

Internal Audit Department

O R A N G E County in the USA

Revenue Generating Lease Audit: OC DANA POINT HARBOR/ DANA POINT SHIPYARD

For the Period
November 1, 2011 through July 31, 2012

**\$1.5M GROSS RECEIPTS FOR
NINE-MONTH AUDIT PERIOD
\$356K RENT TO THE COUNTY**

Dana Point Shipyards (DPS) maintains and operates a complete marine-oriented boat repair yard, ship's chandlery and do-it-yourself boat repair facility at Dana Point Harbor. Rent is paid based on a percentage of gross receipts. We audit the underlying books and records to ensure gross receipts are complete and rent is properly paid as defined by the lease agreement. During the nine-month audit period from November 1, 2011 through July 31, 2012, DPS reported approximately **\$1.5 million** in gross receipts, including receipts of its sublessee Dana Point Jet Ski, and paid about **\$356,000** in rent to the County. Over its 35-year term, the lease and sublease agreements are estimated to generate approximately **\$16.6 million** in rent to the County.

The Internal Audit Department found that DPS's records adequately supported reported gross receipts and rent owed was properly paid to the County, except we identified **four (4) Control Findings** related to the incomplete reporting of sublessee rent and fees; unreported contractor gross receipts; and the Statement of Profit and Loss was not reconciled to the Monthly Sales Report.

AUDIT NO: 1232
REPORT DATE: JUNE 10, 2013

Director: Dr. Peter Hughes, CPA
Senior Audit Manager: Alan Marcum, CPA, CIA
Senior Internal Auditor: Susan Nestor, CPA, CIA

RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners' Hubbard Award For the Most Outstanding Article of the Year



2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award for Recognition of Commitment to Professional Excellence, Quality, and Outreach



ORANGE COUNTY BOARD OF SUPERVISORS'
Internal Audit Department

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

Dr. Peter Hughes **Ph.D., MBA, CPA, CCEP, CITP, CIA, CFE, CFF, CGMA**

Director

Certified Compliance & Ethics Professional (CCEP)

Certified Information Technology Professional (CITP)

Certified Internal Auditor (CIA)

Certified Fraud Examiner (CFE)

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To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: www.ocgov.com/audit



OC Fraud Hotline (714) 834-3608



Transmittal Letter



Audit No. 1232 June 10, 2013

TO: Brad Gross, Director
OC Dana Point Harbor

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

SUBJECT: Revenue Generating Lease Audit:
OC Dana Point Harbor/Dana Point
Shipyards, HA78H-24-2.02

We have completed our revenue generating lease audit of Dana Point Shipyards for the period November 1, 2011 through July 31, 2012. The final **Internal Auditor's Report** is attached along with your responses to our recommendations. We performed this Revenue Generating Lease Audit in accordance with our *FY 2012-13 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee.

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 Dr. Peter Hughes, CPA



Each month I submit an **Audit Status Report** to the BOS where I detail any critical or 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 recommendations.

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 **OC Internal Auditor's Report** on page 3.

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OC Dana Point Harbor/Dana Point Shipyard
Audit No. 1232***

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November 1, 2011 through July 31, 2012

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OC Internal Auditor's Report



Audit No. 1232

June 10, 2013

TO: Brad Gross, Director
OC Dana Point Harbor

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

SUBJECT: Revenue Generating Lease Audit:
OC Dana Point Harbor/Dana Point Shipyard,
HA78H-24-2.02

Audit Highlight

We have performed an audit of certain records and documents of Dana Point Shipyard (DPS) to ensure gross receipts are complete and rent is properly paid as defined by the lease agreement.

Gross receipts generated from the leases during the nine-month audit period were approximately **\$1.5 million** and rent paid to the County was about **\$356,000**. The lease term is 35 years, subject to required lease upgrades. Over this term, the lease and sublease agreements are estimated to generate approximately **\$16.6 million** in rent to the County.

The Internal Audit Department found that DPS's records adequately supported reported gross receipts and rent owed was properly paid to the County, except we identified **four (4) Control Findings** related to the incomplete reporting of sublease rent and fees; unreported contractor gross receipts; and the Statement of Profit and Loss was not reconciled to the Monthly Sales Report.

