



INTERNAL AUDIT DEPARTMENT
COUNTY OF ORANGE

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LIMITED REVIEW OF LEASE REVENUE
FOR
NOEL MARINE CANVAS

For the Period
June 1, 2004 through May 31, 2005

AUDIT NUMBER: 2562

REPORT DATE: MAY 17, 2006

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Deputy Director:	Eli Littner, CPA, CIA
Audit Manager:	Autumn McKinney, CPA, CIA
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**LIMITED REVIEW OF LEASE REVENUE FOR
NOEL MARINE CANVAS**

**For the Period
June 1, 2004 through May 31, 2005**

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Transmittal Letter

Audit No. 2562

May 17, 2006

TO: George Carvalho, Director
Dana Point Harbor Department (DPHD)

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

SUBJECT: Limited Review of Lease Revenue for Noel Marine Canvas & Upholstery,
Sublease of T.B.W. Company, dba Dana West Marina
Parcel HA78H-24-20, 22

We have completed our limited review of lease revenue for Noel Marine Canvas & Upholstery, a sublease of the lease agreement with T.B.W. Company, dba Dana West Marina (TBW), for the period June 1, 2004 through May 31, 2005. The final report is attached along with your responses to our recommendations.

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

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not 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. The Dana Point Harbor Department should complete this template as our audit recommendations are implemented. When we perform our Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

As the Director of Internal Audit, I now submit a monthly audit status report to the Board of Supervisors (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 the Dana Point Harbor Department so 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 be forwarding to the Dana Point Harbor Department a Customer Survey of Audit Services for completion. The Dana Point Harbor Department will receive the survey shortly after the distribution of this report.

Attachment

Other recipients of this report:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Thomas G. Mauk, County Executive Officer
- Paul Lawrence, Manager, DPHD/Leasing & Revitalization
- Bryan Speegle, Director, Resources & Development Management Department (RDMD)
- Mary Fitzgerald, Manager, RDMD/Accounting Services
- Betsy Estrada, Chief, RDMD/Accounting Services/External Claims/HB&P Programs
- Foreperson, Grand Jury
- Darlene J. Bloom, Clerk of the Board of Supervisors



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INTERNAL AUDITOR'S REPORT

Audit No. 2562

May 17, 2006

TO: George Carvalho, Director
Dana Point Harbor Department (DPHD)

SUBJECT: Limited Review of Lease Revenue for Noel Marine Canvas & Upholstery,
Sublease of T.B.W. Company, dba Dana West Marina
Parcel HA78H-24-20, 22

We have performed a limited review of certain records and documents of Noel Marine Canvas & Upholstery (NMC) for the year ended May 31, 2005. NMC is a sublessee under the lease agreement (Lease Agreement) between the County of Orange (County) and T.B.W. Company, dba Dana West Marina (TBW), dated October 21, 1975, as amended. The Lease Agreement is primarily for the operation of the Dana Point West Marina located at Dana Point Harbor. NMC, through a sublease with TBW, dated February 2, 1998 and most recently renewed July 13, 2004, operates a marine canvas and boating upholstery service at the marina.

The primary purpose of our review is to determine whether NMC's records adequately supported gross receipts reported to the County. We also reviewed compliance with certain other provisions of the Lease Agreement, such as accounting methods and payment procedures.

Based on our limited review, we find that NMC **has not** retained sufficient documentation to adequately support monthly gross receipts remitted to the County. **No material weaknesses or significant were identified (in relation to the County).** However, we did identify additional rent of **\$3,045** owed to the County. We also identified **5** control findings related to compliance with the Lease Agreement or improving controls that are noted in the Detailed Observations, Recommendations and Management Responses section of this report. See Attachment A for a description of report item classifications.

We appreciate the courtesy and cooperation extended to us by the personnel at NMC, TBW, DPHD, and RDMD/Accounting Services. If you have any questions regarding our limited review of the operating agreement, please contact Eli Littner, Deputy Director, at (714) 834-5899 or Autumn McKinney, Audit Manager, at (714) 834-6106.

