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# REVENUE GENERATING LEASE AUDIT: OC PUBLIC WORKS BELLA'S KITCHEN

For the Period September 1, 2007 through August 31, 2008

Bella's Kitchen operates a food service establishment located in the Manchester Office Building at the Lamoreaux Family Justice Center in Orange. Gross receipts reported during the audit period were approximately \$869,000 and rent paid to the County was approximately \$87,000.

The Internal Audit Department found that Bella's Kitchen's records adequately supported gross receipts and rent owed was properly paid, except for inadequate records for locker fees and rent overpaid on sales tax.

AUDIT NO: 2838

REPORT DATE: JUNE 5, 2009

County Internal Auditor: Dr. Peter Hughes, CPA, CIA
Deputy Director: Eli Littner, CPA, CIA
Sr. Audit Manager: Autumn McKinney, CPA, CIA
Audit Manager: Lily Chin, CPA



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#### **Providing Facts and Perspectives Countywide**

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

County Internal Auditor Certified Compliance & Ethics Professional (CCEP)

Certified Information Technology Professional (CITP)

Certified Internal Auditor (CIA) Certified Fraud Examiner (CFE)

E-mail: peter.hughes@iad.ocgov.com

Eli Littner CPA, CIA, CFE, CFS, CISA

Deputy Director Certified Fraud Specialist (CFS)

Certified Information Systems Auditor (CISA)

Michael J. Goodwin CPA, CIA

Senior Audit Manager

Alan Marcum MBA, CPA, CIA, CFE

Senior Audit Manager

Autumn McKinney CPA, CIA, CISA, CGFM

Senior Audit Manager Certified Government Financial Manager (CGFM)

#### **Hall of Finance & Records**

12 Civic Center Plaza, Room 232 Santa Ana, CA 92701

Phone: (714) 834-5475 Fax: (714) 834-2880

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OC Fraud Hotline (714) 834-3608

### Letter from Dr. Peter Hughes, CPA







Audit No. 2838 June 5, 2009

**TO:** Bryan Speegle, Director OC Public Works

FROM: Dr. Peter Hughes, CPA

County Internal Auditor

**SUBJECT:** Revenue Generating Lease Audit:

OC Public Works/Bella's Kitchen,

AML/CRE-CEO-99-010

We have completed our revenue generating lease audit of Bella's Kitchen for the period September 1, 2007 through August 31, 2008. The final **County Internal Auditor's Report** is attached along with your responses to our recommendations. We performed this Revenue Generating Lease Audit in accordance with our FY 2008-09 Audit Plan approved by the Audit Oversight Committee.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). As a matter of policy, our **first Follow-Up Audit** will now <u>begin</u> at <u>six months</u> from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will now begin at <u>six months</u> from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented.

At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

### Letter from Dr. Peter Hughes, CPA



Each month I submit an **Audit Status Report** to the BOS where I detail any 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 your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendation.

Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

#### **Attachments**

Other recipients of this report are listed on the **County Internal Auditor's Report** on page 3.

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For the Period September 1, 2007 through August 31, 2008

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### **County Internal Auditor's Report**



Audit No. 2838

June 5, 2009

TO: Bryan Speegle, Director

**OC Public Works** 

FROM: Dr. Peter Hughes, CPA

County Internal Auditor

SUBJECT: Revenue Generating Lease Audit:

OC Public Works/Bella's Kitchen,

AML/CRE-CEO-99-010

#### **Audit Highlight**

Bella's Kitchen operates a food service establishment located in the Manchester Office Building at the Lamoreaux Family Justice Center in Orange. Gross receipts generated during the audit period were approximately **\$869.000** and rent paid to the County was approximately \$87,000.

The Internal Audit
Department found
that Bella's Kitchen's
records adequately
supported gross
receipts and rent
owed was properly
paid, except for
inadequate records
for locker fees and
rent overpaid on
sales tax.

#### **OBJECTIVES**

We have performed an audit of certain records and documents for the period from September 1, 2007 through August 31, 2008, pertinent to the lease agreement (Agreement) between the County of Orange (County) and Joe D'Angelo, a sole proprietor, dba Bella's Kitchen, dated May 5, 2004. The Agreement is for the operation of a food service establishment. Our audit objectives are:

- (1) The primary purpose of our audit is to determine whether Bella's Kitchen's records adequately support their monthly gross receipts reported to the County and rent owed is properly paid.
- (2) The secondary purpose of our audit is to determine whether Bella's Kitchen complies with certain other financial provisions of the Agreement, such as accounting methods, monthly gross receipts statement format, and annual financial statement requirements.