OBJECTIVE

We have performed an audit of certain records and documents of Dana Point Shipyard for the period from November 1, 2011 through July 31, 2012 under a lease agreement (Agreement) between the County of Orange (County) and Dana Point Shipyard (DPS), dated November 1, 2011. The Agreement is primarily for the operation of the DPS facilities and services located at Dana Point Harbor. In addition, DPS has entered into a sublease with Dana Point Jet Ski for the operation of a jet ski and kayak center to provide sales, service, rentals and storage of personal watercraft and sale of related parts and accessories. Our audit objectives were:

- (1) The primary objective of our audit is to determine whether DPS's records adequately support their monthly gross receipts reported to the County.
- (2) The secondary objective of our audit is to determine whether DPS complies with certain other financial provisions of the Agreement.

In addition, while performing the audit we may identify internal control weaknesses for which we will identify suggestions for improvement.

RESULTS

Objective #1: We found that DPS's records adequately supported gross receipts reported and rent owed was properly paid, except we identified **four (4) Control Findings** related to the incomplete reporting of all rents/fees received from its sublessee, Dana Point Jet Ski; non-reporting of contractor gross receipts; and the Statement of Profit and Loss was not reconciled to the Monthly Sales Report.

Objective #2: We found that DPS complied with certain other financial provisions of the Agreement.

OC Internal Auditor's Report



The following *Summary of Findings and Recommendations* shows our findings and recommendations for this audit. See further discussion in the *Detailed Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications.

Finding No.	Finding Classification - See Attachment A	Finding Description	Recommendation	Agreement by Management?	Page No. in Audit Report
1.	Control Finding	DPS did not report as gross receipts totaling \$47,673 to the County for base rent received from Dana Point Jet Ski during the nine-month audit period.	OC DPH require DPS report all rents received from sublessee as gross receipts to the County and pay appropriate percentage rent on these receipts. We further recommend that OC DPH require DPS pay rent of \$9,535 to the County on base rent received from DPJS during the audit period.	Yes	p.4
2.	Control Finding	DPS did not report as gross receipts totaling \$26,146 to the County for administration fees received from Dana Point Jet Ski during the nine-month audit period.	OC DPH require DPS report all fees received from sublessee as gross receipts to the County and pay appropriate percentage rent on these receipts. We further recommend that OC DPH require DPS pay rent of \$5,229 to the County on fees received from DPJS during the audit period.	Yes	p.5
3.	Control Finding	DPS does not report compensation received by contractors for work performed for do-it-yourself customers on the shipyard premises as gross receipts to the County.	OC DPH require DPS report compensation received by contractors for work performed for do-it-yourself customers on the shipyard premises as gross receipts to the County.	Yes	p. 5-6
4.	Control Finding	DPS does not reconcile their monthly sales report to the general Ledger.	OC DPH require Dana Point Shipyard to reconcile the Statement of Profit and Loss to the Monthly Sales Report and report the appropriate gross receipts to the County.	Yes	p.6

BACKGROUND

The County entered into a 30-year lease agreement with DPS, dated June 29, 1982, for the operation of shipyard facility and other related services, located at Dana Point Harbor. The original agreement between the County and DPS was terminated when the County entered into a new lease agreement with DPS, dated November 1, 2011. In addition DPS has a sublease agreement with Dana Point Jet Ski dated March 10, 1990 for the operation of a jet ski and kayak center by providing sales, service, rentals and storage of personal watercraft, and sale of related parts and accessories. The sublease agreement expired on June 30, 2012 and is currently on a month-to-month term.



During the nine-month audit period from November 1, 2011 through July 31, 2012, DPS and Dana Point Jet Ski generated approximately \$1.5 million in gross receipts, and the County received approximately \$356,000 in rent.

SCOPE

Our audit was limited to certain records and documents that support Dana Point Shipyard's gross receipts reported by Dana Point Shipyard and remitted to the County for the nine-month audit period from November 1, 2011 through July 31, 2012. Our audit included inquiry, auditor observation, and limited testing for assessing the adequacy of documentation and ensuring completeness of reported gross receipts.

We performed a separate lease audit of Dana Point Jet Ski and the results of the audit are presented in a separate report (Audit No. 1233).

