



Orange County Auditor-Controller Internal Audit



Revenue Generating Operating Agreement Audit of OC
Dana Point Harbor/Dana Point Marina Inn

For the period April 1, 2014
through March 31, 2015

Audit Number 1436
Report Date: May 11, 2016



O R A N G E C O U N T Y
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Transmittal Letter

Audit No. 1436

May 11, 2016

TO: Brad Gross, Director
OC Dana Point Harbor

SUBJECT: Revenue Generating Operating Agreement Audit of OC Dana Point Harbor/
Dana Point Marina Inn, HA78H-24-004

We have completed our Revenue Generating Operating Agreement Audit of the Dana Point Marina Inn for the period April 1, 2014 through March 31, 2015. Our final report is attached for your review.

I submit an **Audit Status Report** quarterly to the Audit Oversight Committee (AOC) and a monthly report to the Board of Supervisors (BOS) where I detail any critical 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 AOC and BOS.

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.

Toni Smart, CPA, Director
Auditor-Controller Internal Audit Division

ATTACHMENTS

Other Recipients of this report:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Eric H. Woolery, Auditor-Controller
- Frank Kim, County Executive Officer
- Mark Denny, Chief Operating Officer
- Jessica Witt, Deputy Chief Operating Officer
- Lisa Smith, Deputy Director, OC Dana Point Harbor
- Tonya Riley, Director of Satellite Accounting Operations, Auditor-Controller
- Win Swe, Accounting Manager III, Auditor-Controller/OCCR Accounting Services
- Susan Long, Accounting Manager II, Auditor-Controller/OCCR Accounting Services
- Foreperson, Grand Jury
- Robin Stieler, Clerk of the Board of Supervisors
- Macias Gini & O'Connell LLP, County External Auditor



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OC Dana Point Harbor/Dana Point Marina Inn
Audit No. 1436*

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Internal Auditor's Report

Audit No. 1436

May 11, 2016

TO: Brad Gross, Director
OC Dana Point Harbor

FROM: Toni Smart, CPA, Director
Auditor-Controller Internal Audit Division

SUBJECT: Revenue Generating Operating Agreement Audit of OC Dana Point Harbor/
Dana Point Marina Inn, HA78H-24-004

OBJECTIVES

We have performed an audit of certain records and documents for the period from April 1, 2014 through March 31, 2015, pertinent to the operating agreement (Agreement) between the County of Orange (County) and Great Western Hotels Corporation (GWHC) dated June 8, 2009. The Agreement is for the operation of Dana Point Marina Inn (DPMI), located in OC Dana Point Harbor.

1. The primary objective of our audit is to determine whether GWHC's records adequately supported their monthly gross receipts reported to the County and gross receipts were properly remitted to the County.
2. A secondary objective of our audit is to determine whether GWHC's records adequately supported their monthly operating expenses reimbursed by the County and GWHC's management fee was properly calculated. Because all of GWHC's operating expenses and related supporting documentation are approved by OC Dana Point Harbor (OC DPH) management and are reviewed by Auditor-Controller (OCCR Satellite Accounting) prior to reimbursement, we performed only a limited review of GWHC's operating expenses and supporting documentation.
3. A third objective of our audit is to determine whether GWHC complies with certain other financial provisions of the Agreement, such as annual financial statement requirements.

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 GWHC's records, in general, adequately supported gross receipts reported to the County and gross receipts were properly remitted to the County, except we identified **one (1) Significant Control Weakness** where there was inadequate documentation retained for employee discount rate reservations and **one (1) Control Finding** where conference room rental agreements were not pre-numbered.

Objective #2: Based on our limited review, we found that GWHC's records supported their monthly expenses reimbursed by the County and GWHC's management fee was properly calculated; however, we identified **one (1) Control Finding** where the County should provide written guidance to GWHC regarding procurement policies and processes.



Internal Auditor's Report

Objective #3: We found that GWHC complied with certain other financial provisions of the Operating Agreement such as financial reporting, except we identified **one (1) Control Finding** where GWHC's CPA performed an agreed-upon procedures engagement rather than an audit engagement of DPMI's annual gross receipts statement.

During our audit, we also identified **four (4) Critical Control Weaknesses**: 1) OC DPH did not obtain County Counsel's review or input on the expanded employee discount rate program or policies; 2) two key OC DPH managers, with contract oversight responsibilities, utilized the employee discount rate program by either staying at the hotel or by referring a friend or family member who received the employee discount rate; 3) two key managers of the City of Dana Point, who may be designated employees, utilized the employee discount rate program by either staying at the hotel or by referring a friend or family member who received the employee discount rate; and 4) lack of written policy and Board of Supervisors' approval for expanding the employee discount rate program to OC DPH employees and key business partners. We identified **three (3) Significant Control Weaknesses**: 1) inadequate oversight of key managers' usage of employee discount rate program; 2) inadequate oversight of extended discount rate stays; and 3) eligibility for employee discount rate program needs to be better defined. We identified **one (1) Control Finding** related to allowing the employee discount rate to be used during two nights of 100% hotel occupancy. These findings are further described in the Detailed Findings, Recommendations, and Management Responses section of this report.

BACKGROUND

The County entered into a lease agreement with GWHC in 1971 to build and operate the Dana Point Marina Inn (DPMI). The lease agreement expired in 2001 and was converted to an operating agreement. Following expiration of the operating agreement in 2009, a request for proposal was issued and the County entered into a new five-year operating agreement (Agreement) with GWHC dated June 8, 2009, to continue to operate the DPMI. The Agreement provided for an additional five-year extension at the OC DPH Director's discretion, which was approved on July 23, 2013. During the 12-month audit period ended March 31, 2015, GWHC reported and remitted approximately \$3.2 million in gross receipts to the County, was reimbursed by the County for approximately \$2.1 million of operating expenses, and was paid a management fee of \$146,000.