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

*George Carvalho, Director
Dana Point Harbor Department
May 17, 2006
Page 2*

Attachment A – Report Item Classifications
Attachment B – DPHD 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
George Carvalho, Director, Dana Point Harbor Department (DPHD)
Paul Lawrence, Manager, DPHD/Leasing & Revitalization
Bryan Speegle, Director, Resources & Development Management Department (RDMD)
Mary Fitzgerald, Manager, RDMD/Accounting Services
Betsy Estrada, Chief, RDMD/Accounting Services/External Claims/HB&P Programs
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

EXECUTIVE SUMMARY

OBJECTIVES

The Internal Audit Department conducted a limited review of lease revenue pertinent to the lease agreement with T.B.W. Company, dba Dana West Marina (TBW), for the primary purpose of determining whether the records of Noel Marine Canvas & Upholstery (NMC), a sublease of TBW, adequately supported gross receipts remitted to the County.

BACKGROUND

The County of Orange entered into a 30-year lease agreement (Lease Agreement) with T.B.W. Company dba Dana West Marina (TBW), dated October 21, 1975, for the operation of the Dana Point West Marina, and other boat-related services, located at Dana Point Harbor. TBW subsequently entered into a sublease with NMC, dated February 1, 1998, and most recently renewed July 13, 2004, for the operation of a marine canvas and boating upholstery service at the marina. In 2004, NMC generated \$60,892 in gross receipts and the County received approximately \$3,000 in rent payments.

The Lease Agreement with TBW expired October 31, 2005. The County has entered into a management agreement with TBW for the continued operation of the West Marina commencing on November 1, 2005. During the transition period, the County has entered into month-to-month leases with TBW's former sublessees including NMC.

SCOPE

Our review was limited to certain records and documents that support NMC's gross receipts reported to TBW and remitted to the County for the one year period of June 1, 2004 to May 31, 2005. We also reviewed compliance with certain other provisions of the Lease 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 limited review, we find that NMC **has not** retained sufficient documentation to adequately support monthly gross receipts remitted to the County. **No material weaknesses or significant issues were identified (in relation to the County).** However, we did identify additional rent of **\$3,045** owed to the County. We also identified a total of **5** control findings related to compliance with the Lease Agreement or improving controls that are noted in the Detailed Observations, Recommendations and Management Responses section of this report. See Attachment A for a description of report item classifications.



DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Records and Accounts

Clause 14 of the Lease Agreement states that true and complete books, records, and accounts must be maintained of all financial transactions in the operation of all business activities. The records must be supported by source documents such as sales slips, cash register tapes, purchase invoices, or other pertinent documents. During our review we noted that documentation of NMC business activities was not adequate as follows:

Finding No. 1: NMC issues pre-numbered sales receipts for customer orders. If utilized properly, pre-numbered sales receipts are adequate source documents. However, during testing we noted that sales receipts were not always issued in sequence, some receipts were not dated, some receipts were missing and not accounted for, copies of some receipts were not retained to support the sales amount reported, and customer signatures were not obtained upon final payment. Therefore, we were unable to determine whether sales were reported to the County completely and accurately. However, based on additional testing of available records and tax returns, it does not appear the gross receipts were significantly underreported.

Recommendation No. 1: We recommend that DPHD require TBW to ensure NMC's future sales receipts are issued in numerical sequence, sales receipts are retained for every transaction and the numerical sequence is accounted for, and the customer signature is obtained to evidence agreement with final sales amount.

DPHD Response: DPHD concurs; estimated completion date is June 15, 2006.

Finding No. 2: NMC utilizes one bank account for both personal and business transactions. NMC was unable to provide supporting documentation for certain bank deposits that were not business-related activity.

Recommendation No. 2: We recommend that DPHD require TBW to ensure NMC's future business-related financial transactions are recorded in a separate bank account from personal transactions.

DPHD Response: DPHD concurs; estimated completion date is June 15, 2006.

Incorrect Rent Percentages Used

In addition to a fixed monthly building rent, NMC is required to report their gross receipts to TBW and pay percentage rent to the County. Clause 10 of the Lease Agreement identifies the gross receipt categories and related rent percentages.

Finding Nos. 3 & 4: TBW used an incorrect rate (5%) to calculate the percentage rent for the NMC sublease rather than the correct rate (10%). This incorrect percentage was not identified as a finding in our prior audit performed in 2000.

