OC Board of Supervisors'

Internal Audit Department

ORANGE COUNTY

REVIEW OF LEASE REVENUE SUNSET AQUATIC PARK, LTD., DBA SUNSET AQUATIC MARINA

For the Period
September 1, 2006 through August 31, 2007

Sunset Aquatic Park, Ltd., dba Sunset Aquatic Marina operates a boat marina, boat launch, dry boat storage, and marine repair facility located in Seal Beach. Gross receipts generated during the audit period were approximately $4.2 million and rent paid to the County was approximately $717,000.

The Internal Audit Department found that Sunset Aquatic Marina's records adequately supported gross receipts and rent was properly paid.

AUDIT NO: 2740
REPORT DATE: AUGUST 14, 2008

Audit Director: Peter Hughes, Ph.D., MBA, CPA
Deputy Director: Eli Littner, CPA, CIA
Sr. Audit Manager: Autumn McKinney, CPA, CIA
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Letter from Director Peter Hughes

Transmittal Letter

AUDIT NO. 2740 AUGUST 14, 2008

TO: Steve Franks, Director
OC Community Resources

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Review of Lease Revenue for Sunset Aquatic Park, Ltd., dba Sunset Aquatic Marina, PR26A-101, 2.02, 3M1

We have completed our review of lease revenue for Sunset Aquatic Park, Ltd., dba Sunset Aquatic Marina for the period September 1, 2006 through August 31, 2007. On March 18, 2008 by resolution of the Board of Supervisors, Resources & Development Management Department (RDMD) was reorganized. The reorganization established the OC Community Resources and OC Public Works. The final **Internal Auditor's Report** is attached along with your responses to our recommendations.

Please note we have a 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). As a matter of policy, our **first Follow-Up Audit** will now begin at six months from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

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 six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented.

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

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

Letter from Director Peter Hughes

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendation.

Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

Attachments

Other recipients of this report listed on the Internal Auditor's Report on page 3.

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Audit No. 2740

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September 1, 2006 through August 31, 2007

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INTERNAL AUDITOR'S REPORT

AUDIT NO. 2740 **AUGUST 14, 2008**

TO: Steve Franks, Director
OC Community Resources

FROM: Dr. Peter Hughes, CPA, Director
FOR Internal Audit Department

SUBJECT: Review of Lease Revenue for Sunset Aquatic Park, Ltd., dba Sunset Aquatic Marina, PR26A-101, 2.02, 3M1

Audit Highlight

Sunset Aquatic Marina operates a boat marina, boat launch, dry boat storage, and marine repair facility located in Seal Beach. Gross receipts generated during the audit period were approximately $4.2 million and rent paid to the County was approximately $717,000.

The Internal Audit Department found that Sunset Aquatic Marina's records adequately supported gross receipts and rent was properly paid.

OBJECTIVES

We have performed a review of certain records and documents for the period from September 1, 2006 through August 31, 2007, pertinent to the amended and restated lease agreement (Agreement) between the County of Orange (County) and Sunset Aquatic Park, Ltd. (Sunset Aquatic Marina), dated December 20, 1994. The Agreement is for the operation of a marina, boat launch, dry boat storage, and marine repair facility.

The primary purpose of our review is to determine whether Sunset Aquatic Marina'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.

BACKGROUND

The County of Orange (County) entered into an amended and restated lease agreement (Agreement) with Sunset Aquatic Park, Ltd, a California limited partnership, also known as Sunset Harbour Marina (Sunset Aquatic Marina) dated December 20, 1994, for the operation of a marina, boat launch, dry boat storage, and marine repair facility located in Seal Beach. The marine repair facility is operated by Sunset Aquatic Marine Center, Ltd., a sublessee of Sunset Aquatic Marina. During the audit period, Sunset Aquatic Marina generated approximately $4.2 million in gross receipts and paid the County approximately $717,000 in rent.

On March 18, 2008 by resolution of the Board of Supervisors, Resources & Development Management Department (RDMD) was reorganized. The reorganization established OC Community Resources and OC Public Works.