ACKNOWLEDGEMENT

We appreciate the courtesy and cooperation extended to us by the personnel at Dana Point Shipyard, OC Dana Point Harbor and OCPW Accounting Services. If you have any questions regarding our revenue generating lease audit, please call me directly at (714) 834-5475 or Alan Marcum, Senior Audit Manager at (714) 834-4119.

Attachment A: Report Item Classifications
Attachment B: OC Dana Point Harbor Responses

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Michael B. Giancola, County Executive Officer
Paul Lawrence, Manager, OC DPH/Leasing & Revitalization
Jonathon Bordeaux, Real Property Officer, OC DPH/Real Estate
Mary Fitzgerald, Director, OCPW/Administration
Randi Dunlap, Manager, OCPW/Administrative Services
Howard Thomas, Senior Manager, OCPW/Accounting
Betsy Estrada, Manager/OCPW Accounting
Jeanette Tyler, Senior Accountant/OCPW/Dana Point Accounting
Foreperson, Grand Jury
Susan Novak, Clerk of the Board of Supervisors
Vavrinek, Trine, Day & Co., LLP, County External Auditor

Detailed Findings, Recommendations and Management Responses



Finding Nos. 1 and 2 - Unreported Base Rent and Fees Received from Sublessee (Two Control Findings)

Dana Point Shipyard (DPS) has a sublease agreement with Dana Point Jet Ski (DPJS) for the operation of a jet ski and kayak center to provide sales, service, rentals and storage of personal watercraft, and sale of related parts and accessories. In accordance with the sublease agreement, DPJS reports its monthly gross receipts from its business operations and pays percentage rent to DPS. DPS reports the combined receipts to the County and applies the County percentage to determine the percentage rent due. DPJS also pays DPS a monthly base rent and an additional percentage rent of 4.0% (administration fee) on all percentage rent categories per the sublease terms. The base rent and the administration fees are not reported to the County as gross receipts subject to percentage rent.

Lease Clause 12(G): Definition of Gross Receipts to be reported [to the County] defines gross receipts to include Gross Receipts of TENANT from all operations and businesses operated by TENANT or TENANT Parties, on or from the Premises with the exception of do-it-yourselfers.

Lease Clause 1: Definitions define "Tenant Parties" to include "...any party otherwise conducting COUNTY approved business from the Premises under or through the TENANT."

Percentage rent paid by DPJS for water craft and other rentals is 20% of gross receipts in accordance with the lease and sublease agreements.

Finding No. 1: We found that for the nine-month audit period, Dana Point Jet Ski, remitted base rent of \$47,673 to Dana Point Shipyard, in accordance with their sublease, which was not reported by DPS to the County as gross receipts. Rent on these receipts was not paid to the County.

Recommendation No. 1: We recommend that OC DPH requires DPS report all rents received from sublessees as gross receipts to the County and pay appropriate percentage rent on these receipts. We further recommend that OC DPH require DPS pay the County \$9,535 (20% X \$47,673) for base rent received from DPJS for the audit period, November 1, 2011 through July 31, 2012.

OC Dana Point Harbor Response:

Concur. The attached letter from OC Dana Point Harbor requires DPS to report all rents received from their sublessees as gross receipts to the County and pay appropriate percentage rent on these receipts. Furthermore, OC Dana Point Harbor requires DPS pay the County \$9,535 (20% X \$47,673) for base rent received from DPJS, for the audit period, November 1, 2011 through July 31, 2012. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Detailed Findings, Recommendations and Management Responses



Finding No. 2: We found that for the nine-month audit period, Dana Point Jet Ski, remitted administration fees of \$26,146, in accordance with their sublease agreement, to Dana Point Shipyard. DPS did not report this revenue to the County as gross receipts. Rent on these receipts was not paid to the County.

Recommendation No. 2: We recommend that OC DPH require DPS report all fees received from sublessees as gross receipts to the County and pay appropriate percentage rent on these receipts.

We further recommend that OC DPH require DPS pay the County \$5,229 (20% X \$26,146) for administration fees received from DPJS for the audit period, November 1, 2011 through July 31, 2012.

