

Internal Audit Department

O R A N G E C O U N T Y
6th Largest County in the USA

Special Purpose Lease Review: OC COMMUNITY RESOURCES/OC PARKS SANTIAGO EQUESTRIAN CENTER

For the Period
January 1, 2009 through December 31, 2009

**\$3.4M Estimated Gross
Receipts Over Lease Term
\$274K Estimated Rent Paid to
the County Over Lease Term**

Santiago Equestrian Center operates an equestrian center located within Limestone Canyon & Whiting Ranch Wilderness Park. Over its twenty (20) year term, this lease agreement is estimated to generate approximately **\$274,000** in rent to the County. Rent is paid based on a percentage of gross receipts. We audit the underlying books and records to ensure gross receipts are complete and rent is properly paid as defined by the lease agreement. Gross receipts reported during the audit period were approximately **\$199,000** and rent paid to the County was approximately **\$16,000**.

This is the first audit of the lease. The goal of our review is to help ensure the lessee's records are on the "right track" and to make any necessary corrections timely in the lease term. The Internal Audit Department found that Santiago Equestrian Center's records adequately supported gross receipts and rent owed was properly paid. We did identify **three (3) Control Findings** related to improving records and the accounting methodology used to report gross receipts. OC Parks agreed with all three findings and recommendations and has worked with Santiago Equestrian Center to implement corrective actions.

AUDIT NO: 2934
REPORT DATE: OCTOBER 5, 2010

Director: Dr. Peter Hughes, CPA
Deputy Director: Eli Littner, CPA, CIA
Senior Audit Manager: Autumn McKinney, CPA, CIA
Audit Manager: Lily Chin, CPA

RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year



2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach



GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

Dr. Peter Hughes
Director

Ph.D., MBA, CPA, CCEP, CITP, CIA, CFE
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
Deputy Director

CPA, CIA, CFE, CFS, CISA
Certified Fraud Specialist (CFS)
Certified Information Systems Auditor (CISA)

Michael J. Goodwin
Senior Audit Manager

CPA, CIA

Alan Marcum
Senior Audit Manager

MBA, CPA, CIA, CFE

Autumn McKinney
Senior Audit Manager

CPA, CIA, CISA, CGFM
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

To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: www.ocgov.com/audit



OC Fraud Hotline (714) 834-3608

Letter from Dr. Peter Hughes, CPA

Transmittal Letter



Audit No. 2934 October 5, 2010

TO: Steve Franks, Director
OC Community Resources

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Special Purpose Lease Review:
OCCR/OC Parks, Santiago Equestrian
Center PR50S-150

We have completed a special purpose lease review of Santiago Equestrian Center for the period January 1, 2009 through December 31, 2009. The final **OC Internal Auditor's Report** is attached along with your responses to our recommendations. We performed this Special Purpose Lease Review in accordance with our FY 2009-10 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 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 now 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.

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 **OC Internal Auditor's Report** on page 3.

Table of Contents



*Special Purpose Lease Review:
OC Community Resources/OC Parks
Santiago Equestrian Center
Audit No. 2934*

For the Period
January 1, 2009 through December 31, 2009

Transmittal Letter	i
OC Internal Auditor's Report	
OBJECTIVES	1
BACKGROUND	2
SCOPE	2
RESULTS	2
Detailed Findings, Recommendations, and Management Responses	
Audit Objective #1 – Adequate Records	4
1. Horse Boarding and Trailer Storage Agreements Not Pre-Numbered (Control Finding)	4
2. Updating Accounts Receivable Records for Billing Amount Changes (Control Finding)	4
Audit Objective #2 – Compliance with Agreement	5
3. Accounting Methodology for Reporting Gross Receipts (Control Finding)	5
ATTACHMENT A: Report Item Classifications	6
ATTACHMENT B: OC Parks Responses	7

OC Internal Auditor's Report



Audit No. 2934

October 5, 2010

Audit Highlight

Santiago Equestrian Center operates an equestrian center located within Limestone Canyon & Whiting Ranch Wilderness Park.