SCOPE

Our review was limited to certain records and documents that support Sunset Aquatic Marina's gross receipts reported to the County for the 12-month period of September 1, 2006 to August 31, 2007. We also reviewed compliance with certain other provisions of the Agreement, such as accounting methods and payment procedures. Our review included inquiry, auditor observation, and limited testing for assessing the adequacy of documentation and ensuring completeness of reported gross receipts.

CONCLUSION

Based on our review, we find that Sunset Aquatic Marina's records adequately supported monthly gross receipts reported to the County. **No material weaknesses or significant issues were identified.** However, we identified three (3) control findings which are noted in the Detailed Observations, Recommendations and Management Responses section of this report. See Attachment A for a description of report item classifications.

ACKNOWLEDGMENT

We appreciate the courtesy and cooperation extended to us by the personnel at Sunset Aquatic Marina, OC Community Resources, OC Parks/Real Estate, and OC Public Works/Accounting Services. If you have any questions regarding our review of lease revenue, please call me, Eli Littner, Deputy Audit Director, at (714) 834-5899, or Autumn McKinney, Senior Audit Manager, at (714) 834-6106.

Attachment A: **Report Item Classifications**
Attachment B: **OC Community Resources Management Responses**

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Alisa Drakodaidis, Deputy CEO/OC Infrastructure
Mark Denny, Director, OC Community Resources/OC Parks
Michael Brajdic, Deputy Director, OC Community Resources/OC Parks
Doug Berry, Financial Manager, OC Community Resources/OC Parks
Michael Hentzen, Administrative Manager I, OC Community Resources/ OC Parks/Real Estate
Andrea Richard, Real Property Agent III, OC Community Resources/ OC Parks/Real Estate
Anna Peters, Director of Administrative Services, OC Community Resources
Mary Fitzgerald, Accounting Manager, OC Public Works/Accounting Services
Jenny Tu, Chief, OC Public Works/Accounting/Santa Ana River, Watershed, Flood, Leases and Infrastructure
Tam Vu, Admin. Manager I, OC Public Works/Accounting/Watershed, Flood, Leases and Infrastructure
Brian Cich, Senior Accountant I, OC Public Works/Accounting/Leases and Infrastructure
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Annual Lease Rent Calculation - Tax Basis Revenue vs. Gross Receipts

Clause 8B of the Agreement requires annual rent paid to the County to be the greater of minimum annual rent (greater of base or percentage rent) or lease rent (percentage of net cash flows).

The calculation for annual lease rent is a formula containing several components including annual gross receipts that are defined by Clause 11 of the Agreement.

Finding No. 1: In the annual lease rent calculation included in Sunset Aquatic Marina's 2006 and 2007 Audited Schedule of Gross Receipts, the total revenue amount (income tax basis) was used in the calculation rather than the required gross receipts amount.

We recalculated lease rent using the gross receipts amount and determined that no additional rent was owed to the County for 2006 and 2007. However, future lease rent calculations should use the required gross receipts amount.

Recommendation No. 1: We recommend that OC Parks require Sunset Aquatic Marina to calculate annual lease rent in accordance with Clause 8B of the Agreement.

OC Community Resources Management Response: Concur. By letter dated July 17, 2008, Sunset Aquatic Marina has agreed, beginning with the 2008 calculations, to calculate Annual Lease Rent using annual gross receipts, as that term is defined in the lease, rather than using the total revenue amount (income tax basis).

Misclassification of Sublease Gross Receipts

Finding No. 2: We noted that certain sublessee gross receipts were misclassified on Sunset Aquatic Marina's Monthly Rent Report and 2006 Audited Schedule of Gross Receipts as follows:

- Do-It-Yourself Yard (rental of space) gross receipts were incorrectly classified as Ships Chandlery (parts) rather than Do-It-Yourself Yard.
- Service and Labor, Outside Labor, and Freight/Miscellaneous gross receipts were incorrectly classified as Do-It-Yourself Yard rather than Boat Repairs.
- Laydays (rental charge for boat located on cradle during repairs) gross receipts were incorrectly classified as Ships Chandlery (parts) rather than Boat Repairs.

