

Internal Audit Department

FINAL CLOSE-OUT**FIRST FOLLOW-UP AUDIT:****REVIEW OF LEASE REVENUE
OC DANA POINT HARBOR/OCEAN INSTITUTE
ORIGINAL AUDIT No. 2577****As of May 31, 2008**

OC Dana Point Harbor and Ocean Institute satisfactorily implemented or addressed all seventeen (17) audit recommendations from our original audit report.

During the original audit, Ocean Institute reported gross receipts (not subject to percentage rent) of \$3.9 million to the County and paid \$12,000 in rent to the County for the year ended January 31, 2006. Ocean Institute is a non-profit corporation. This lease agreement of about 35 years is estimated to generate at least \$1.2 million in rent to OC Dana Point Harbor.

AUDIT NO: 2741-D
REPORT DATE: MAY 29, 2009

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Letter from Dr. Peter Hughes, CPA



Transmittal Letter



Audit No. 2741-D May 29, 2009

TO: Brad Gross, Director
OC Dana Point Harbor Department

FROM: Dr. Peter Hughes, CPA
County Internal Auditor

SUBJECT: **First and Final Close-Out** Follow-Up
Audit of Review of Lease Revenue for
Ocean Institute (Original Audit No. 2577,
Issued November 6, 2007)

We have completed a First and Final Close-Out Follow-Up Audit of the Review of Lease Revenue for Ocean Institute. Our audit was limited to reviewing, as of May 31, 2008, actions taken to implement seventeen recommendations in our report dated November 6, 2007.

The results of our Follow-Up Audit are discussed in the **OC Internal Auditor's Executive Report** following this transmittal letter. Because satisfactory corrective action has been taken for all recommendations, **this report represents the close-out of the original audit.**

Each month I submit an **Audit Status Report** to the Board of Supervisors 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.

ATTACHMENTS

Other recipients of this report listed on the Internal Auditor's Report on page 2.

Table of Contents



*First and Final Follow-Up Audit of
Review of Lease Revenue for Ocean Institute,
Original Audit No. 2577
Audit No. 2741-D*

As of May 31, 2008

Transmittal Letter	i
INTERNAL AUDITOR'S REPORT	1
1. Percentage Rent Not Paid on Facility Rental Revenue (Control Findings)	1
2. Facility Rental Security Deposits (Control Findings)	2
3. Percentage Not Paid on Museum Style Retail Store Sales	2
4. Commercial Cruises (Control Findings)	3
5. Commercial Cruise Flat Rent Should Be Separate from Minimum Annual Rent (Control Findings)	3
6. Periodic Increases to Minimum Annual Rent (Control Finding)	4
7. Periodic Increases to Security Deposit (Control Finding)	4
8. Required Financial Statements Not Submitted (Control Finding)	4
9. Other Required Annual Reports (Control Finding)	5
10. Monthly Gross Receipts Statement (Control Findings)	5
11. Audit Cost Provision (Control Finding)	6



INTERNAL AUDITOR'S REPORT

Audit No. 2741-D

May 29, 2009

TO: Brad Gross, Director
OC Dana Point Harbor Department

FROM: Dr. Peter Hughes, CPA
County Internal Auditor

SUBJECT: **First and Final Close-Out** Follow-Up Audit of Review of
Lease Revenue for Ocean Institute (Original Audit No.
2577, Issued November 6, 2007)

Scope of Review

We have completed a First and Final Close-Out Follow-Up Audit of the Review of Lease Revenue for Ocean Institute. Our audit was limited to reviewing actions taken as of May 31, 2008 to implement the seventeen (17) recommendations made in our original audit report.

Background

The original audit reviewed whether Ocean Institute's records adequately supported their monthly gross receipts reported to the County. In our original audit, Ocean Institute reported gross receipts (not subject to percentage rent) of \$3.9 million to the County and paid \$12,000 in rent to the County for the year ended January 31, 2006. The original audit report identified additional potential rent owed of \$66,895 related to facility rental revenue. We also identified seventeen (17) control findings related to compliance with the Agreement or improving controls.

Results

OC Dana Point Harbor (DPHD) and Ocean Institute successfully implemented or addressed (closed) all seventeen (17) recommendations. As such, this report represents the **final close-out** of the original audit. Following is the implementation status of the seventeen (17) original recommendations:

1. **Percentage Rent Not Paid on Facility Rental Revenue (Two Control Findings)**

Recommendation No. 1: We recommend that DPHD determine and clarify in writing whether Ocean Institute should report facility rental revenue as gross receipts subject to percentage rent.