SCOPE

Our audit was limited to certain records and documents that support GWHC's gross receipts and operating expenses reported to the County for the 12-month audit period from April 1, 2014 through March 31, 2015. For employee discounts only, we expanded our audit period to cover January 1, 2013 to September 30, 2015. We also reviewed limited additional information for the period February 6, 2009 through September 13, 2012, prior to our audit period, at the request of County Executive Management. Our audit included inquiry, auditor observation, and limited testing for assessing the adequacy of documentation for gross receipts, operating expenses, and the management fee calculation, as well as ensuring completeness of remitted gross receipts. Our audit did not include compliance with the County's procurement policies and applicable laws.

FOLLOW-UP PROCESS

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). Our **First Follow-Up Audit** will begin at six months from the official release of the report. A copy of all our Follow-Up Audit reports are provided to the BOS as well as to all those individuals indicated on our standard distribution list.



Internal Auditor's 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 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. We bring to the AOC's attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. Such open issues appear on the AOC 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 recommendation is 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 form to facilitate our review.

The Auditor-Controller Internal Audit Division is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations.

ACKNOWLEDGMENT

We appreciate the courtesy extended to us by the personnel at the Great Western Hotels Corporation, OC Dana Point Harbor, and OCCR Accounting during our audit. If you have any questions regarding our revenue generating operating agreement audit, please contact me directly at (714) 834-5442, or Nancy Ishida, Senior Audit Manager at (714) 796-8067.



Detailed Findings, Recommendations, and Management Responses

Employee Discount Program – Background Information for Findings No. 1 - 6 Below:

The Dana Point Marina Inn (DPMI) offers a “Friends and Family” discounted room rate to Great Western Hotel Corporation (GWHC) employees, i.e., hotel employees. The discounted rate is \$35 per night for a standard or harbor view room and \$50 per night for a suite. We refer to this as the employee discount rate or employee discount program.

The DPMI is a 136 room, mid-market, limited service hotel with nine one-bedroom suites and two two-bedroom suites. For fiscal year (FY) 2014-2015, the actual average room rate charged was \$102 per night. The hotel’s rack room rate (published rate) can range from about \$100 to \$350 (2-bedroom suite) per night depending on the room type, day of the week, time of the year, etc.; however, a variety of discount types (over 50 types) are also offered to reduce the rack rate, such as AAA (10%), Corporate (15%), Weekly (20%), Midweek, Government, etc.

Clause 14 of the Operating Agreement allows GWHC to “establish fair market room rates...Fair market rates and fees shall mean rates and fees charged for similar motels and inns in locations similar to the Premises.” OC Dana Point Harbor (OC DPH) management informed us that pursuant to the operating agreement, the hotel’s General Manager (employee of GWHC) has the discretion to allow a variety of discounts to maximize occupancy and revenue.

Criteria for the employee discount rate as specified on a February 4, 2014 memo issued to hotel front desk personnel and hotel department heads by the hotel General Manager includes:

- The “*benefit of an employee rate is offered to employee friends and family members coming to visit the area from out of town. The employee rate is not intended for personal use as a ‘vacation’ or ‘get-away’.*”
- “*In order to receive an employee rate, the following criteria must be met:*
 - *The employee requesting the rate must have successfully passed their 90 day probationary period. Some blackout dates may apply. Use common sense and do not request an employee rate during busy time periods, especially weekends in July and August.*
 - *The request must be submitted at least one week prior to the arrival date, in writing and prior approval must be granted. Do not ask for exceptions.*
 - *All employee room rate reservations must be placed by the General Manager.*”

The memo also states that “*County Officials have been privy to this special rate and have offered the rate to key business partners in order to reduce direct expenses for services or as a special discount to direct friends and family. Please note that the same procedures apply. No exceptions.*”

According to the hotel’s current General Manager, several years ago the employee discount rate was expanded to include OC DPH employees and other Dana Point Harbor business partners such as Dana Point Harbor lessees, operators, and contractors. The hotel’s General Manager believes expanding the employee discount program was discussed by him and approved by OC DPH management during one of their bi-monthly operator meetings; however, the hotel’s General Manager did not recall when the discount was expanded or who specifically at OC DPH authorized it.



Detailed Findings, Recommendations, and Management Responses

Current OC DPH management informed us they did not provide approval for the inception of the hotel employee discount program and felt any approval would have been prior to OC DPH becoming a separate department in April 2005.

To help identify an inception date, current OC DPH management obtained a letter dated November 4, 2015, from the GWHC Vice President where he recalls beginning work in the corporate office of GWHC as the Vice President of Finance in 2005 and that the employee discount rate had already been established then. This letter also states the current hotel General Manager started in 2003 and believes the employee rate was in place prior to then. This letter did not address or discuss when the employee discount rate program was later expanded beyond hotel employees to include County employees.

Because, a) there is no written documentation of the approvals of the employee discount program inception or later expansion, b) the hotel’s current General Manager does not recall when he obtained approval from the County to expand the discount program to County employees, c) the former OC DPH Operations Manager is retired, and d) current OC DPH management stated they did not provide approvals, it is unclear as to when the employee discount program was expanded (beyond hotel employees) to include County employees and key business partners of the County.