All of the above business activities are 5% rent categories per Clause 8.A.2 of the Agreement. Therefore, no additional rent is due to the County as a result of the misclassifications.

Recommendation No. 2: We recommend that OC Parks require Sunset Aquatic Marina to report the sublessee gross receipts in the correct percentage rent categories.

OC Community Resources Management Response: Concur. By letter dated July 17, 2008, Sunset Aquatic Marina has agreed to report future sublessee gross receipts using the correct percentage rent categories. Additionally, Sunset Aquatic Marina corrected the misclassification of the sublessee's gross receipts on the June 2008 monthly gross receipts report.

Boat Launch Parking Non-Resettable Counter

Clause 14 of the Agreement requires that registers or comparable devices used to record charges be equipped with counters which are not resettable and which record transaction numbers and sales details.

Sunset Aquatic Marina utilizes an automated gate arm system to control entry to the boat launch parking area. The customer puts cash into the machine which generates a parking ticket and opens the gate arm for entry into the lot. Weekly or bi-weekly depending on activity, the On-Site Manager and another employee open the machine and remove the cash bag. When the cash bag is removed, the machine generates a Cash Box ticket documenting the sales details used to balance the cash. A non-resettable counter number is printed on the Cash Box ticket.

The non-resettable counter number should be accounted for to ensure there are no breaks in sequence. If breaks in sequence are not accounted for, there is an increased risk of cash being improperly removed from the machine without being detected.

Finding No. 3: We noted that the sequential non-resettable counter number on the Cash Box tickets was not accounted for during the balancing process.

Recommendation No. 3: We recommend that OC Parks require Sunset Aquatic Marina to account for the sequential number on the Cash Box tickets during the balancing process to ensure there are no breaks in sequence.

OC Community Resources Management Response: Concur. Pursuant to the letter dated July 17, 2008, Sunset Aquatic Marina has established written control procedures for the collection of gate parking revenues. These procedures will account for the sequential numbering on the Cash Box tickets issued by the non-resettable parking gate machine. OC Parks will monitor Sunset Aquatic Marina to ensure the procedures are properly accounting for the gate parking revenues.

ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

- **Material Weaknesses:**
  Audit findings or a combination of Significant Issues that can result in financial liability and exposure to a department/agency and to the County as a whole. Management is expected to address "Material Weaknesses" brought to their attention immediately.

- **Significant Issues:**
  Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of processes or internal controls. Significant Issues do not present a material exposure throughout the County. They generally will require prompt corrective actions.

- **Control Findings and/or Efficiency/Effectiveness Issues:**
  Audit findings that require management's corrective action to implement or enhance processes and internal controls. Control Findings and Efficiency/Effectiveness issues are expected to be addressed within our follow-up process of six months, but no later than twelve months.

ATTACHMENT B: OC Community Resources Management Responses

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Steve Franks
Director
OC Community Resources

Jennifer Phillips
Director
OC Animal Care

Karen Roper
Director
OC Community Services

Mark Denny
Director
OC Parks

Helen Fried
County Librarian
OC Public Libraries

MEMORANDUM

DATE: August 5, 2008

TO: Peter Hughes, Director, Internal Audit Department

FROM: Steve Franks, Director, OC Community Resources

SUBJECT: **RESPONSE TO LIMITED REVIEW AUDIT NO. 2740 – SUNSET AQUATIC PARK, LTD., DBA SUNSET AQUATIC MARINA**

OC Community Resources has reviewed the Draft Letter of the Internal Audit Department's Limited Review of the Amended and Restated Lease (Agreement) between the County of Orange (County) and Sunset Aquatic Park, Ltd., (Sunset Aquatic Marina), dated December 20, 1994. The Agreement is for the operation of a marina, boat launch, dry boat storage, and marine repair facility located in the City of Seal Beach. **During the twelve month audit period of September 1, 2006 through August 31, 2007, Sunset Aquatic Marina generated approximately $4.2 million in gross receipts and paid the County approximately $717,000 in rent.**

We understand that the primary purpose of Internal Audit's review was to determine whether Sunset Aquatic Marina's records adequately supported their monthly gross receipts reported to the County. We also understand that Internal Audit reviewed compliance with certain other provisions of the Agreement such as accounting methods and payment procedures.