Current Status: Implemented. Our review of documentation provided by DPHD found that DPHD has determined Ocean Institute must report facility rental revenue as gross receipts and DPHD has provided written clarification to Ocean Institute as recommended.



Recommendation No. 2: We also recommend that if DPHD determines the facility rental revenue is subject to percentage rent, that DPHD require Ocean Institute to pay percentage rent owed of \$66,895 for the 28 month period of February 2005 through May 2007. DPHD should also require Ocean Institute to calculate and pay percentage rent owed for the period of June 2007 through the month of correction. A net credit for minimum monthly rent of \$1,000 less flat rent (\$50 per cruise) for commercial cruises could potentially reduce these amounts owed. See details below in Finding No.7.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute has been directed to pay the County \$71,913 in additional rent on unreported facility rental revenue, as recommended. DPHD agreed to a payment plan proposed by Ocean Institute of \$1,600 per month to be included on the monthly rent statement, which we confirmed has commenced January 2008.

2. Facility Rental Security Deposits (Two Control Findings)

Recommendation No. 3: If the facility rental revenue is determined to be gross receipts "subject to rent," we recommend that DPHD require Ocean Institute to report security deposits for facility rentals as gross receipts "subject to rent" and pay the percentage rent owed (10%) when the security deposit is collected.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute is reporting and paying percentage rent on security deposits when collected, as recommended.

Recommendation No. 4: If the facility rental revenue is determined to be gross receipts "subject to rent," we also recommend that DPHD require Ocean Institute to make a one-time adjustment to report the balance of security deposits as of the date of correction as gross receipts "subject to rent" and pay the percentage rent owed (10%).

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute made the one-time adjustment to report the balance of security deposits and paid additional rent due as of the date of correction, as recommended.

3. Percentage Not Paid on Museum Style Retail Store Sales (Control Finding)

Recommendation No. 5: We recommend that DPHD determine and clarify in writing whether the merchandise sold at Ocean Institute's store complies with the Agreement and should be excluded from percentage rent.



Current Status: Implemented. Our review of documentation provided by DPHD found that DPHD determined the merchandise sold at Ocean Institute's store complies with the Agreement and should be excluded from percentage rent. DPHD has provided written clarification to Ocean Institute, as recommended.

4. **Commercial Cruises (Two Control Findings)**

Recommendation No. 6: We recommend that DPHD require Ocean Institute pay additional rent owed of \$450 for commercial cruises for the months of August 2005 and January 2006.

Current Status: Implemented. Our review of documentation provided by DPHD found that the additional rent owed was addressed and settled as part of the \$71,913 owed from Recommendation No. 2 above.

Recommendation No. 7: We also recommend that DPHD remind Ocean Institute of the need for accurate reporting of commercial cruises to the County.

Current Status: Implemented. Our review of documentation provided by DPHD found that DPHD provided written clarification to Ocean Institute regarding the need for accurate reporting of commercial cruise revenues, as recommended.

5. **Commercial Cruise Flat Rent Should Be Separate From Minimum Annual Rent (Two Control Findings)**

Recommendation No. 8: We recommend that DPHD require Ocean Institute to properly segregate and pay the flat rent for commercial cruises.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute is properly segregating and paying flat rent for commercial cruises, as recommended.

Recommendation No. 9: We also recommend that DPHD and Ocean Institute evaluate the proper reporting of minimum annual rent in relation to percentage rent.

Current Status: Implemented. Our review of documentation provided by DPHD found that DPHD determined Ocean Institute is obligated to pay the percentage rent in addition to minimum rent. DPHD has provided written clarification to Ocean Institute, as recommended.



6. Periodic Increases to Minimum Annual Rent (Control Finding)

Recommendation No. 10: We recommend that DPHD adjust Ocean Institute's minimum annual rent as allowed by the Agreement.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute's minimum annual rent was adjusted as allowed by the Agreement, as recommended.

7. Periodic Increases to Security Deposit (Control Finding)

Recommendation No. 11: We recommend that DPHD adjust Ocean Institute's security deposit amount as allowed by the Agreement.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute's security deposit amount was adjusted as allowed by the Agreement, as recommended.