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

#### **BACKGROUND**

The County entered into an Agreement with Joe D'Angelo, a sole proprietor, dba Bella's Kitchen, dated May 5, 2004, for the operation of a food service establishment located in the Manchester Office Building at Lamoreaux Justice Center in the City of Orange. During the audit period, Bella's Kitchen reported approximately \$869,000 in gross receipts and paid the County approximately \$87,000 in rent.

### **County Internal Auditor's Report**



#### **SCOPE**

Our audit was limited to certain records and documents that support Bella's Kitchen's gross receipts reported to the County for the 12-month period of September 1, 2007 to August 31, 2008. Our audit included inquiry, auditor observation, and limited testing for assessing the adequacy of documentation and ensuring completeness of reported gross receipts.

#### **RESULTS**

Below are the results of our audit:

Objective #1 – Adequate Records: Determine whether Bella's Kitchen's records adequately support monthly gross receipts reported to the County and rent owed is properly paid.

**Results:** We found Bella's Kitchen's records adequately supported the reported gross receipts and rent owed was properly paid, except for inadequate records for locker fees and rent overpaid on sales tax which is excludable from gross receipts. We noted four (4) **Control Findings** where recordkeeping should be enhanced to support the reported gross receipts and one (1) **Control Finding** where rent was overpaid on sales tax. (See pages 4-6 for details)

Objective #2 – Compliance: Determine whether Bella's Kitchen complies with certain other financial provisions of the agreement.

**Results:** We found Bella's Kitchen generally complied with certain other financial provisions of the agreement such as accounting methods, monthly gross receipts statement format, and annual financial statements.

See all (5) **Control Findings** in the Detailed Findings, Recommendations, and Management Responses section of this report. See **Attachment A** for a description of report item classifications.

#### **ACKNOWLEDGMENT**

We appreciate the courtesy and cooperation extended to us by the personnel at Bella's Kitchen, OC Public Works/Corporate Real Estate, and OC Public Works/Accounting Services. If you have any questions regarding our review of lease revenue, please call me directly; or Eli Littner, Deputy Director at (714) 834-5899, or Autumn McKinney, Senior Audit Manager at (714) 834-6106.

**Attachment A: Report Item Classifications** 

Attachment B: OC Public Works Management Responses

### **County Internal Auditor's Report**



Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Alisa Drakodaidis, Deputy CEO/OC Infrastructure
Jess A. Carbajal, Chief Deputy Director, OC Public Works
Dori Malloy, Director, OC Public Works/OC Facilities
Carlos Bustamante, Director, OC Public Works/Administration
Thomas Mason, Interim Division Manager, OC Pubic Works/OC
Facilities/Real Estate and Asset Management/Corporate Real Estate
James Campbell, Project Manager, OC Public Works/OC Facilities/Real
Estate and Asset Management/Corporate Real Estate
Tony Bernard, Manager, OC Public Works/Administration/Purchasing
Mary Fitzgerald, Accounting Manager, OC Public Works/Accounting
Services

Jenny Tu, Chief, OC Public Works/Accounting/Santa Ana River, Watershed, Flood, Leases and Infrastructure

Tam Vu, Admin. Manager I, OC Public Works/Accounting/Watershed, Flood, Leases and Infrastructure

Brian Cich, Senior Accountant I, OC Public Works/Accounting/Leases and Infrastructure

Foreperson, Grand Jury

Darlene J. Bloom, Clerk of the Board of Supervisors



#### Audit Objective #1 – Adequate Records

#### 1. Inadequate Locker Fee Records (Control Finding)

Bella's Kitchen charges its customers two dollars (\$2.00) for temporarily holding electronic devices such as cameras as they are not allowed in the juvenile courtrooms. Bella's Kitchen reports the gross receipts as Locker Fees on the monthly gross receipts statement submitted to the County. It reported \$1,344 and \$810 for our sample months of June 2008 and December 2007, respectively. The number of locker fee transactions in our sample months ranged from approximately 400 to 700.

Clause 14.A of the Agreement requires all sales and charges be recorded by means of cash registers or other comparable devices and automatically issue a receipt.

**Finding No. 1:** Bella's Kitchen does not record the \$2 locker fee collected in its cash register nor issue a handwritten receipt or pre-numbered ticket. Bella's Kitchen maintains a separate handwritten record of the monies collected. The handwritten record lists the date and the total receipts for the day. Bella's Kitchen informed us that it wanted to report the locker fees separately from the food and beverage sales. Locker fees could be accumulated separately from food and beverage sales in the cash register by enabling a separate ring key/category for locker fees in the cash register.

**Recommendation No. 1:** We recommend that OC Public Works require Bella's Kitchen to enable a separate ring key/category in its cash register for locker fees and record all locker transactions in its cash register.