The audit concluded that Sunset Aquatic Marina's records adequately supported monthly gross receipts reported to the County and no material weaknesses or significant issues were identified. However, the audit identified three control findings and made three recommendations.

OC Community Resources staff provided Sunset Aquatic Marina with a copy of Audit No. 2740 and discussed with Sunset Aquatic Marina management the findings, OC Community Resources responses to the findings and any required actions. The OC Community Resources responses are provided on the following pages, immediately below the Internal Audit Department descriptions, findings and recommendations (shown as indented, in italics and with a smaller font).

Annual Lease Rent Calculation - Tax Basis Revenue vs. Gross Receipts

Clause 8 of the Agreement requires annual rent paid to the County to be the greater of minimum annual rent (greater of base or percentage rent) or lease rent (percentage of net cash flows).

The calculation for annual lease rent is a formula containing several components including annual gross receipts that are defined by Clause 11 of the Agreement.
Finding No. 1: *In the annual lease rent calculation included in Sunset Aquatic Marina's 2006 and 2007 Audited Schedule of Gross Receipts, the total revenue amount (income tax basis) was used in the calculation rather than the required gross receipts amount.*

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ATTACHMENT B: OC Community Resources Management Responses (continued)

We recalculated lease rent using the gross receipts amount and determined that no additional rent was owed to the County for 2006 and 2007. However, future lease rent calculations should use the required gross receipts amount.

Recommendation No. 1: *We recommend that OC Parks require Sunset Aquatic Marina to calculate annual lease rent in accordance with Clause 8B of the Agreement.*

OC Community Resources Response: Concur. By letter dated July 17, 2008, Sunset Aquatic Marina has agreed, beginning with the 2008 calculations, to calculate Annual Lease Rent using annual gross receipts, as that term is defined in the lease, rather than using the total revenue amount (income tax basis).

Misclassification of Sublease Gross Receipts

Finding No. 2: *We noted that certain sub lessee gross receipts were misclassified on Sunset Aquatic Marina's Monthly Rent Report and 2006 Audited Schedule of Gross Receipts as follows:*

- *Do-It-Yourself Yard (rental of space) gross receipts were incorrectly classified as Ships Chandlery (parts) rather than Do-It-Yourself Yard.*
- *Service and Labor, Outside Labor, and Freight/Miscellaneous gross receipts were incorrectly classified as Do-It-Yourself Yard rather than Boat Repairs.*
- *Lay days (rental charge for boat located on cradle during repairs) gross receipts were incorrectly classified as Ships Chandlery (parts) rather than Boat Repairs.*

All of the above business activities are 5% rent categories per Clause 8.A.2 of the Agreement. Therefore, no additional rent is due to the County as a result of the misclassifications.

Recommendation No. 2: *We recommend that OC Parks require Sunset Aquatic Marina to report the sub lessee gross receipts in the correct percentage rent categories.*

OCCR Response: Concur. By letter dated July 17, 2008, Sunset Aquatic Marina has agreed to report future sub lessee gross receipts using the correct percentage rent categories. Additionally, Sunset Aquatic Marina corrected the misclassification of the sub lessee's gross receipts on the June 2008 monthly gross receipts report.

Boat Launch Parking Non-Resettable Counter

Clause 14 of the Agreement requires that registers or comparable devices used to record charges be equipped with counters which are not resettable and which record transaction numbers and sales details.