Based on our review of DPML’s Source of Business Report (filtered for rate code EM which indicates the employee discount rate) and “Comments” section of the folio screen, we summarized the employee discount activity (number of employee discount rate nights) during the period January 1, 2013 through September 30, 2015. We also included additional information we received from County Executive Management for the period February 6, 2009 through September 13, 2012, prior to our audit period, as shown below.

Number of Nights Using the Employee “Friends and Family” Discount (Code EM)

| Period | Hotel Employees | OC DPH Employees | DP Harbor Lessees or Operators | DP Harbor Contractors | City of Dana Point Employees | Total |
|------------------|-----------------|------------------|--------------------------------|-----------------------|------------------------------|------------|
| 1/1/13 – 9/30/15 | 473 | 132 | 100 | 50 | 176 | 931 |
| 2/6/09 – 9/13/12 | * | 9 | 20 | 6 | 22 | 57 |
| Total | 473 | 141 | 120 | 56 | 198 | 988 |

*No additional information provided by County Executive Management

During January 1, 2013 through September 30, 2015, the hotel had about 136,408 maximum “room nights available” (136 rooms x 1,003 calendar days) for guests assuming that all rooms were available for use 100% of the time. The 931 employee discount nights represent about 0.7% of the 136,408 maximum “room nights available.”

The table below provides a projected estimate of the difference between: a) the FY 2014-15 actual average room rate charged of \$102 by the hotel and b) the employee discount room rate under the “Family and Friends” discount program for the period January 1, 2013 through September 30, 2015. For the period February 6, 2009 through September 13, 2012, we used an average room rate charged of \$92 based on information provided by the hotel and a Standard room discount rate since room type information was not available. The purpose is to provide some high-level context of potential monetary impact. The estimate does not reflect that the hotel likely had a vacancy on most of the nights and the rooms may not have been otherwise occupied had the employee discount rate not been available. Also, the actual average rate is a blended rate for all room types including suites.



Detailed Findings, Recommendations, and Management Responses

For the period of 1/1/13 – 9/30/15

| | | |
|---|----------------------|------------------|
| Employee Discount Rate - Standard or Harbor View Room | \$ 35 x 722 Rooms = | \$ 25,270 |
| Employee Discount Rate - Suite | \$ 50 x 209 Rooms = | \$ 10,450 |
| | Total | \$ 35,720 |
| FY 14-15 Actual Average Rate Charged | \$102 x 931 Rooms = | \$ 94,962 |
| | Estimated Difference | \$ 59,242 |

For the period of 2/6/09 – 9/13/12

| | | |
|---|----------------------|------------------|
| Employee Discount Rate –Standard Room | \$ 35 x 57 Rooms = | \$ 1,995 |
| FY 09-13 Average Rate Charged | \$ 92 x 57 Rooms = | \$ 5,244 |
| | Estimated Difference | \$ 3,249 |
| Total of Room Rate Estimated Differences | | \$ 62,491 |

Finding 1 – OC DPH Did Not Obtain County Counsel Review or Input on Expanded Employee Discount Rate Program or Policies (Critical Control Weakness)

Finding No. 1: In our discussions with current OC DPH management, they stated they had not discussed the employee discount rate program with County Counsel or asked for their input. Current OC DPH management stated they were aware the employee discount program was expanded to include OC DPH employees and key business partners, but that the expanded employee discount program was established under prior County management.

OC DPH management indicated the employee discounts could help maximize revenue to the County during non-peak times when the hotel was not fully occupied and employee discounts were also a customary practice within the hotel industry. While that may be true for employees of the hotel itself, there are other important factors to consider when discounts are provided to County employees, County vendors (operators/lessees), and other business partners (such as City of Dana Point employees and contractors working in the Dana Point Harbor). While they are not responsible for key policy decisions, County Counsel could have reviewed and provided critical input on important issues as follows.

One issue is who has the authority to approve or establish the employee discount rate program since GWHC is operating the hotel on behalf of the County under an operating agreement, i.e., was Board of Supervisors' approval required or is the approval authority delegated to OC DPH. See **Finding No. 4** below regarding lack of written policy and Board of Supervisors' approval.

Another potential issue is California Government Code Section 1090 which provides that a County officer or employee shall not be financially interested in any contract made by them in their official capacity. For example, if a County employee is responsible for participating in the award of an operating agreement, extending the term, or monitoring the performance of the operator, a concern could arise as to whether receiving discounted rates could potentially result in a conflict of interest for the employee, especially if the discount is only utilized by a small group of OC DPH employees by policy or practice. The concern is whether receiving discounts could potentially impair the employee from discharging their fiduciary duties with undivided loyalty and allegiance to the County.

Other potential issues to consider are the County Gift Ban Ordinance (Article 2 contains prohibitions regarding the acceptance of gifts by designated employees) and the Political Reform Act (includes California Government Code Sections 87200-87210 and 87302 containing requirements for filing a statement of economic interest and disclosure of gifts valued at \$50 or more). Designated employees/positions are identified in an organization's conflict of interest code and are subject to the Political Reform Act.



Detailed Findings, Recommendations, and Management Responses

Under the Political Reform Act, discounts to “friends and families” could potentially be considered disclosable gifts to the designated employee unless they are made available to the general public or if they are offered to all County employees without regard to official status. Therefore, it is important to consider whether the discount has been offered to all County employees or in practice, primarily to OC DPH employees.

Another potential issue to consider is whether the discount is actually from GWHC (the County’s operator) or the County itself (i.e., public funds since the operator remits 100% of the gross receipts, net of discounts, to the County). Correspondingly, who has the authority (such as Board of Supervisors) to authorize the employee discount policy and the individual employee discount reservations (e.g., OC DPH vs. hotel management) needs to be evaluated.

