



Orange County Auditor-Controller Internal Audit



Revenue Generating Lease Audit:
OC Community Resources/OC Parks -
Newport Dunes Partnership
For the Period December 1, 2014 through November 30, 2015

Audit Number 1561
Report Date: September 29, 2016



O R A N G E C O U N T Y
AUDITOR-CONTROLLER
I N T E R N A L A U D I T

Eric H. Woolery, CPA
Orange County Auditor-Controller

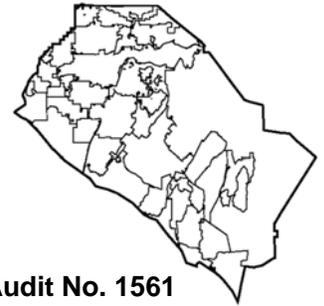
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ERIC H. WOOLERY, CPA
AUDITOR-CONTROLLER



Transmittal Letter

Audit No. 1561

September 29, 2016

TO: Steve Franks, Director
OC Community Resources

SUBJECT: Revenue Generating Lease Audit:
OC Community Resources/OC Parks - Newport Dunes Partnership,
HA55B-101.21, 104.1, 101.51

We have completed our Revenue Generating Lease Audit of Waterfront Resort Properties, L.P., a California limited partnership, and Newport Dunes Partnership Marina, LLC, a California limited liability company (hereinafter referred collectively as "Newport Dunes Partnership") for the period December 1, 2014 through November 30, 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 that 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 Woolery, Auditor-Controller
- Frank Kim, County Executive Officer
- Lilly Simmering, Deputy Chief Operating Officer
- Stacy Blackwood, Director, OC Community Resources/OC Parks
- Connie Chang, Financial Planning Manager, OC Community Resources
- Brian Rayburn, Business Office Manager, OC Community Resources
- Ron Inouye, Real Property Agent III, CEO/Real Estate
- Nicole Nguyen, Budget Analyst, OC Community Resources
- Tonya Riley, Director, Satellite Accounting Operations, Auditor-Controller
- Win Swe, Accounting Manager III, Auditor-Controller/OC Community Resources
- Susan Long, Accounting Manager II, Auditor-Controller/OC Community Resources
- Foreperson, Grand Jury
- Robin Stieler, Clerk of the Board of Supervisors
- Macias Gini & O'Connell LLP, County External Auditor



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OC Community Resources/OC Parks - Newport Dunes Partnership
Audit No. 1561**

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Internal Auditor's Report

Audit No. 1561

September 29, 2016

TO: Steve Franks, Director
OC Community Resources

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

SUBJECT: Revenue Generating Lease Audit:
OC Community Resources/OC Parks – Newport Dunes Partnership
HA55B-101.21, 104.4, 101.51

OBJECTIVES

We performed an audit of certain records and documents for the period December 1, 2014 through November 30, 2015, pertinent to the lease agreement (Agreement) between the County of Orange (County) and Waterfront Resort Properties, L.P., a California limited partnership and Newport Dunes Partnership Marina, LLC, a California limited liability company (hereinafter referred collectively as "Newport Dunes Partnership"), dated February 16, 1989, which has been subsequently amended and restated on August 25, 2009. The Agreement is for 50 years for the operation and maintenance of Newport Dunes Partnership, a waterfront resort and marina recreation facility located in Newport Beach, California. The facility includes a marina, recreational vehicle park, dry boat storage, restaurant, and recreational day use supported by food, beverage, and retail operations.

1. The primary objective of our audit was to determine whether Newport Dunes Partnership's records adequately supported its monthly gross receipts reported to the County and rent owed was properly paid.
2. The secondary objective of our audit was to determine whether Newport Dunes Partnership complied with certain other financial provisions of the Agreement, such as monthly gross receipts statement format and annual financial statement requirements.

In addition, while performing the audit, if we identified internal control weaknesses, we have provided suggestions for improvement.

RESULTS

Objective #1: We found that Newport Dunes Partnership's records adequately supported reported gross receipts and rent was properly paid to the County, except for one **(1) Significant Control Weakness** regarding the lack of an adequate control system to validate parking activity.