Over its 20 year term, this lease agreement is estimated to generate over **\$274,000** in rent to the County. Gross receipts generated during the 12-month audit period were about **\$199,000** and rent paid to the County was about **\$16,000**.

The Internal Audit Department found that Santiago Equestrian Center records adequately supported gross receipts and rent owed was properly paid overall. We did identify **three (3) Control Findings** related to improving records and the accounting methodology used to report gross receipts.

TO: Steve Franks, Director
OC Community Resources

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Special Purpose Lease Review:
OCCR/OC Parks/Santiago Equestrian Center
PR50S-150

OBJECTIVES

We have performed an audit of certain records and documents for the period from January 1, 2009 through December 31, 2009, pertinent to the lease agreement (Agreement) between the County of Orange (County) and Southern Sierra Land & Cattle Company dba Santiago Equestrian Center, dated December 8, 2008. The Agreement is for the operation of an equestrian center located within Limestone Canyon & Whiting Ranch Wilderness Park.

While this lease generates a relatively small amount of gross receipts, OC Parks requested our special purpose review of the lease as this is a new lease with a twenty (20) year term. The goal of our review is to help ensure the lessee's records are on the "right track" and to make any necessary corrections timely in the lease term.

Our audit objectives are:

- (1) The primary purpose of our audit is to determine whether Santiago Equestrian Center'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 Santiago Equestrian Center 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.

OC Internal Auditor's Report



BACKGROUND

The County of Orange entered into an Agreement with Southern Sierra Land & Cattle Company dba Santiago Equestrian Center, dated December 8, 2009 for the operation of an equestrian center located within Limestone Canyon & Whiting Ranch Wilderness Park. During the 12-month audit period, Santiago Equestrian Center reported approximately **\$199,000** in gross receipts and paid the County approximately **\$16,000** in rent. Over its twenty (20) year term, this lease agreement is estimated to generate over **\$274,000** in rent to the County.

SCOPE

Our audit was limited to certain records and documents that support Santiago Equestrian Center's gross receipts reported to the County for the 12-month audit period of January 1, 2009 through December 31, 2009. 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 Santiago Equestrian Center's records adequately support monthly gross receipts reported to the County and rent owed is properly paid.
- **Results:** We found that Santiago Equestrian Center's records adequately supported the reported gross receipts and rent owed was properly paid overall. We noted **two (2) Control Findings** where recordkeeping should be enhanced to support the reported gross receipts. (See page 4 for details)

- **Objective #2 – Compliance with Agreement:** Determine whether Santiago Equestrian Center complies with certain other financial provisions of the agreement.
- **Results:** We found that Santiago Equestrian Center complied with certain other financial provisions of the agreement such as accounting methods, annual financial statements and monthly gross receipts statement format. We noted **one (1) Control Finding** related to the accounting methodology used to report gross receipts. (See page 5 for details)

See all **three (3) Control Findings** in the Detailed Findings, Recommendations, and Management Responses section of this report. See **Attachment A** for a description of report item classifications.

OC Internal Auditor's Report



ACKNOWLEDGMENT

We appreciate the courtesy and cooperation extended to us by the personnel at Santiago Equestrian Center, OC Community Resources/OC Parks, and OC Community Resources/Accounting Services. If you have any questions regarding our revenue generating lease audit, 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 Parks Responses

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
Anna Peters, Director of Administrative Services, OC Community Resources
Mark Denny, Director, OC Community Resources/OC Parks
Michael Brajdic, Deputy Director, OC Community Resources/OC Parks
Kirk Holland, Program Manager, OC Community Resources/OC Parks
Rich Adler, Real Estate Manager, OC Community Resources/OC Parks
Michael Hentzen, Lease Manager, OC Community Resources/OC Parks
Tonya Burnett, Accounting Manager, OC Community Resources/Accounting
Win Swe, Manager, OC Community Resources/Accounting
Yolanda Vazquez, Administrative Manager I, OC Community Resources/Accounting
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors

Detailed Findings, Recommendations, and Management Responses



Audit Objective #1 – Adequate Records

1. Horse Boarding and Trailer Storage Agreements Not Pre-Numbered (Control Finding)

Clause 12.A of the Agreement requires that in the event of admission charges or rentals, tenant shall issue serially numbered tickets for each such admission or rental and shall keep an adequate record of said tickets, both issued and unissued.