8. Required Financial Statements Not Submitted (Two Control Findings)

Recommendation No. 12: We recommend that DPHD require Ocean Institute to submit annual balance sheets and income statements (or comparable statements for a non-profit organization) prepared or audited by a CPA that comply with the Agreement.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute submitted annual financial statements for year-ended 12/31/07 that comply with the Agreement.

Recommendation No. 13: We also recommend that DPHD require Ocean Institute to submit annual statements of gross receipts and related schedule (as defined in the Agreement) audited by a CPA that comply with the Agreement. DPHD should evaluate whether to require Ocean Institute to submit the audited statement of gross receipts and related schedule for previous years.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute submitted an annual statement of gross receipts for year-ended 12/31/07 that generally complies with the Agreement. The annual gross receipts statement appears to include only gross receipts as specifically defined in Clause 5.B (excluded from rent) and 5.C (subject to rent) of the Agreement. Other support and revenue generated by Ocean Institute (such as contributions, memberships, grants, interest income, and revenue from off-site activities) are not included on the annual gross receipts statement. However, the other support and revenue is included in Ocean Institute's audited annual statement of activities for Ocean Institute as a whole, which is also submitted to the County and should suffice. DPHD determined that Ocean Institute is not required to submit the audited statement of gross receipts for previous years.



9. Other Required Annual Reports (Control Finding)

Recommendation No. 14: We recommend that DPHD require Ocean Institute to submit the other annual reports required by Clause 14.C (as described above) on a go forward basis.

Current Status: Partially Implemented/Closed. Our review of documentation provided by DPHD found that Ocean Institute has submitted the other annual reports for year-end 12/31/07 required by Clause 14.C, as recommended, except for the Capital Replacement Fund report requirement. Ocean Institute has not established a Capital Replacement Fund since they determined it is not economically feasible at the present time and during the foreseeable future. Ocean Institute did provide DPHD with a ten (10) year maintenance plan for the facility that was developed in 2007 by a project management consultant. Additionally, Ocean Institute provided DPHD with an annual expense statement of direct and indirect costs spent on maintaining the facility during 2007. DPHD has determined that it will not enforce the Capital Replacement Fund requirements of the Agreement at this time. Instead, DPHD will continue to periodically inspect the conditions of the facility and review Ocean Institute's expenditure reports. However, DPHD does reserve the right to enforce the Capital Replacement Fund requirements in the future. The Agreement also requires DPHD to approve any structures or capital improvements to the facility. As such, we will close-out this recommendation at this time.

10. Monthly Gross Receipts Statement (TwoControl Findings)

Recommendation No. 15: We recommend that DPHD require Ocean to sign and certify the monthly gross receipts statement submitted to the County.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute is signing and certifying the monthly gross receipts statements submitted to the County, as recommended.

Recommendation No. 16: We recommend DPHD to require Ocean Institute to completely report all gross receipts generated from the premises, regardless if subject to percentage rent.

Current Status: Implemented. Our review of sample monthly gross receipts statement (April 2008) provided by DPHD found that Ocean Institute's monthly gross receipts statement generally complies with the Agreement.

Further Details: Ocean Institute's April 2008 monthly gross receipts statement only included gross receipts of \$363,263 as specifically defined in Clause 5.B and 5.C of the Agreement. Other support and revenue of \$614,743 was not included in the monthly gross receipts statement.



According to Ocean Institute, the \$614,743 includes grant, donations, memberships, and off-site activities. Based on our review of the Agreement, it appears appropriate that memberships, donations, and grants are not included in the monthly gross receipts statement. However, the off-site activities are not as clearly evident. There is merit to excluding off-site activities from the monthly gross receipts statement, but we did not audit the underlying details of the off-site events to see if they originated at the lease premises. As the off-site activities are not subject to percentage rent and are reported annually in the audited annual statement of activities provided to the County, we will not pursue this issue further at this time.

11. Audit Cost Provision (Control Finding)

Recommendation No. 17: Depending on the outcome of Finding No. 1 above, we recommend that DPHD evaluate whether to assess Ocean Institute for audit costs.

Current Status: Implemented. Our review of documentation provided by DPHD found that Ocean Institute is paying audit costs of \$5,760 as part of the \$71,913 owed as discussed above in Recommendation No. 2.

We appreciate the cooperation and assistance extended to us by OC DPHD/Leasing & Revitalization, OC Public Works/Accounting Services, and Ocean Institute during our Follow-Up Audit. If you have any questions, please contact me directly or Eli Littner, Deputy Director at 834-5899, or Autumn McKinney, Senior Audit Manager at 834-6106.

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

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