Sunset Aquatic Marina utilizes an automated gate arm system to control entry to the boat launch parking area. The customer puts cash into the machine which generates a parking ticket and opens the gate arm for entry into the lot. Weekly or bi-weekly depending on activity, the On-Site Manager and another employee open the machine and remove the cash bag. When the cash bag is removed, the machine generates a Cash Box ticket documenting the sales details used to balance the cash. A non-resettable counter number is printed on the Cash Box ticket.

ATTACHMENT B: OC Community Resources Management Responses (continued)

The non-resettable counter number should be accounted for to ensure there are no breaks in sequence. If breaks in sequence are not accounted for, there is an increased risk of cash being improperly removed from the machine without being detected.

Finding No. 3: *We noted that the sequential non-resettable counter number on the Cash Box tickets was not accounted for during the balancing process.*
Recommendation No. 3: *We recommend that OC Parks require Sunset Aquatic Marina to account for the sequential number on the Cash Box tickets during the balancing process to ensure there are no breaks in sequence.*

OC Community Resources Response: Concur. Pursuant to the letter dated July 17, 2008, Sunset Aquatic Marina has established written control procedures for the collection of gate parking revenues. These procedures will account for the sequential numbering on the Cash Box tickets issued by the non-resettable parking gate machine. OC Parks will monitor Sunset Aquatic Marina to ensure the procedures are properly accounting for the gate parking revenues.

Thank you for allowing us to respond to your Draft letter. If you have any questions or need additional information, please feel free to contact Michael Hentzen of my staff at (949) 923-3753.

Attachments: G&K letter dated July 17, 2008

c: Thomas G. Mauk, County Executive Officer
Alisa Drakodaidis, Deputy CEO/OC Infrastructure
Mark Denny, Director, OC Community Resources/OC Parks
Michael Brajdic, Deputy Director, OC Community Resources/OC Parks
Doug Berry, Financial Manager, OC Community Resources/OC Parks
Michael Hentzen, Administrative Manager I, OC Community Resources/OC Parks/Real Estate
Andrea Richard, Real Property Agent III, OC Community Resources/OC Parks/Real Estate
Anna Peters, Director of Administrative Services, OC Community Resources
Mary Fitzgerald, Accounting Manager, OC Public Works/Accounting Services
Jenny Tu, Chief, OC Public Works/Accounting/Santa Ana River, Watershed, Flood, Leases and Infrastructure
Tam Vu, Admin. Manager I, OC Public Works/Accounting/Watershed, Flood, Leases and Infrastructure
Brian Cich, Senior Accountant I, OC Public Works/Accounting/Leases and Infrastructure

ATTACHMENT B: OC Community Resources Management Responses (continued)

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July 17, 2008

Mr. Mike Hentzen
County of Orange- RDMD
Harbors, Beaches and Parks
300 N. Flower Street
Santa Ana, CA 92702-4048

SUBJECT: Sunset Aquatic Marina – County Internal Audit No. 2740

Dear Mr. Hentzen:

As requested in our telephone conversation on Tuesday, July 15, 2008, the following are our responses to the findings reported in the subject audit:

Finding No. 1 - Annual Lease Rent Calculation - Sunset Aquatic Marina recognizes that the lease rent is based on the higher of percentage rents or a percentage of net cash flows. Since now the percentage rent is so much higher than the percentage of cash flows, it currently is irrelevant whether Lessee uses gross receipts or tax basis revenue. Since this difference in future years may be significant, Lessee will calculate Annual Lease Rent using annual gross receipts beginning with the 2008 calculations.

Finding No. 2 - Misclassification of Sublease Gross Receipts - The misclassification of sublessee gross receipts were corrected on the June 2008 monthly rent report. Sunset Aquatic Marina will report future sublessee gross receipts using the correct percentage rent categories.

Finding No. 3 - Boat Launch Parking Counter – Sunset Aquatic Marina has established written control procedures to include the non-resettable parking gate arm machine sequential counter number when accounting for gate parking receipts.

If you have any questions, please feel free to give me a call at (310) 280-5082.

Sincerely,

G & K MANAGEMENT, INC.

Michael E. Drandell, CPA
Chief Financial Officer

cc: Zenaida Bongolan

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