Finding No. 1: Santiago Equestrian Center uses written horse boarding agreements for boarding services and a separate agreement for storing horse trailers on the premises. However, these agreements are not numbered.

Recommendation No. 1: We recommend that OC Parks require Santiago Equestrian Center to use serially numbered horse boarding and trailer storage agreements.

OC Parks Response: Concur. OC Parks discussed this Finding with Santiago Equestrian Center's management and they have implemented the use of serially numbered agreements for horse boarding agreements and trailer storage agreements.

2. Updating Accounts Receivable Records for Billing Amount Changes (Control Finding)

Clause 12.A of the Agreement requires tenant shall, at all times during the lease term 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.

Finding No. 2: Santiago Equestrian Center generates a monthly invoice to bill for horse boarding. During our testing of the invoices, we found the boarding and feeding fees billed did not match the written horse boarding agreements for two of eight sampled boarders. One boarder moved stall locations and the other boarder received a monthly \$20 credit for providing their own pellets. However, these changes were not updated in the accounts receivable records and therefore, the boarders were over billed. The Site Manager should notify the Office Manager when billing amounts change so that the accounts receivable records can be updated.

Recommendation No. 2: We recommend that OC Parks require Santiago Equestrian Center to update the accounts receivable records when changes that affect the amounts billed occur.

OC Parks Response: Concur. OC Parks discussed this Finding with Santiago Equestrian Center's management and they have implemented new bookkeeping procedures to ensure the accounts receivable records are updated when changes occur that affect the amounts billed.

Detailed Findings, Recommendations, and Management Responses



Audit Objective #2 – Compliance with Agreement

3. Accounting Methodology for Reporting Gross Receipts (Control Finding)

Clause 9.B of the Agreement states that gross receipts include charges made by tenant for the sale or rendition on or from the premises of services of any nature or kind whatsoever, whether for cash or credit, whether payment is actually made or not, and whether the services are actually performed or not. If approved in writing by the Auditor-Controller, gross receipts may be reported on the cash basis of method of accounting.

Finding No. 3: We found that Santiago Equestrian Center reports gross receipts on the cash basis; however, written approval from the Auditor-Controller was not obtained as required by the Agreement. We also found that the reported gross receipts on Santiago Equestrian Center's 2009 income tax return was approximately \$221,000 while the reported gross receipts to the County was approximately \$199,000, resulting in a timing difference of reported gross receipts of approximately \$22,000. The income tax return was prepared on an accrual basis of accounting whereas gross receipts reported to the County were on the cash basis. The timing difference in recognizing the gross receipts between accrual and cash basis accounting resulted in additional potential rent owed of approximately \$1,760 (\$22,000 x 8% percentage rent) for the audit period.

Recommendation No. 3: We recommend that OC Parks require Santiago Equestrian Center to either obtain permission for the cash basis of reporting gross receipts or report gross receipts on the accrual basis and pay additional rent of \$1,760 for the calendar year of 2009.

OC Parks Response: Concur. OC Parks discussed this Finding with Santiago Equestrian Center's management and they have changed their reporting of gross receipts to the accrual basis and has paid the additional rent of \$1,760 owed for calendar year 2009.

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:

▶ **Material Weaknesses:**

Audit findings or a combination of Significant Issues that can result in financial liability and exposure to a department/agency and/or 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 will generally require management's prompt corrective actions.