Clause 1.12 of the NMC sublease, dated 7/13/04, states NMC will pay TBW "5% of the gross receipts from operations on and from the premises." TBW reported NMC's gross receipts as "Hull Care Services" and paid 5% rent on the gross receipts. DPHD informed us that hull care services



are typically performed below water on a boat's hull, and canvas & upholstery services are not hull care services. Instead, under the Lease Agreement, TBW should have reported the gross receipts as Retail Sales and Services, which is a 10% rent category. As a result, additional rent of **\$3,045** (5% x \$60,892) is owed for the period 1/1/04 – 12/31/04.

This issue has already been reported in our Audit Report No. 2539 (audit of master lessee - TBW) and no specific recommendation will be made in this audit report.

Timeliness of Reporting Gross Receipts

Finding No. 5: Clause 12 of the Lease Agreement states that gross receipts shall include all fees charged, including but not limited to deposits accepted. We found that NMC does not report advance deposits when received from the customer. Instead, NMC reports the total amount of the sale upon receipt of final payment, which may be several months later. Additionally, in some instances NMC did not report the final charges in the month the order was completed, but rather in subsequent months.

Recommendation No. 5: We recommend that DPHD require TBW to ensure NMC reports advance deposits as gross receipts when received and reports the remaining balance as gross receipts in the month the order is completed.

DPHD Response: DPHD concurs; estimated completion date is June 30, 2006.



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we have classified 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 immediately address “Material Weaknesses” brought to their attention.

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:

Audit findings 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.




ATTACHMENT B: DPHD Management Responses



COUNTY OF ORANGE
DANA POINT HARBOR DEPARTMENT

George A. Carvalho, Director
24650 Dana Point Harbor Drive
Dana Point, CA 92629

Telephone: (949) 923-3798
Fax: (949) 496-1225

DATE: May 12, 2006
TO: Peter Hughes, Ph.D., CPA, Director Internal Audit Department
FROM: George A. Carvalho, Director Dana Point Harbor Department 
SUBJECT: Limited Review of Lease Revenue for Noel Marine Canvas & Upholstery;
Sublease of T.B.W. Company, dba Dana West Marina; Parcel HA78H-24-20, 22;
Audit 2562.
CC:

Attached are responses to the findings and recommendations of your audit: Limited Review of Lease Revenue for Noel Marine Canvas & Upholstery, Sublease of T.B.W. Company, dba Dana West Marina Parcel HA78H-24-20, 22; Audit 2562. We concur with your recommendations.

I would like to express my appreciation for your department's work regarding the audit of Noel Marine Canvas & Upholstery.

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2006 MAY 16 PM 2:04



DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

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Recommendation No. 1: We recommend that DPHD require TBW to ensure NMC's future sales receipts are issued in numerical sequence, sales receipts are retained for every transaction and the numerical sequence is accounted for, and the customer signature is obtained to evidence agreement with final sales amount.

DPHD Response: DPHD concurs; estimated completion date is June 15, 2006.

Finding No. 2: NMC utilizes one bank account for both personal and business transactions. NMC was unable to provide supporting documentation for certain bank deposits that were not business-related activity.

Recommendation No. 2: We recommend that DPHD require TBW to ensure NMC's future business-related financial transactions are recorded in a separate bank account from personal transactions.

DPHD Response: DPHD concurs; estimated completion date is June 15, 2006.

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This issue has already been reported in our Audit Report No. 2539 (audit of master lessee - TBW) and no specific recommendation will be made in this audit report.

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Finding No. 5: Clause 12 of the Lease Agreement states that gross receipts shall include all fees charged, including but not limited to deposits accepted. We found that NMC does not report advance deposits when received from the customer. Instead, NMC reports the total amount of the sale upon receipt of final payment, which may be several months later. Additionally, in some instances NMC did not report the final charges in the month the order was completed, but rather in subsequent months.

Recommendation No. 5: We recommend that DPHD require TBW to ensure NMC reports advance deposits as gross receipts when received and reports the remaining balance as gross receipts in the month the order is completed.

DPHD Response: DPHD concurs; estimated completion date is **June 30, 2006**.