Objective #2: We found that Newport Dunes Partnership complied with some financial provisions of the Agreement; however, we identified **four (4) Control Findings** regarding: 1) no review and reconciliation of financial statements performed by OC Community Resources Accounting, 2) County's Dredging Reserve requirement was not met, 3) inadequate rental agreement supporting records, and 4) optional services and uses for two programs were not properly authorized.



Internal Auditor's Report

BACKGROUND

The County entered into a 50-year lease agreement with Newport Dunes Partnership, dated February 16, 1989 which was subsequently amended and restated on August 25, 2009 for the operation of Newport Dunes Partnership, a waterfront resort and marina recreation facility located in Newport Beach, California. During the 12-month audit period ended November 30, 2015, Newport Dunes Partnership reported approximately **\$18 million** in gross receipts and rent paid to the County was **\$2,936,164**.

SCOPE AND METHODOLOGY

Our audit was limited to certain records and documents that support Newport Dunes Partnership's gross receipts reported to the County for the audit period December 1, 2014 through November 30, 2015. Our audit included inquiry, auditor observation, and limited testing for assessing the adequacy of documentation and ensuring completeness of reported gross receipts.

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 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 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 its 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 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.

ACKNOWLEDGEMENT

We appreciate the courtesy extended to us by the personnel at Newport Dunes Partnership and OC Community Resources (OCCR) during our audit. If you have any questions regarding our revenue generating lease 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

Finding No. 1 – Lack of an Adequate Control System for Parking (Significant Control Weakness)

Newport Dunes lacks an adequate control system to validate daily parking activity. The parking attendants' daily parking activity reports, which are manually prepared, did not agree to the parking system generated tapes and/or credit card summary reports. It appears that the parking attendants are not "closing out" the parking system properly at the end of each shift. Therefore, we were unable to validate the actual parking activity generated at the gates to the daily reports submitted.

Section 15.A, Records and Accounts of the Agreement states, "TENANT understands and agrees, at all times during the term of this Lease, to keep or cause to be kept true and complete books, records, and accounts of all financial transactions in the operation of all business activities, of whatever nature, conducted in pursuance of the rights granted herein. The records must be supported by source documents such as sales slips, cash register tapes, purchase invoices, or other pertinent documents.

In the event of boat launching, parking, and/or rental charges, TENANT shall issue serially numbered tickets for each vehicle or rental and shall keep an adequate record of said tickets, both issued and unissued."

A proper control system is important to ensure all parking activities are accounted for and to minimize the risk that unreported income could go undetected.

Recommendation No. 1:

We recommend OCCR require Newport Dunes Partnership to maintain an adequate control system to ensure the completeness of the parking activity generated at the gates. The register tapes generated from the gate system should be reconciled to the reports submitted to ensure all parking activities are properly recorded.

OCCR/OC Parks Management Response:

Concur: The County will send a letter with detailed instructions to the Newport Dunes Partnership regarding the recommendation above. These procedures are to be implemented within 60 days. The Newport Dunes Partnership will be required to provide evidence to OCCR management to ensure new procedures are in place and being practiced.

Finding No. 2 – Review and Reconciliation of Audited Financial Statements Not Performed (Control Finding)

Auditor-Controller/OCCR Accounting did not perform timely reviews and reconciliations of Newport Dunes Partnership's audited financial statements for the years ended December 31, 2012, 2013 and 2014 as required. Auditor-Controller/OCCR Accounting informed us that it has experienced a high volume of vacancies and other priorities.

By not performing timely reviews and reconciliations, there is a risk that unreported gross receipts or errors may not be detected and corrected in a timely manner. This could result in a potential loss of revenue and interest earnings.

Recommendation No. 2:

We recommend OCCR develop and implement policies and procedures to ensure Newport Dunes Partnership's audited financial statements are reviewed and reconciled in a timely manner.



Detailed Findings, Recommendations, and Management Responses

OCCR Management Response:

Concur: OCCR Accounting has collaborated with CEO Real Estate and developed and implemented procedures to ensure that audited financial statements are received, reviewed and reconciled in a timely manner. Any unreported income and related revenue will be invoiced accordingly. Newport Dunes Partnership reconciliations of audited financial statements have been prepared and are currently being reviewed for years 2012, 2013, 2014 and 2015.