Alternatively, pre-numbered two-part tickets or handwritten receipts could be issued for each locker fee collected. The numerical sequence of the tickets/receipts would need to be accounted for and the tickets/receipts would need to be reconciled with monies collected as part of the daily balancing process.

**OC Public Works Management Response:** Concur. OC Public Works agrees with the alternative recommendation and we discussed the finding with Bella's Kitchen. Bella's Kitchen agrees with the alternative control recommendation and will amend its procedure to include the issuance of the three-part receipt for all locker fees collected. One copy of the receipt will be placed with the item in the storage locker, the second copy of the receipt will be given to the customer to claim the item stored, and the third copy of the receipt will remain as the transaction record for the money collected and will be reported on the daily receipts. The receipts will be sequentially numbered.

#### 2. Rent Overpaid on Sales Tax (Control Finding)

Clause 11.F of the Agreement states that gross receipts shall exclude sales tax and excise taxes payable by the lessee to federal, state, county, or municipal governments as a direct result of operation under the Agreement.



**Finding No. 2:** During our testing of two sample months, we found that Bella's Kitchen over reported food and beverage gross receipts to the County by including the sales tax. Bella's Kitchen did not realize that sales tax was excludable from gross receipts and informed us that it has reported in such manner since the inception of the Agreement in 2004. We found that Bella's Kitchen over reported food and beverage sales by \$2,720 for June 2008 and by \$1,920 for December 2007, resulting in rent overpaid by \$272 and \$192, respectively.

**Recommendation No. 2:** We recommend that OC Public Works evaluate whether rent overpaid due to sales tax should be refunded to Bella's Kitchen.

**OC Public Works Management Response:** Concur. OC Public Works has determined that Bella's Kitchen overpaid their rent from September 2004 to September 2008. Bella's Kitchen included sales tax as a part of the gross receipts, which resulted in the over-payment. The accountant for Bella's Kitchen has submitted a claim for a refund of \$9,237.83. That claim is now being reviewed for accuracy by OC Public Works Accounting. A refund or rent credit may be issued to Bella's Kitchen upon completion of the overpaid rent claim.

#### 3. Gift Certificates Not Serially Numbered (Control Finding)

Bella's Kitchen sells gift certificates. Clause 14.A of the Agreement requires the tenant to issue serially numbered tickets for each admission or rental and shall keep an adequate record of said tickets, both issued and unissued.

**Finding No. 3:** We found that gift certificates were not numbered. A log was not maintained to account for the issued and unissued certificates.

**Recommendation No. 3:** We recommend that OC Public Works require Bella's Kitchen to use serially numbered gift certificates and maintain a log of issued and unissued certificates.

**OC Public Works Management Response:** Concur. OC Public Works agrees with the recommendation and has discussed the procedure with Bella's Kitchen. Bella's Kitchen agrees with the recommendation and has implemented the issuance of serially numbered gift certificates and the record keeping of both issued and unissued gift certificates.

#### 4. Catering Invoices Not Serially Numbered (Control Finding)

Bella's Kitchen offers catering service for large orders of food items. For one of its frequent customers, Bella's Kitchen uses a handwritten form to process the order and uses it as an invoice. This form contains the date, customer's name, description of items ordered and the total order amount. This form is issued to the customer and Bella's Kitchen receives payment for the catering based on the form.

Finding No. 4: We found that the catering invoices are not serially numbered.

**Recommendation No. 4**: We recommend that OC Public Works require Bella's Kitchen to serially number its catering invoices.



**OC Public Works Management Response:** Concur. OC Public Works agrees with the recommendation and discussed the finding with Bella's Kitchen. Bella's Kitchen agrees and has commenced using serially numbered catering invoices.

#### 5. Supporting Documentation for Voids (Control Finding)

**Finding No. 5:** During our testing, we found the supporting documents (cash register receipts) for voided or canceled transactions were not consistently retained and reasons for the voids were not noted.

**Recommendation No. 5:** We recommend that OC Public Works require Bella's Kitchen to retain all supporting documents (cash register receipts) related to voided or canceled transactions along with reasons for the void/cancellation noted.

**OC Public Works Management Response:** Concur. OC Public Works agrees with the recommendation and discussed the finding with Bella's Kitchen. Bella's Kitchen agrees to retain all voided transactions and record the reason for each void.



#### **ATTACHMENT A: Report Item Classifications**

For purposes of reporting our audit findings and recommendations, we will classify 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 address "Material Weaknesses" brought to their attention immediately.

#### 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 and/or Efficiency/Effectiveness Issues:

Audit findings that require management's corrective action to implement or enhance processes and internal controls. Control Findings and Efficiency/Effectiveness issues are expected to be addressed within our follow-up process of six months, but no later than twelve months.