▶ **Control Findings:**

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 Parks Responses

ORANGE COUNTY
OC Community Resources
Our Community. Our Commitment.
MEMORANDUM

STEVE FRANKS
DIRECTOR
OC COMMUNITY RESOURCES

RYAN DRABEK
DIRECTOR
OC ANIMAL CARE

KAREN ROPER
DIRECTOR
OC COMMUNITY SERVICES

MARK DENNY
DIRECTOR
OC PARKS

HELEN FRIED
COUNTY LIBRARIAN
OC PUBLIC LIBRARIES

OCT 01 2010

INTERNAL AUDIT
DEPARTMENT

DATE: September 29, 2010
TO: Peter Hughes, Director, Internal Audit Department
FROM: Director, OC Community Resources

**SUBJECT: RESPONSE TO DRAFT REPORT ON SPECIAL PURPOSE LEASE REVIEW
OF SANTIAGO EQUESTRIAN CENTER – AUDIT NO. 2934**

OC Community Resources (OCCR) has reviewed Internal Audit Department's Draft Report on Special Purpose Lease Review (Audit No. 2934) of the lease agreement (Agreement) between the County of Orange (County) and Southern Sierra Land & Cattle Co. dba Santiago Equestrian Center. The Agreement is for the operation of an equestrian center located within Limestone Canyon and Whiting Ranch Wilderness Park, which is operated under the purview of OC Parks. During the 12-month audit period (January 1, 2009 to December 31, 2009), Santiago Equestrian Center reported approximately \$199,000 in gross receipts and paid the County approximately \$16,000 in rent.

While this lease generates a relatively small amount of gross receipts, OC Parks requested this special purpose lease review as this was a new lease with a twenty (20) year term. The goal of the review was to help ensure Santiago Equestrian Center's records were on the "right track" and to make any necessary corrections timely in the lease term. We understand that the primary purpose of Internal Audit's review (Audit Objective #1) was to determine whether Santiago Equestrian Center's records adequately supported their monthly gross receipts reported to the County and that rent is properly paid. We also understand that Internal Audit reviewed compliance with certain other provisions of the Agreement (Audit Objective #2) such as accounting methods, monthly gross receipts statement format, and annual financial statement requirements.

The audit concluded that for Audit Objective #1, Santiago Equestrian Center's records adequately supported gross receipts reported to the County and that rent owed was properly paid. However, two (2) Control Findings were noted where recordkeeping should be enhanced to support the reported gross receipts.

The audit concluded that for Audit Objective #2, Santiago Equestrian Center has complied with the financial provisions of the Agreement. However, the audit identified one (1) Control Finding related to the accounting methodology used to report gross receipts.

OC Parks staff provided OC Santiago Equestrian Center's management with a copy of Audit No. 2934 and discussed the findings, OC Parks responses to the findings, and required actions. The OC Parks Responses are provided on the following pages, immediately below the Internal Audit Department descriptions, findings, and recommendations (shown as indented, in italics and with a smaller font).

1770 NORTH BROADWAY, SANTA ANA, CA 92706-2642 • PHONE (714) 480-2788 FAX (714) 480-2899

Detailed Findings, Recommendations, and Management Responses



ATTACHMENT B: OC Parks Responses (continued)

RESPONSE TO DRAFT REPORT ON SPECIAL PURPOSE LEASE REVIEW OF SANTIAGO EQUESTRIAN CENTER – AUDIT NO. 2934
PAGE 2 OF 3
SEPTEMBER 20, 2010

Audit Objective #1 – Adequate Records

1. Horse Boarding and Trailer Storage Agreements Not Pre-Numbered (Control Finding)

Clause 12.A of the Agreement requires that in the event of admission charges or rentals, tenant shall issue serially numbered tickets for each such admission or rental and shall keep an adequate record of said tickets, both issued and unissued.

Finding No. 1: Santiago Equestrian Center uses written horse boarding agreements for boarding services and a separate agreement for storing horse trailers on the premise. However, the agreements are not numbered.

Recommendation No. 1: We recommend that OC Parks require Santiago Equestrian Center to use serially numbered horse boarding agreements and trailer storage agreements.

OC Parks Response: Concur. OC Parks discussed this Finding with Santiago Equestrian Center's management and they have implemented the use of serially numbered agreements for horse boarding agreements and trailer storage agreements.

2. Updating Accounts Receivable Records for Billing Amount Changes (Control Finding)

Clause 12.A of the Agreement requires tenant shall, at all times during the lease term 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.