Because of the complexity of rules for local governments and because GWHC is acting as the County’s operator when providing discounts, guidance from County Counsel should be obtained to help ensure the discounts are allowable and to help prevent any unintended violations of state laws or County ordinances.

According to current OC DPH management, the employee discount program evolved over the years leading up to the current management and they relied on a former management employee with contract expertise who was involved in the employee discount program. Regardless of when the employee discount rate program was established, once current OC DPH management who had contract oversight authority became aware of the discounts and/or utilized the discounts, they should have obtained County Counsel guidance as to the potential impact of their utilization of the employee discount program.

In our discussions with OC DPH management, they indicated that some other lessees located in Dana Point Harbor may also offer discounts to employees who work in Dana Point Harbor (including County employees) such as 10% off coffee. As such, OC DPH should determine whether discounts to County employees are being offered by other County operators and lessees in Dana Point Harbor, and include these discounts in their analysis and any follow-up action.

Note: Lessees have entered into revenue lease agreements with the County where the lessee pays rent to the County as a percentage of gross receipts. Operators have entered into operating agreements with the County and remit 100% of gross receipts to the County and in return receive a management fee and reimbursement of approved operating expenses.

The current OC DPH management informed us they have suspended the employee discount rate program effective October 28, 2015 once the various issues were brought to their attention.

Recommendation No. 1: We recommend that OC DPH seek a County Counsel opinion and work with the CEO to ensure discounts offered to employees of OC DPH, GWHC, and other key business partners (e.g., Dana Point Harbor lessees, operators, contractors, and City of Dana Point employees) are appropriate and do not violate any state laws or County ordinances. As part of this process, OC DPH should determine whether similar employee discounts are also being offered by other County operators and lessees in Dana Point Harbor, and include those discounts in analysis and any corrective action and resulting policy.

OC Dana Point Harbor Management Response:

Concur. OC DPH did not find any documentation whereby management obtained County Counsel review or input to the Expanded Employee Discount Rate Program or policies.



Detailed Findings, Recommendations, and Management Responses

Finding 2 – Two Key OC DPH Managers With Contract Oversight Responsibilities Utilized the Employee Discount Rate Program (Critical Control Weakness)

Finding No. 2: We identified at least two key OC DPH managers (one current and one former) who utilized the “family and friends” employee discount rate program (by either staying at the hotel or by referring a friend or family member who received the employee discount rate) and who also appeared to have contract oversight responsibilities, such as extending the operating agreement term (per letter dated July 23, 2013); approving the operator’s annual budget; and monitoring the operator’s performance. As these employees are “designated employees” under the Political Reform Act, utilization of the employee discount rate program should be specifically reviewed to ensure there was no violation of state law or County ordinance.

Recommendation No 2: We recommend that OCDPH work with County Counsel and the CEO to evaluate key OC DPH managers’ use of employee discounts to determine if any corrective action is needed.

OC Dana Point Harbor Management Response:

Concur. OC Dana Point Harbor will work with County Counsel and the CEO to evaluate key OC DPH managers’ use of employee discounts to determine if any follow up action is necessary.

Finding 3 – Two Key Managers of the City of Dana Point Who May Be Designated Employees Utilized the Employee Discount Rate Program (Critical Control Weakness)

Finding No. 3: During our testing, we noted that two key managers of the City of Dana Point who utilized the employee discount rate (by either staying at the hotel or by referring a friend or family member who received the employee discount rate) for a total of 176 nights during calendar year 2013. One of the two managers is a County employee formerly providing contract services to the city. As noted below in **Finding No. 7**, one of the managers stayed in a suite at the DPMI for 147 consecutive nights from February 28, 2013 to July 25, 2013. According to the “Comments” section of the folio in the hotel’s reservation system, former OC DPH management approved these instances of the employee discount. Other than the “Comments” section, the hotel did not retain any other supporting documentation of the approval.

As these two managers are likely to be “designated employees” under the Political Reform Act, utilization of the employee discount rate program should be specifically reviewed to ensure there was no violation of state law or County ordinance.

Recommendation No 3: If the employee discount program is to continue, we recommend that OC DPH work with County Counsel and the CEO to evaluate the two key City of Dana Point managers’ (one of which is a County Employee) use of employee discounts to determine what responsibilities the County has and whether any corrective action is needed.

OC Dana Point Harbor Management Response:

Concur. OC Dana Point Harbor has terminated the program.



Detailed Findings, Recommendations, and Management Responses

Finding 4 – Lack of Written Policy and Board of Supervisors’ Approval for Expanding Employee Discount Rate Program (Critical Control Weakness)

Finding No. 4: OC DPH has no written policy or formally documented approval for the expansion of the employee rate discount program to include County/OC DPH employees or key business partners. The only documentation of the policy expansion was a February 6, 2014 memo written by the hotel's General Manager to his employees that described the employee discount rate program.

To provide guidance and ensure conformance with laws and regulations, OC DPH should prepare written policies and procedures for the employee rate discount program that addresses:

- Purpose and intent of the program, including how the program promotes the interests of the County.
- Eligibility for the discount rate (see **Finding No. 8** below).
- Approvals for individual discount reservations and required documentation (see **Finding No. 5** below).
- Additional or independent approvals and monitoring requirements for key managers' usage of discounts (see **Finding No. 6** below).
- Establishing thresholds for extended periods of discounted stays and monitoring requirements (see **Finding No. 7** below).
- Excluded or blackout time periods (see **Finding No. 9** below).