Finding No. 3 – Dredging Reserve Requirement Not In Compliance (Control Finding)

The County did not comply with the required dredging reserve contribution. OCCR/OC Parks calculated the County's required annual contribution amount to the dredging reserve to be \$272,200 due by January 1, 2015. The County's annual contribution amount to the dredging reserve fund (DRF) for fiscal year (FY) 2014-15 was \$254,200 instead of the required revised amount of \$272,200. OCCR Budget informed us it was not notified of the dredging reserve amount increase.

The Agreement Section 28.C.2. Adjustments to Dredging Reserve Fund Contributions states, "Both the COUNTY's and TENANT's annual contributions to the DRF shall be automatically adjusted on January 1, 2015 and every five (5) years thereafter in proportion to changes in the Consumer Price Index for Los Angeles – Anaheim – Riverside, CA (All Urban Consumers – All Items) promulgated by the Bureau of Labor statistics of the U.S. Department of Labor, or any replacement index thereto.

Section 28.C.2.c. states, "The adjusted annual contributions are automatic and shall become effective on the adjustment date. Director of Parks shall, but is not required to, provide notice to the TENANT of each adjusted annual contribution for both COUNTY and TENANT."

Recommendation No. 3:

We recommend OCCR ensure the County makes the correct annual contribution to the dredging reserve fund as required by the Agreement.

OCCR/OC Parks Management Response:

Concur: OCCR has corrected the \$18,000 shortfall that occurred in the Newport Tidelands dredging reserve for FY 2014-15 through an appropriation of \$18,000 during the FY 2016-17 Budget in addition to the \$272,200 required annual contribution. This increased contribution to the Newport Dunes dredging reserve was approved as part of the FY 2016-17 Newport Tidelands Budget by the Board of Supervisors on June 28, 2016 and will be implemented by the Auditor-Controller in FY 2016-17. In addition, OCCR will work with CEO Real Estate to ensure that OCCR Budget staff are notified of the proper amount to add to the Newport Dunes dredging reserve when that amount is adjusted on January 1, 2020.

Finding No. 4 – Adequacy of Rental Agreement Supporting Records (Control Finding)

Newport Dunes Partnership's watersports rental agreements were not properly completed. Pertinent information such as boat description, driver's license number, items left for deposit, due back time, rental amount, and date were sometimes omitted on the rental agreements. None of the rental agreements reviewed for the date of July 20, 2016 were fully completed and the Watersports Manager informed us they were unaware of the occurrence until our discovery.



Detailed Findings, Recommendations, and Management Responses

Newport Dunes Partnership's marketplace rental forms for surreys, bikes, golf carts, fire pits, cabanas, and umbrellas are not serially pre-numbered as required by the Agreement.

The missing information and lack of serially numbered receipts contribute to an increased risk that rental charges may not be reported accurately to the County.

Section 15.A, Records and Accounts of the Agreement states, "TENANT understands and agrees, at all times during the term of this Lease, to keep or cause to be kept true and complete books, records and accounts of all financial transactions in the operation of all business activities, of whatever nature, conducted in pursuance of the rights granted herein. The records must be supported by source documents such as sale slips, cash register tapes, purchase invoices, or other pertinent documents.

In the event of boat launching, parking and/or rental charges, TENANT shall issue serially numbered tickets for each vehicle or rental and shall keep an adequate record of said tickets, both issued and unissued."

Recommendation No. 4:

We recommend OCCR require Newport Dunes Partnership to instruct its staff about the importance of ensuring that the rental agreement forms are complete and accurate. The rental agreements should be reviewed by the Watersports Manager for completeness and accuracy. We also recommend that OCCR require Newport Dunes Partnership to utilize serially pre-numbered rental forms for all rental activity and ensure all rental forms are issued in sequential order and properly accounted for.

OCCR/OC Parks Management Response:

Concur: CEO Real Estate will send a letter with detailed instructions to Newport Dunes regarding the items noted in Recommendation No. 4 above. These procedures are to be implemented within 60 days. Newport Marina will be required to provide evidence to OCCR management to ensure new procedures are in place and being practiced.

