account for used and unused documents.

   Recommendation No. 1.A: RDMD require RBH to use pre-numbered documents for banquet contracts and banquet orders, and to account for the sequential integrity of the documents.

   Response: RDMD concurs with Recommendation No. 1.A.

   Action: RDMD will direct RBH to commence utilizing pre-numbered documents for banquet contracts and banquet orders. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

   B. Banquet Deposits

   RBH collects nonrefundable banquet deposits for banquet reservations. RBH reports the deposits to the County as gross receipts when the banquet is held, rather than when the deposit is received. Clause 9.F.(1) of the Agreement states security deposits shall be considered gross receipts when received by Tenant. RBH should report the banquet deposits as gross receipts to the County when received.

Recommendation No. 1.B: RDMD require RBH to report banquet deposits as gross receipts to the County when received.

Response: RDMD concurs with Recommendation No. 1.B.

Action: RDMD will direct RBH to commence reporting banquet deposits as gross receipts when received by RBH. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

C. Miscellaneous Rental Fees

Internal Audit reviewed a banquet held in June 2004 and noted that RBH charged the customer a rental fee for a dance floor and an arch obtained through an outside party. The rental fee charged to the customer was the same fee charged to RBH and there was no markup. RBH informed Internal Audit that it provides items as a courtesy to the customer and does not charge an additional fee.

Clause 9.B. of the Agreement states gross receipts shall include charges made by Tenant for the sale or rendition on or from the Premises of services of any nature or kind whatsoever. Based on Internal Audit's discussions with RDMD, RBH should be disclosing these types of transactions as a separate line item on the monthly report to the County, with no percentage rent paid unless there is a mark-up (additional fee) assessed to the customer. If there is a mark-up assessed, RBH should pay percentage rent on the amount of the mark-up.

Recommendation No. 1.C: RDMD require RBH to report pass through rental charges on the monthly rent report to the County and pay percentage rent on the mark-up amounts, if any.

Response: RDMD concurs with Recommendation No. 1.C; noting additional requirements of the Agreement.

Action: In accordance with Section 5.C., optional services and uses are "subject to the prior written approval of the Director…" RDMD requires RBH to submit a written request for services provided by outside parties. In accordance with Section 5.D. "TENANT agrees not to… permit any other business activity within or from the Premises." In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

2. Gift Cards:

A. Gift Card Redemptions

RBH properly reports gift card sales as gross receipts when the gift card is sold rather than when redeemed. However, upon redemption of the gift card, RBH also reports the sale as gross receipts. This may result in overpayment of gross receipts to the County.

RBH is allowed to make an adjustment to sales for gift card redemptions, but only if the gift card was sold at the Dana Point location. Adjustments are not allowed for gift cards sold at other locations or gift cards issued for promotional purposes because they are not reported as gross receipts to the County when issued/sold.

Recommendation No. 2.A: RDMD will communicate the potential over reporting of gift card redemptions to RBH so that it can be corrected in the future.

Response: RDMD concurs with Recommendation No. 2.A.

Action: By RBH receipt of this report, Audit Number 2461, RDMD notifies RBH that a potential for over reporting of gift card redemptions may exist.

B. Reconciling Gift Card Sales and Activations

RBH began selling gift cards (in lieu of gift certificates) in April 2004. Gift card sales are recorded in RBH's Point of Sale (POS) cashiering system. A separate electronic reader activates the gift card for the sold amount. Internal Audit noted that RBH did not reconcile the amount activated on the reader to the amount recorded in the POS and then reported to the County.

Recommendation No. 2.B: RDMD require RBH to reconcile gift cards sales in the POS with gift cards activated in the electronic reader.

Response: RDMD concurs with Recommendation No. 2.B.

Action: RDMD will direct RBH to commence reconciling gift card sales in the POS with gift cards activated in the electronic reader. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

C. Sequential Integrity of Gift Certificates/Cards

RBH maintains a manual log of gift certificates/cards issues. The log includes the certificate/card number, amount, type of transaction (e.g., cash, credit card, or promotion), date sold and the employee's initials. Internal Audit reviewed the log for February 2004 and noted there were gaps in the sequential numbers of the certificates and therefore, not all gift certificate activity was recorded on the log. The numerical sequence of gift certificates/cards issued should be accounted for.

Recommendation No. 2.C: RDMD require RBH to account for numerical sequence of gift certificates/cards issued by periodically reviewing the gift card log for completeness and sequential integrity.

Response: RDMD concurs with Recommendation No. 2.C.

Action: RDMD will direct RBH to commence accounting for numerical sequence of gift certificates/cards issued. In accordance with Section 12.A. Tenant "shall keep an adequate record of said tickets, both issued and not issued." In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

3. Minor Clerical Errors in Compiling and Reporting Monthly Gross Receipts

RBH's accounting records (general ledger) are not "closed" by the time the monthly rent report is due to the County. Therefore, gross receipts reported to the County are based on the monthly reports from RBH's point of sale (POS) cashiering system, adjusted as necessary. For gift certificates/cards, the amount reported to the County is based on an adding machine tape of amounts from the daily POS reports.

For the sample months of February 2004 and June 2004, RBH made minor clerical errors when compiling the monthly gross receipts reported to the County. The following discrepancies were noted:

- For June 2004, gift certificate sales were under reported to the County by $280. The adding machine tape supporting the amount of gift certificate sales reported to the County was not retained by RBH.
- For February 2004, banquet deposits were reported in the gift certificates sold category and vice versa.