If the employee discount program is to continue, OC DPH should work with County Counsel to obtain approval of the policy from the Board of Supervisors. OC DPH should also ensure the written policies and procedures are then followed.

Recommendation No. 4: If the employee discount program is to continue, we recommend that OC DPH work with County Counsel and the CEO to develop written policies and procedures for the employee discount rate program and obtain necessary approval from the Board of Supervisors. OC DPH should then provide the written policies and procedures to the various participants and eligible employees and ensure the written policies and procedures are being followed.

OC Dana Point Harbor Management Response:

Concur. OC Dana Point Harbor has terminated the program and will develop approved written policies and procedures should it be implemented in the future.

Finding 5 – Inadequate Documentation Retained for Employee Discount Rate Reservations (Significant Control Weakness)

A February 6, 2014 memo written by the hotel's General Manager to hotel employees specifies that the employee's request for a discounted room reservation "must be submitted at least one week prior to the arrival date, in writing and prior approval must be granted." "All employee rate room reservations must be placed by the General Manager." According to the hotel's General Manager, the same process applied to OC DPH employees and key business partners, except that the approver was to be the OC DPH Operations Manager or Director.



Detailed Findings, Recommendations, and Management Responses

During our discussions with the hotel's General Manager, he stated that he documents his approval of the hotel employees' discount rate reservations in the "Comments" section of the reservation confirmation screen (folio) in the hotel's reservation and property management system. For OC DPH employees and business partners, the hotel's General Manager obtains verbal approval from OC DPH management (such as the Operations Manager or on occasion the Director), and then he enters the approver's name into the "Comments" section of the folio.

Finding No. 5: During our audit, we found there was inadequate supporting documentation for requests and approvals of employee discount rate reservations and "Comments" in the folio were not archived. There was a written form created by the hotel for the employee to request the discount and for management to document approval, but the form was not used by the hotel or the County. Based on our discussions with the hotel's General Manager, it appears that most, if not all, of the approvals for hotel employees, OC DPH employees, and DP Harbor business partners, were made verbally. We also saw many instances in which the "Comments" section of the folio was left blank or listed the name of the employee. Also, during our audit we were unable to review the "Comments" section of the folio prior to 2013 because we were informed the "Comments" section is not electronically (or hard copy) retained or archived for more than a few years.

Clause 17.B of the Operating Agreement states that GWHC "shall, at all times, during the term of this Agreement, keep and maintain true and complete books, records, and accounts (the "Supporting Records") of all collections of gross receipts..." Clause 17.B also requires records to be supported by "source documents."

Recommendation No 5: If the employee discount program is to continue, we recommend that OC DPH work with GWHC to prepare a written policy and implement a formal process for requesting and approving employee discount rate reservations that includes retention of adequate supporting documentation of the approval. This should include the completion and retention of employee discount request forms and associated approvals and the retention or archival of the "Comments" section or use of a different field that is not periodically purged from the hotel's reservation and property management system.

OC Dana Point Harbor Management Response:

Concur. OC Dana Point Harbor has terminated the program and will provide written direction to the operator as stated should it be implemented in the future.

Finding 6 – Inadequate Oversight of Key Managers' Usage of Employee Discount Rate Program (Significant Control Weakness)

Finding No. 6: During our audit, we did not see evidence of supervisory approval when three key managers (two from OC DPH and one from GWHC) used the employee discount for friends and family. The Comments section of the folio was either blank or noted the same name of the key manager using the discount. There was nothing else in writing retained to provide evidence of supervisory approval. This could result in the actual or appearance of the key manager's "self-approving" usage of the employee rate discount program.

Two of the three key managers' use of the employee discount rate program represented 57% and 59% of the discount nights for those employee groups for the period of time shown in the two tables below.



Detailed Findings, Recommendations, and Management Responses

Information regarding which employee referred (or was related to) the hotel guest was provided by the hotel's General Manager based on his knowledge as the folio generally did not document this.

For the period of 1/1/13 – 9/30/15

| | OC DPH Employees | Number of Discounted Nights | Percentage of Total Nights |
|---|--|-----------------------------|----------------------------|
| 1 | Key Manager A | 7 | 5.3% |
| 2 | Former Key Manager B (now retired) | 75 | 57.0% |
| 3 | Employee A | 4 | 3.0% |
| 4 | Employee B | 7 | 5.3% |
| 5 | Employee C | 2 | 1.5% |
| 6 | Employee D | 2 | 1.5% |
| 7 | Employee E (employee of Assessor) | 4 | 3.0% |
| 8 | Employee F, transferred to another dept. | 24 | 18.0% |
| 9 | Employee G, retired | 7 | 5.4% |
| | Total OC DPH Employee Nights | 132 | 100.0% |

For the periods of 1/1/13 – 3/31/14 and 4/1/15 – 9/30/15

| | Hotel Employees | Number of Discounted Nights | Percentage of Total Nights |
|--|------------------------------------|-----------------------------|----------------------------|
| | Key Hotel Employee | 165 | 59% |
| | Other Hotel Employees Combined | 113 | 41% |
| | Total Hotel Employee Nights | 278 | 100% |

During January 1 2013 through September 30, 2015, the hotel had about 136,408 maximum "room nights available" (136 rooms x 1,003 calendar days) for guests assuming that all rooms were available for use 100% of the time. The 132 OC DPH employee discount nights represent about 0.1% of the 136,408 maximum "room nights available."