OC Dana Point Harbor Response:

Concur. The attached letter from OC Dana Point Harbor requires DPS to report all fees received from sublessees as gross receipts to the County and pay appropriate percentage rent on these receipts. Furthermore, OC Dana Point Harbor requires DPS pay the County \$5,229 (20% X \$26,146) for administration fees received from DPJS, for the audit period, November 1, 2011 through July 31, 2012. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Finding No. 3 - Contractor Gross Receipts Not Reported (Control Finding)

DPS offers customers the option for use of the site as “a do-it-yourself boat repair facility,” with the customer paying rent based upon the number of days the boat is at the facility for repair. Some customers hire contractors to perform the repair work rather than doing it themselves.

The contractors receive compensation directly from the customers. DPS does not have agreements with these contractors nor do they require contractors to report these gross receipts. As the receipts were not reported to DPS, we were unable to determine the amount of these receipts for our audit period.

We found that the lease agreement does not explicitly address the inclusion or exclusion of contractor gross receipts received for repair work performed for customers on the shipyard premises as reportable gross receipts by DPS.

Recommendation No. 3: We recommend OC Dana Point Harbor require DPS report gross receipts received by contractors for work performed for do-it-yourself customers on the shipyard premises as gross receipts to the County.

Detailed Findings, Recommendations and Management Responses



OC Dana Point Harbor Response:

Concur. The attached letter from OC Dana Point Harbor requires DPS to report compensation received by contractors for work performed for do-it-yourself customers on the shipyard premises as gross receipts to the County. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Finding No. 4 - Statement of Profit and Loss Was Not Reconciled to the Monthly Sales Report (Control Finding)

DPS reports to the County gross receipts using the totals from the Statement of Profit and Loss generated from their financial system. A Monthly Sales Report is also generated from their financial system.

For our sample months of May and June 2012, we compared the gross receipt totals from the Statement of Profit to the Monthly Sales Reports and found that they did not agree. For the months of May and June 2012, sales amounts per the monthly Sales Report were greater by \$1,570 and \$1,788, respectively. As the monthly Sales Report does not present sales by category, we were unable to determine the impact on the rent paid to the County.

Recommendation No. 4: We recommend OC DPH require Dana Point Shipyard to reconcile the Statement of Profit and Loss to the Monthly Sales Report and report the appropriate gross receipts to the County.

OC Dana Point Harbor Response:

Concur. The attached letter from OC Dana Point Harbor requires DPS to reconcile the Statement of Profit and Loss to the Monthly Sales Report and report the appropriate gross receipts to the County. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.



ATTACHMENT A: Report Item Classifications

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

▶ **Critical Control Weaknesses:**

Audit findings or a combination of Significant Control Weaknesses that represent serious exceptions to the audit objective(s) and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

▶ **Significant Control Weaknesses:**

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require prompt corrective actions.

▶ **Control Findings:**

Audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months.

Detailed Findings, Recommendations and Management Responses



ATTACHMENT B: OC Dana Point Harbor Responses

 COUNTY OF ORANGE
DanaPointHarbor
Memorandum

Brad Gross, Director
24650 Dana Point Harbor Drive
Dana Point, CA 92629

Telephone: (949) 923-2236
Fax: (949) 923-3792

April 3, 2013

To: Dr. Peter Hughes, CPA, Director
OC Internal Audit Department

From: Brad Gross, Director 

Subject: Draft Report on Revenue Generating Lease Audit No. 1232 of Dana Point Shipyard

OC Dana Point Harbor appreciates the support provided by Internal Audit and we concur with the Control Findings and Recommendations (1 through 4) as presented in the attached Draft Report on Revenue Generating Lease Audit of Dana Point Shipyard (DPS), Audit No. 1232.

The County Executive Office has reviewed and approved of OC Dana Point Harbor's responses to each recommendation, which responses are intended to ensure DPS fully complies with all recommendations from the Internal Audit Department. A summary of Internal Audit's recommendations 1 through 4, along with OC Dana Point Harbor's responses, are as follows:

Recommendation No. 1: We recommend that OC Dana Point Harbor requires DPS report all rents received from sublessees as gross receipts to the County and pay appropriate percentage rent on these receipts. We further recommend that OC Dana Point Harbor requires DPS pay the County \$9,535 (20% X \$47,673), for base rent received from Dana Point Jet Ski (DPJS) as subtenant of DPS, for the audit period, November 1, 2011 through July 31, 2012.