#### **ATTACHMENT B: OC Public Works Management Responses**



2009 JUN -3 AM 9: 56

Bryan Speegle, Director 300 N. Flower Street Santa Ana, CA

Santa Ana, CA 92702-4048

#### memo

DATE: June 1, 2009

TO: Peter Hughes, Ph.D., CPA, Director

Internal Audit Department

FROM: Director, OC Public Works

SUBJECT: Response to Revenue Generating Lease Audit of Bella's Kitchen - No. 2838

I am pleased to provide OC Public Works' response to the Internal Audit Department's Draft Report on the Revenue Generating Lease Audit of Bella's Kitchen. Our response has been reviewed and approved by the County Executive Office.

While there were no material weaknesses of significant issues, we will work to implement the Internal Audit Department's recommendations as indicated in our following responses.

Recommendation No. 1: We recommend that OC Public Works require Bella's Kitchen to enable a separate ring key/category in its cash register for locker fees and record all locker transactions in its cash

Alternatively, pre-numbered two-part tickets or handwritten receipts could be issued for each locker fee collected. The numerical sequence of the tickets/receipts would need to be accounted for and the tickets/receipts would need to be reconciled with monies collected as part of the daily balancing process.

OC Public Works Response: Concur. OC Public Works agrees with the alternative recommendation and we discussed the finding with Bella's Kitchen. Bella's Kitchen agrees with the alternative control recommendation and will amend its procedure to include the issuance of a three-part receipt for all locker fees collected. One copy of the receipt will be placed with the item in the storage locker, the second copy of the receipt will be given to the customer to claim the item stored, and the third copy of the receipt will remain as the transaction record for the money collected and will be reported on the daily receipts. The receipts will be sequentially numbered.

Recommendation No. 2: We recommend that OC Public Works evaluate whether rent overpaid due to sales tax should be refunded to Bella's Kitchen.

OC Public Works Response: Concur. OC Public Works has determined that Bella's Kitchen overpaid their rent from September 2004 to September 2008. Bella's Kitchen included sales tax as a part of the gross receipts, which resulted in the over-payment. The accountant for Bella's Kitchen has submitted a claim for a refund of \$9,237.83. That claim is now being reviewed for accuracy by OC Public Works Accounting. A refund or rent credit may be issued to Bella's Kitchen upon completion of the overpaid rent

Recommendation No. 3: We recommend that OC Public Works require Bella's Kitchen to use serially numbered gift certificates and maintain a log of issued and unissued certificates.

OC Public Works Response: Concur. OC Public Works agrees with the recommendation and has discussed the procedure with Bella's Kitchen. Bella's Kitchen agrees with the recommendation and has



# **ATTACHMENT B: OC Public Works Management Responses** (continued)

Audit No. 283 Page 2 of

implemented the issuance of serially numbered gift certificates and the record keeping of both issued and unissued gift certificates.

**Recommendation No. 4:** We recommend that OC Public Works require Bella's Kitchen to serially number its catering invoices.

**OC Public Works Response:** Concur. OC Public Works agrees with the recommendation and discussed the finding with Bella's Kitchen. Bella's Kitchen agrees and has commenced using serially numbered catering invoices.

**Recommendation No. 5:** We recommend that OC Public Works require Bella's Kitchen to retain all supporting documents (cash register receipts) related to voided or canceled transactions along with reasons for the void/cancellation noted.

**OC Public Works Response:** Concur. OC Public Works agrees with the recommendation and discussed the finding with Bella's Kitchen. Bella's Kitchen agrees to retain all voided transactions and record the reason for each void.

I would like to express my appreciation for the professionalism of the Internal Audit Department staff that conducted this audit.

Should you have any questions regarding OC Public Works' responses to the Internal Audit Department's recommendations, or require additional information on these items, please contact Tony Bernard, Manager, Purchasing and Contract Services at (714) 834-6731.

Thank you.

Bryan Speegle, Director

c: Jess A. Carbajal, Chief Deputy Director, OC Public Works Dori Malloy, Director, OC Public Works/OC Facilities Carlos Bustamante, Director, OC Public Works/Administration Mary Fitzgerald, Manager, OC Public Works/Accounting Services Tony Bernard, Manager, OC Public Works/Administration/Purchasing Brian Cich, Sr. Accountant I, OC Public Works/Accounting/Leases & Infrastructure Eli Littner, Deputy Director, Internal Audit Department Autumn McKinney, Sr. Audit Manager, Internal Audit Lily Chin, Audit Manager, Internal Audit

Tom Mason, Manager, OC Public Works/OC Facilities/Real Estate & Asset Management