To avoid the actual or appearance of excessive use of the employee discount rate program, especially by the key managers who are responsible for the day-to-day approvals of employee discount reservations, OC DPH should implement a written policy and process for supervisory or independent approvals of key managers' usage of the employee discount rate program.

Recommendation No. 6: If the employee discount program is to continue, we recommend that OC DPH develop a written policy and implement a formal process for supervisory or independent approvals for key managers' utilization of the employee discount rate program.

OC Dana Point Harbor Management Response:

Concur. OC DPH has terminated the program and will develop policies and processes as identified should it be implemented in the future.



Detailed Findings, Recommendations, and Management Responses

Finding 7 – Inadequate Oversight of Extended Discount Rate Stays (Significant Control Weakness)

During the period January 1, 2013 through September 30, 2015, we identified six (6) instances of the employee discount rate used for a hotel stay of 10 consecutive nights or longer as shown in the table below.

| | Guest | Period | Room Type | Number of Nights |
|---|--|---------------------|-----------|------------------|
| 1 | Former Key Manager of City of Dana Point/ County (A) | 2/28/13 – 7/25/13 | Suite | 147 |
| 2 | DP Harbor Lessee - Restaurant Owner (B) | 11/26/13 – 12/10/13 | Standard | 14 |
| 3 | Friend of Key Hotel Manager (C) | 10/03/13 – 10/13/13 | Standard | 10 |
| 4 | Friend of Key Hotel Manager (D) | 4/09/15 – 4/20/15 | Standard | 11 |
| 5 | Friend of Hotel Employee (E) | 10/18/13 – 10/28/13 | Standard | 10 |
| 6 | Friend of Hotel Employee (F) | 12/31/13 – 1/17/14 | Standard | 17 |

A February 6, 2014 memo written by the hotel’s General Manager to hotel employees specifies that the “employee rate is offered to employee friends and family members coming to visit the area from out of town. The employee rate is not intended for personal use as a ‘vacation’ or ‘get-away’.” The memo also states “County Officials have been privy to this special rate and have offered the rate to key business partners in order to reduce direct expenses for services or as a special discount to direct friends and family.” OC DPH management informed us that the hotel’s General Manager has the discretion to allow a variety of discounts to maximize occupancy and revenue.

Finding No. 7: A written policy or formal approval process has not been established for extended stays using a discounted rate, such as the employee discount rate program, including allowed terms and purposes. This results in a lack of adequate oversight. A threshold should be established wherein discounted rate stays exceeding certain thresholds (over a specified time period and over a certain discount percentage) are required to have additional level of approvals. This will help avoid the actual or appearance of misuse of the discount rate programs. Additionally, a periodic report of discounted rate stays exceeding the established threshold should be provided to OC DPH management for their monitoring.

According to the current OC DPH Director, once he became aware of the employee with the 147 night utilization, he instructed the hotel’s General Manager to suspend the employee’s stay using the employee discount rate. The current OC DPH Director stated he was informed of this situation when the hotel’s General Manager contacted him regarding the employee’s request to extend their stay further.

Recommendation No. 7: We recommend that OC DPH work with GWHC to prepare a written policy and implement a formal process requiring additional levels of approvals for extended discounted hotel stays over certain thresholds. This policy should include thresholds for discount percentages and number of nights, as well as allowable purposes or uses for extended discount rate stays. The process should include documentation of the justification for the individual stay and periodic reports of extended discount hotel stay utilization submitted to OC DPH for their monitoring.

OC Dana Point Harbor Management Response:

Concur. OC DPH will work with GWHC to develop policies as indicated in the audit.



Detailed Findings, Recommendations, and Management Responses

Finding 8 – Eligibility for Employee Discount Program Needs to be Better Defined (Significant Control Weakness)

The February 6, 2014 memo written by the hotel's General Manager states that "*County Officials have been privy to this special rate and have offered the rate to key business partners in order to reduce direct expenses for services or as a special discount to direct friends and family.*"

Finding No. 8: "Key business partners" of the County is a broad statement that needs to be better defined in a written procedure. In our discussions with the hotel's General Manager and OC DPH management, the intent was to help reduce operating costs for operators in Dana Point Harbor that have an operating agreement with the County. For example, one of the Dana Point Harbor operators has an employee based out of San Diego that periodically performs work and the discounted room rate will lower costs to be reimbursed by the County. The other intent discussed was to offer other lessees (tenants) located in Dana Point Harbor and contractors working in Dana Point Harbor the employee discount rate as a way to promote the hotel, increase occupancy, and generate additional gross receipts for the County.

We also noted that former employees (retired or separated) of both the hotel and OC DPH utilized the employee discount rate. It is unclear if the policy was intended to include former employees.

Recommendation No. 8: If the employee discount program is to continue, we recommend that OC DPH work with County Counsel and the CEO to clearly define the eligibility criteria for the employee discount program and whether it is appropriate for the "key business partners" and retired/separated employees to participate. The eligibility criteria should be documented in a written policy and a clear nexus as to how the program benefits or promotes the County.

OC Dana Point Harbor Management Response:

Concur. OC DPH has terminated the program and will develop eligibility criteria as identified should it be implemented in the future.

Finding 9 – Employee Discount Rate Was Allowed to Be Used During Two Nights of 100% Occupancy (Control Finding)

The February 6, 2014 memo written by the hotel's General Manager to hotel employees specifies that "*Some black out dates may apply. Use common sense and do not request an employee rate during busy time periods, especially weekends in July and August.*" According to the hotel's General Manager, the employee discount rate should not be used during peak periods and when the hotel is at full occupancy. For FY 2014-15, the average annual occupancy was 57.85%, with the highest average month being June 2015 (75%) and the lowest average month being January 2015 (35%).