Finding No. 3: Santiago Equestrian Center generates a monthly invoice to bill for horse boarding. During our testing of the invoices, we found the boarding and feeding fees billed did not match the written horse boarding agreements for two of eight sampled boarders. One boarder moved stall locations and the other boarder received a monthly \$20 credit for providing their own pellets. However, these changes were not updated in the accounts receivable records, and boarders were over billed. The Site Manager should notify the Office Manager when billing amounts change so that the accounts receivable records can be updated.

Recommendation No. 3: We recommend that OC Parks require Santiago Equestrian Center to update the accounts receivable records when changes that affect the amounts billed occur.

OC Parks Response: Concur. OC Parks discussed this Finding with Santiago Equestrian Center's management and they have implemented new bookkeeping procedures to ensure the accounts receivable records are updated when changes occur that affect the amounts billed.

Audit Objective #2 – Compliance with Agreement

3. Accounting Methodology for Reporting Gross Receipts (Control Finding)

Clause 9.B of the Agreement states that gross receipts include charges made by tenant for the sale or rendition on or from the premises of services of any nature or kind whatsoever, whether for cash or credit, whether payment is actually made or not, and whether the services are actually performed or not. If approved in writing by the Auditor-Controller, gross receipts may be reported on the cash basis of method of accounting.

Finding No. 4: We found that Santiago Equestrian Center reports gross receipts on the cash basis; however, written approval from the Auditor-Controller was not obtained as required by the Agreement. We also found that the reported gross receipts on Santiago Equestrian Center's 2009 income tax return were receipts approximately \$221,000 while the reported gross receipts to the County were approximately \$199,000, resulting in a timing difference of reported gross receipts of

Detailed Findings, Recommendations, and Management Responses



ATTACHMENT B: OC Parks Responses (continued)

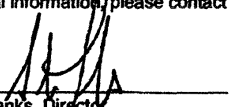
RESPONSE TO DRAFT REPORT ON SPECIAL PURPOSE LEASE REVIEW OF SANTIAGO EQUESTRIAN CENTER – AUDIT
NO. 2934
PAGE 3 OF 3
SEPTEMBER 20, 2010

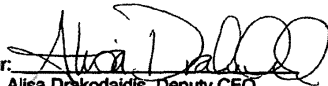
approximately \$22,000. The income tax return was prepared on an accrual basis of accounting whereas gross receipts reported to the County were on the cash basis. The timing difference in recognizing the gross receipts between accrual and cash basis accounting resulted in additional potential rent owed of approximately \$1,760 (\$22,000 x 8% percentage rent) for the audit period.

Recommendation No. 4: *We recommend that OC Parks require Santiago Equestrian Center to either obtain permission for the cash basis of reporting gross receipts or report gross receipts on the accrual basis and pay additional rent of \$1,760 for the calendar year of 2009.*

OC Parks Response: Concur. OC Parks discussed this Finding with Santiago Equestrian Center's management and they have changed their reporting of gross receipts to the accrual basis and has paid the additional rent of \$1,760 owed for calendar year 2009.

Thank you for allowing us to respond to your Draft Letter. If you have any questions or need additional information, please contact Michael Hentzen of my staff at (949) 923-3753.


Steve Franks, Director
OC Community Resources

Concur: 
Alisa Drakodaidis, Deputy CEO
OC Infrastructure

c: Alisa Drakodaidis, Deputy CEO, OC Infrastructure
Mark Denny, Director, OC Community Resources/OC Parks
Michael Brajdic, Deputy Director, OC Community Resources/OC Parks
Kirk Holland, Program Manager, OC Community Resources/OC Parks
Rich Adler, Real Estate Manager, OC Community Resources/OC Parks
Michael Hentzen, Lease Manager, OC Community Resources/OC Parks
Anna Peters, Director of Administrative Services, OC Community Resources
Tonya Burnett, Accounting Manager, OC Community Resources Accounting
Win Swe, Manager, OC Community Resources/Accounting
Yolanda Vazquez, Administrative Manager I, OC Community Resources/Accounting