OC Dana Point Harbor Response: Concur

The attached letter from OC Dana Point Harbor requires DPS to report all rents received from their sublessees as gross receipts to the County and pay appropriate percentage rent on these receipts. Furthermore, OC Dana Point Harbor requires DPS pay the County \$9,535 (20% X \$47,673) for base rent received from DPJS, for the audit period, November 1, 2011 through July 31, 2012. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Recommendation No. 2: We recommend that OC Dana Point Harbor requires DPS report all fees received from sublessees as gross receipts to the County and pay appropriate percentage rent on these receipts. We further recommend that OC Dana Point Harbor requires DPS pay the County \$5,229 (20% X 26,146) for administration fees received from DPJS for the audit period, November 1, 2011 through July 31, 2012.

Detailed Findings, Recommendations and Management Responses



ATTACHMENT B: OC Dana Point Harbor Responses

Page 2
No. 1232 - DPS
April 3, 2013

OC Dana Point Harbor Response: Concur

The attached letter from OC Dana Point Harbor requires DPS report all fees received from sublessees as gross receipts to the County and pay appropriate percentage rent on these receipts. Furthermore, OC Dana Point Harbor requires DPS pay the County \$5,229 (20% X 26,146) for administration fees received from DPJS for the audit period, November 1, 2011 through July 31, 2012. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Recommendation No. 3: We recommend that OC Dana Point Harbor requires DPS report compensation received by contractors for work performed for do-it-yourself customers on the shipyard premises as gross receipts to the County.

OC Dana Point Harbor Response: Concur

The attached letter from OC Dana Point Harbor requires DPS to report compensation received by contractors for work performed for do-it-yourself customers on the shipyard premises as gross receipts to the County. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Recommendation No. 4: We recommend that OC Dana Point Harbor requires DPS to reconcile the Statement of Profit and Loss to the Monthly Sales Report and report the appropriate gross receipts to the County.

OC Dana Point Harbor Response: Concur

The attached letter from OC Dana Point Harbor requires DPS to reconcile the Statement of Profit and Loss to the Monthly Sales Report and report the appropriate gross receipts to the County. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Thank you and should you have any questions, please call me at 949-923-3798.

Enclosures: Audit No. 1233 of DPJS
Draft Letter from OC Dana Point Harbor to Dana Point Shipyard

cc: Steven Eldred, Interim Deputy, CEO
Susan Nestor, Senior Internal Auditor
Lily Chin, Audit Manager, OC Internal Audit Department
Paul Lawrence, Operations Manager, OC Dana Point Harbor
Jonathan Bordeaux, Real Property Officer, OC Dana Point Harbor

Detailed Findings, Recommendations and Management Responses



ATTACHMENT B: OC Dana Point Harbor Responses



Brad Gross, Director
24650 Dana Point Harbor Drive
Dana Point, CA 92629

Telephone: (949) 923-2236
Fax: (949) 923-3792

June __, 2013

Catherine Cope
Dana Point Shipyard
34671 Puerto Place
Dana Point, CA 92629

Re: Audit #1232 for Dana Point Shipyard and Audit #1233 for Dana Point Jet Ski

Dear Mrs. Cope,

As you know, the County's Internal Audit has conducted their audit of the financial records and reporting by the Shipyard and your sublessee, Dana Point Jet Ski, in accordance with your Lease that commenced on November 1, 2011. Please find the attached Audit #1232 and Audit #1233, as provided by Internal Audit, as well as our responses to their Findings and Recommendations.

Overall, the Shipyard and Jet Ski records adequately support reported gross receipts, and rent owed was properly paid. However, Internal Audit reports there are four (4) Findings for DPS and five (5) Findings for DPJS, along with respective Recommendations for both DPS and DPJS to make necessary adjustments in their financial reporting. Please make these necessary adjustments to your financial reporting as soon as possible. As required by County policy, a follow up will be conducted by Internal Audit within six (6) months from the date of their Audit report to ensure all adjustments are meeting Internal Audit's Recommendations.

Thank you and should you have any questions, please contact Jonathan Bordeaux at 949-923-3787.

Sincerely,

Brad Gross, Director
OC Dana Point Harbor

Cc: Susan Nestor, Senior Internal Auditor, OC Internal Audit
Lily Chin, Audit Manager, OC Internal Audit
Paul Lawrence, Operations Manager, OC Dana Point Harbor
Jonathan Bordeaux, Real Property Officer, OC Dana Point Harbor