Finding No. 5 – Optional Services and Uses Not Properly Authorized (Control Finding)

Newport Dunes Partnership did not seek required prior approval from the Director of OC Parks for the 2015 Camp James Summer Program and collection of charitable contributions.

Camp James is considered an optional service that was previously approved by OC Parks for three (3) summers from 2012 through 2014; however, Newport Dunes Partnership did not request approval for the 2015 Camp James Summer Program. To ensure there is no misunderstanding, requests for operational services and uses as well as assigned percentages of rent, if any, should be submitted in writing to OC Parks.

Newport Dunes Partnership also did not obtain prior approval for optional services and uses related to the collection of charitable donations from guests during their stays at the resort. Newport Dunes Partnership does not retain any portion of the donations collected. Guests may donate (\$1 per stay day) to a non-profit organization such as Orange County Coastal Keepers or Children Hospital of Orange County (CHOC) and Newport Dunes Partnership subsequently submits the donations to the designated non-profit organizations.

Section 8. Rent for Optional Services and Uses further states, "Rent for other services and uses approved by the Director OC Parks, shall be determined by the Director of OC Parks."



Detailed Findings, Recommendations, and Management Responses

Section 5.B. Optional Services and Uses of the Agreement states, "Subject to the prior written approval of use and location by Director of OC Parks, TENANT may provide those additional services and uses which are ancillary to and compatible with the required services and uses herein."

Recommendation No. 5:

We recommend that OCCR ensure the agreed percentage of rent, if any, for optional services and uses such as Camp James Summer Program is documented and communicated to Newport Dunes Partnership. We also recommend that OCCR require Newport Dunes Partnership to obtain prior written approval from the Director of OC Parks for the collection of charitable donations which benefit non-profit organizations.

OCCR/OC Parks Management Response:

Concur: CEO Real Estate will send a letter to Newport Dunes regarding the requirements noted in Recommendation No. 5 above. The County is requiring Newport Dunes to establish a license agreement with the County for Camp James Summer Program and said license shall be retroactive and inclusive for the 2016 summer. The license shall include all terms and rent percentages. Also, the County is requiring Tenant to establish a license agreement for charitable events, which will be limited to two events per year and one ongoing contributory event. All licenses must document gross revenue received by Tenant, percentage of rents due and rents paid to the County.



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: OCCR/OC Parks Management Responses



September 22, 2016

STEVE FRANKS
DIRECTOR
OC COMMUNITY RESOURCES

JENNIFER HAWKINS, DVM
DIRECTOR
OC ANIMAL CARE

RENEE RAMIREZ
INTERIM DIRECTOR
OC COMMUNITY SERVICES

JULIA BIDWELL
INTERIM DIRECTOR
HOUSING COMMUNITY
DEVELOPMENT & HOMELESS
PREVENTION

STACY BLACKWOOD
DIRECTOR
OC PARKS

HELEN FRIED
COUNTY LIBRARIAN
OC PUBLIC LIBRARIES

TO: Toni Smart, Director
Auditor-Controller, Internal Audit Division

RE: **AUDIT NO. 1561 REVENUE GENERATING LEASE AUDIT:
OC COMMUNITY RESOURCES/OC PARKS – NEWPORT DUNES
PARTNERSHIP, HA55B-101.21, 104.1, 101.51**

The Auditor-Controller Internal Audit Division completed an audit of Revenue Generating Lease Agreement Audit of Waterfront Resort Properties, L.P. a California limited partnership, and Newport Dunes Partnership Marina, LLC, a California limited liability company (Newport Dunes Partnership) for the period December 1, 2014 through November 30, 2015. Below are OC Community Resources' responses to the audit findings and recommendations, which have been reviewed and approved by the County Executive Office.

**Finding No. 1 – Lack of an Adequate Control System for Parking
(Significant Control Weakness)**

Recommendation No. 1:

We recommend OCCR require Newport Dunes Partnership to maintain an adequate control system to ensure the completeness of the parking activity generated at the gates. The register tapes generated from the gate system should be reconciled to the reports submitted to ensure all parking activities are properly recorded.

OCCR/Parks Management Response:

Concur: The County will send a letter with detailed instructions to the Newport Dunes Partnership regarding the recommendation above. These procedures are to be implemented within 60 days. The Newport Dunes Partnership will be required to provide evidence to OCCR management to ensure new procedures are in place and being practiced.