During the audit period of April 1, 2014 through March 31, 2015, the DPMI was at 100% occupancy for the four (4) nights of May 17, 2014, June 27, 2014, June 28, 2014, and October 4, 2014.

Finding No. 9: For two (2) of the four (4) nights where the DPMI was at 100% occupancy as listed above, there was one (1) GWHC corporate employee who stayed at the hotel in a standard room using the employee discount rate. The nights were June 27 and 28, 2014. This utilization is not in compliance with the intention of the employee discount program.



Detailed Findings, Recommendations, and Management Responses

Recommendation No. 9: If the employee discount program is to continue, we recommend that OC DPH remind GWHC that the employee discount rate should not be utilized during periods of 100% occupancy.

OC Dana Point Harbor Management Response:

Concur. OC DPH has terminated the program and will remind GWHC of this restriction as identified should it be implemented in the future.

Finding 10 – No Written Purchasing Policies and Procedures (Control Finding)

Clause 12 of the operating agreement states that “Each month, OPERATOR shall pay all operating expenses applicable to the Premises that have been incurred and are expressly provided for under the then applicable COUNTY approved Operating Budget...Operator shall endeavor at all times to obtain the most efficient and lowest cost for the service or expense authorized herein.” Clause 18.B states that “OPERATOR shall perform all construction on the Premises as required for public projects and public works under the California Public Contract Code and other applicable law.” Other than the requirement to follow California Public Contract code for public works, the operating agreement does not provide purchasing requirements for GWHC to follow when procuring goods and services that will be reimbursed by the County.

In our discussions with the hotel’s General Manager and OC DPH management, both have an understanding that GWHC should generally be following guidelines established in the County Contract Policy Manual (CPM) and working with the County Procurement Office (CPO) for guidance.

While the scope of our audit did not include compliance with County purchasing policies, we did identify the below issue during our discussions with the hotel’s General Manager warranting inclusion in this report.

Finding No. 10: The County has not provided formal guidance or a written policy to GWHC for the procurement of goods, services, and public works projects under the operating agreement. The hotel’s General Manager informed us that the OC DPH’s prior Procurement Officer (now separated) would help the hotel with requisitions, requests for proposals, bids, contracts, etc. Currently, the hotel’s General Manager stated GWHC has been given more procurement responsibilities.

We reviewed a December 3, 2014 email from the CPO to the hotel’s General Manager providing some high-level guidance (thresholds and competitive bid requirements for public works, commodities, and service contracts) and a CPO contact for questions; however, the hotel’s General Manager indicated he was still unclear as to how the current procurement processes should work. Also, the roles and responsibilities (County vs. hotel) for the various procurement types and thresholds has not been documented.

To help ensure GWHC follows proper procurement processes, the County should provide them detailed written guidance and training.

Recommendation No. 10: We recommend that OC DPH work with CPO and County Counsel to provide GWHC with written policies, procedures, and training as needed for procurement. The written policies and procedures should clearly define the roles and responsibilities between GWHC, OC DPH, and CPO.



Detailed Findings, Recommendations, and Management Responses

OC Dana Point Harbor Management Response:

Concur. OC DPH has already met with GWHC management as well as provided a copy of the County's approved purchasing manual. OC DPH will make sure GWHC continues to follow the stated procedures for purchasing of equipment and large dollar items for the County's facility.

Finding 11 – Annual Gross Receipts Statement Not Audited (Control Finding)

Clause 17.F of the operating agreement requires GWHC to submit an annual statement of gross receipts “certified as to accuracy” (i.e., audited) by a Certified Public Accountant (CPA) wherein the total gross receipts for the accounting year are classified according to the categories of business conducted on or from the premises.

Finding No. 11: The schedule of gross receipts for the year ended June 30, 2014 submitted by GWHC was not audited by a CPA. Instead, the CPA firm performed an agreed-upon procedures engagement. The agreed upon procedures engagement does not provide an audit opinion.

Recommendation No. 11: We recommend that OC DPH require GWHC to submit annual statements of gross receipts that are audited by a CPA.

OC Dana Point Harbor Management Response:

Concur. OC DPH will require these statements from GWHC.

Finding 12 – Conference Room Rental Agreements Not Pre-Numbered (Control Finding)

DPMI has three (3) meeting rooms available for rental. When a room rental is requested, a contract is prepared by the hotel and then signed by the customer.

Finding No. 12: The hotel's room rental agreements are not pre-numbered. Pre-numbering the forms allows for sequential integrity to help ensure completeness of gross receipts remitted for room rentals.

Recommendation No. 12: We recommend that OC DPH require GWHC to use pre-numbered documents for meeting room rentals.

OC Dana Point Harbor Management Response:

Concur. OC DPH will require these documents from GWHC.



Detailed Findings, Recommendations, and Management Responses

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:**
These are Audit Findings or a combination of Auditing Findings that represent critical exceptions to the audit objective(s) and/or business goals. Such conditions may involve either actual or potential large dollar errors or be of such a nature as to compromise the Department's or County's reputation for integrity. Management is expected to address Critical Control Weaknesses brought to their attention immediately.
- ▶ **Significant Control Weaknesses:**
These are Audit Findings or a combination of Audit Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require prompt corrective actions.
- ▶ **Control Findings:**
These are 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, but no later than twelve months.




Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: OC Dana Point Harbor Management 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

DATE: April 22, 2016
TO: Toni Smart, Director, Auditor-Controller Internal Audit Division
FROM: Brad Gross, Director 
SUBJECT: Draft Report on Revenue Generating Operating Agreement, Dana Point Marina Inn

OC Dana Point Harbor appreciates the support provided by Internal Audit and we concur with the Findings and Recommendations as presented in the attached Draft Report on Revenue Generating Operating Agreement, Dana Point Marina Inn (DPMI).

The County Executive Office has reviewed and approved of OC Dana Point Harbor's responses to each recommendation, which responses are intended to ensure DPML fully complies with all recommendations from the Internal Audit Department. It should be noted a majority of the report is focused on the Employee Discount Rate Program, this program has been suspended effective 10/23/2015 based on the information received during this audit. A summary of Internal Audit's recommendations, along with OC Dana Point Harbor's responses, are as follows:

Recommendation No. 1: OC Dana Point Harbor did not obtain County Counsel review or input on Expanded Employee Discount Rate Program or Policies.

OC Dana Point Harbor Response: Concur

OC DPH did not find any documentation whereby management obtained County Counsel review or input to the Expanded Employee Discount Rate Program or policies.

Recommendation No. 2: OC DPH work with County Counsel and the CEO to evaluate key OC DPH managers' use of employee discounts to determine if any corrective action is needed.

OC Dana Point Harbor Response: Concur

OC Dana Point Harbor will work with County Counsel and the CEO to evaluate key OC DPH managers' use of employee discounts to determine if any follow up action is necessary.

Recommendation No. 3: If the employee discount program is to continue, we recommend that OC DPH work with County Counsel and the CEO to evaluate the two key City of Dana Point Managers' (one of which is a County Employee) use of the employee discounts to determine what responsibilities the County has and whether any corrective action is needed.

OC Dana Point Harbor Response: Concur

OC Dana Point Harbor has terminated the program.



Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: OC Dana Point Harbor Management Responses (continued)

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Recommendation No. 4: If the employee discount program is to continue, we recommend OC DPH work with County Counsel and the CEO to develop written policies and procedures for the employee discount rate program and obtain necessary approval from the Board of Supervisors. OC DPH employees should then provide the written policies and procedures to the various participants and eligible employees and ensure the written policies and procedures are being followed.

OC Dana Point Harbor Response: Concur

OC Dana Point Harbor has terminated the program and will develop approved written policies and procedures should it be implemented in the future.

Recommendation No. 5: If the employee discount program is to continue, we recommend that OC DPH work with GWHC to prepare a written policy and implement a formal process for requesting and approving employee discount rate reservations that includes retention of adequate supporting documentation of the approval. This should include the completion and retention of employee discount request forms and associated approvals and the retention or archival of the "Comments" section or use of a different field that is not periodically purges from the hotels reservation and property management system.

OC Dana Point Harbor Response: Concur

OC Dana Point Harbor has terminated the program and will provide written direction to the operator as stated should it be implemented in the future.

Recommendation No. 6: If the employee discount program is to continue, we recommend that OC DPH develop a written policy and implement a formal process for supervisory or independent approvals for key managers utilization of the employee discount rate program.

OC Dana Point Harbor Response: Concur

OC DPH has terminated the program and will develop policies and processes as identified should it be implemented in the future.

Recommendation No. 7: OC DPH work with GWHC to prepare a written policy and implement a formal process requiring additional levels of approvals for extended discounted hotel stays over certain thresholds. This policy should include thresholds for discount percentages and number of nights, as well as allowable purposes or uses for extended discount rate stays. The process should include documentation of the justification for the individual stay and periodic reports of extended discount hotel stay utilization submitted to OC DPH for their monitoring.

OC Dana Point Harbor Response: Concur

OC DPH will work with GWHC to develop policies as indicated in the audit.

Recommendation No. 8: If the employee discount program is to continue, we recommend that OC DPH work with County Counsel and the CEO to clearly define the eligibility criteria for the employee discount program and whether it is appropriate for the "key business partners" and retired/separated employees to participate. The eligibility criteria should be documented in a written policy and a clear nexus as to how the program benefits or promotes the County.



Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: OC Dana Point Harbor Management Responses (continued)

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OC Dana Point Harbor Response: Concur

OC DPH has terminated the program and will develop eligibility criteria as identified should it be implemented in the future.

Recommendation No. 9: If the employee discount program is to continue, we recommend that OC DPH remind GWHC that the employee discount rate should not be utilized during periods of 100% occupancy.

OC Dana Point Harbor Response: Concur

OC DPH has terminated the program and will remind GWHC of this restriction as identified should it be implemented in the future.

Recommendation No. 10: Recommend that OC DPH work with CPO and County Counsel to provide GWHC with written policies, procedures, and training as needed for procurement. The written policies and procedures should clearly define the roles and responsibilities between GWHC, OC DPH, and CPO.

OC Dana Point Harbor Response: Concur

OC DPH has already met with GWHC management as well as provided a copy of the County's approved purchasing manual. OC DPH will make sure GWHC continues to follow the stated procedures for purchasing of equipment and large dollar items for the County's facility.

Recommendation No. 11: Recommend that OC DPH require GWHC to submit annual statements of gross receipts that are audited by a CPA.

OC Dana Point Harbor Response: Concur

OC DPH will require these statements from GWHC.

Recommendation No. 12: Recommend that OC DPH require GWHC to use pre-numbered documents for meeting room rentals.

OC Dana Point Harbor Response: Concur

OC DPH will require these documents from GWHC.

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

cc: Mark Denny, COO
Susan Nestor, Senior Internal Auditor
Autumn McKinney, Senior Audit Manager