- For June 2004, reported gross receipts for food, beverage/bar, and room charges did not agree to RBH's general ledger, resulting in a net difference of $278 being over reported to the County. Part of the difference resulted from a $307 gratuity tax reported as gross receipts.

Recommendation No. 3A: RDMD require RBH to establish procedures to help ensure reported gross receipts are accurate. This should include a comparison of sales reported to the County with sales recorded on RBH's monthly general ledger. Any necessary corrections could be reported to the County in the following month.

RDMD Response: RDMD concurs with Recommendation No. 3.A.

Action: RDMD will direct RBH to establish procedures to help ensure reported gross receipts are accurate. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

Recommendation No. 3B: RDMD require RBH to retain adding machine tapes or other manual records prepared that support gift certificates/cards and adjustments to gross receipts reported to the County.

RDMD Response: RDMD concurs with Recommendation No. 3.B.

Action: RDMD directs RBH to retain adding machine tapes or other manual records prepared that support gift certificates/cards and adjustments to gross receipts reported to the County. In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

4. Financial Statements

Clause 12.C. of the Agreement requires RBH to submit annual financial statements to the County, attest under penalty of Perjury the accuracy of the financial statements, and submit a gross receipts statement compiled by a Certified Public Accountant (CPA). The following areas of non-compliance were noted:

- For the years ended 12/31/01 and 12/31/02, RBH did not submit a gross receipts statement compiled by a CPA or annual financial statements prepared by RBH.
- For the year ended 12/31/03, RBH did submit a gross receipt statement prepared by a CPA. However, the CPA did not prepare an Accountants' Standard Report on Compilation required by the professional standards – Statements on Standards for Accounting and Review Services (SSARS).
- For the year ended 12/31/03, RBH did submit monthly financial statements with year-to-date amounts. However, RBH did not attest as to the accuracy of the statements under penalty of perjury.

Recommendation No. 4: RDMD require RBH to submit financial statements that comply with Clause 12.C. of the Agreement.

RDMD Response: RDMD concurs with Recommendation No. 4.

Action: RDMD will direct RBH to submit the required documents outlined above. RDMD has previously sent, by certified mail - return receipt requested, a demand for the required reports on August 19, 2004 and again on September 7, 2004. Although documents were received by RDMD from RBH on August 23, 2004 and a letter from RBH's accountant on September 14, 2004, those documents were not submitted in accordance with the requirements of the Agreement. In accordance with the Agreement,

General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

5. Internet Sales

   RBH maintains an internet website where merchandise and gift certificates are sold for all of their restaurant locations, including Dana Point. RBH informed us that the internet sales are managed by a separate business entity of RBH. The internet sales are not reported to the County as gross receipts. RDMD should determine whether any of the internet sales should be reported as gross receipts to the County.

   Recommendation No. 5: RDMD review and determine the appropriate reporting of RBH's internet website sales.

   RDMD Response: RDMD concurs with Recommendation No. 5.

   Action: RDMD has determined that internet sales conducted from a location other than Dana Point would not result in percentage rent owed to the County, EXCEPT in the sale of gift certificates/cards as addressed in Item 2 of this report where gift certificates sold at a location other than Dana Point must be reported when redeemed in Dana Point. Gift certificates/cards sold at another location and redeemed at Dana Point will result in percentage rent owed to the County.

6. Valet Parking

   RBH contracts with a private company to provide valet parking service. RBH informed Internal Audit that it does not receive a share of the revenue from the valet company, and there is no written contract or service agreement. Lease Clause 5.C. of the Agreement states that RBH may provide additional restaurant related services and uses subject to prior approval from the Director of RDMD.

   Recommendation No. 6: RDMD review and determine the appropriate reporting of the valet parking activity.

   RDMD Response: RDMD concurs with Recommendation No. 6.

   Action: RDMD has determined that valet services are a service provided by an outside company. In accordance with Section 5.C., optional services and uses are "subject to the prior written approval of the Director…" RDMD requires RBH to submit a written request for services provided by outside parties. In accordance with Section 5.D. "TENANT agrees not to… permit any other business activity within or from the Premises." In accordance with the Agreement, General Terms and Conditions, Section 18.A.(3), this item must be cured within 10 days of RBH receipt of this report, Audit Number 2461, or the County may pursue any available legal action.

7. Signed Monthly Rent Reports

   Internal Audit reviewed the monthly rent reports submitted to the County for July 1, 2003, through June 30, 2004, and noted that the monthly rent report was not signed by RBH for 5 of the 12 months. Clause 10.A. of the Agreement requires RBH to sign the monthly rent reports under penalty of perjury

   Recommendation No. 7: RDMD require RBH to sign each monthly rent report under penalty of perjury.

   RDMD Response: RDMD concurs with Recommendation No. 7.

   Action: RDMD directs RBH sign all monthly reports certifying their accuracy under penalty of perjury.

RDMD staff will continue to pursue appropriate responses and actions from RBH as presented in Audit 2461.

Bryan Speegle, Director
Resources & Development Management Department

cc: Thomas G. Mauk, County Executive Officer
Vicki Wilson, Deputy CEO, CEO/Infrastructure & Environmental Services
Kevin Thomas, Director, RDMD/Harbors, Beaches, & Parks
Paul Lawrence, Manager, RDMD/HB&P/Dana Point Harbor Administration
Jackie Cadotte, Lease Compliance Specialist, RDMD/HB&P/Dana Point Harbor Administration
Steve Danley, Director, RDMD/Administrative Services
Mary Fitzgerald, Manager, RDMD/Accounting Services
Brian Murphy, Chief, RDMD/Central Quality Assurance