**Finding No. 2: Review and Reconciliation of Audited Financial
Statements Not Performed (Control Finding)**

Recommendation No. 2:

We recommend OCCR develop and implement policies and procedures to ensure Newport Dunes Partnership's audited financial statements are reviewed and reconciled in a timely manner.

OCCR/Parks Management Response:

Concur: OCCR Accounting has collaborated with CEO Real Estate and developed and implemented procedures to ensure that audited financial statements are received, reviewed and reconciled in a timely manner. Any unreported income and related revenue will be invoiced accordingly. Newport Dunes Partnership reconciliations of audited financial statements have been prepared and are currently being reviewed for years 2012, 2013, 2014 and 2015.



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Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: OCCR/OC Parks Management Responses (continued)

OC COMMUNITY RESOURCES RESPONSE TO AUDIT REPORT #1561
PAGE 2 OF 3
SEPTEMBER 22, 2016

Finding No. 3: Dredging Reserve Requirement Not In Compliance (Control Finding)

Recommendation No. 3:

We recommend OCCR ensure the County makes the correct annual contribution to the dredging reserve fund as required by the Agreement.

OCCR/Parks Management Response:

Concur: OCCR has corrected the \$18,000 shortfall that occurred in the Newport Tidelands dredging reserve for FY 2014-15 through an appropriation of \$18,000 during the FY 2016-17 Budget in addition to the \$272,200 required annual contribution. This increased contribution to the Newport Dunes dredging reserve was approved as part of the FY 2016-17 Newport Tidelands Budget by the Board of Supervisors on June 28, 2016 and will be implemented by the Auditor-Controller in FY 2016-17. In addition, OCCR will work with CEO Real Estate to ensure that OCCR Budget staff are notified of the proper amount to add to the Newport Dunes dredging reserve when that amount is adjusted on January 1, 2020.

Finding No. 4: Adequacy of Rental Agreement Supporting Records (Control Finding)

Recommendation No. 4:

We recommend OCCR require Newport Dunes Partnership to instruct its staff about the importance of ensuring that the rental agreement forms are complete and accurate. The rental agreements should be reviewed by the Watersports Manager for completeness and accuracy. We also recommend that OCCR require Newport Dunes Partnership to utilize serially pre-numbered rental forms for all rental activity and ensure all rental forms are issued in sequential order and properly accounted for.

OCCR/Parks Management Response:

Concur: CEO Real Estate will send a letter with detailed instructions to Newport Dunes regarding the items noted in Recommendation No. 4 above. These procedures are to be implemented within 60 days. Newport Marina will be required to provide evidence to OCCR management to ensure new procedures are in place and being practiced.

Finding No. 5: Optional Services and Uses Not Properly Authorized (Control Finding)

Recommendation No. 5:

We recommend that OCCR ensure the agreed percentage of rent, if any, for optional services and uses such as Camp James Summer Program is documented and communicated to Newport Dunes Partnership. We also recommend that OCCR require Newport Dunes Partnership to obtain prior written approval from the Director of OC Parks for the collection of charitable donations which benefit non-profit organizations.

OCCR/Parks Management Response:

Concur: CEO Real Estate will send a letter to Newport Dunes regarding the requirements noted in Recommendation No. 5 above. The County is requiring Newport Dunes to establish a license agreement with the County for Camp James Summer Program and said license shall be retroactive and inclusive for the 2016 summer. The license shall include all terms and rent percentages. Also, the County is requiring Tenant to establish a license agreement for charitable events, which will be limited to two events per year and one ongoing contributory event. All licenses must document gross revenue received by Tenant, percentage of rents due and rents paid to the County.



Detailed Findings, Recommendations, and Management Responses

ATTACHMENT B: OCCR/OC Parks Management Responses (continued)

OC COMMUNITY RESOURCES RESPONSE TO AUDIT REPORT #1561
PAGE 3 OF 3
SEPTEMBER 22, 2016

If you have any questions related to these responses, please contact Brian Rayburn, Business Office Manager, OC Community Resources at 714-480-2885.

Sincerely,

Signature  Date 9/22/16

SAF:bwf