Internal Audit Department

Revenue Generating Lease Audit:
**OC Dana Point Harbor/Dana Point Jet Ski**

For the Period
November 1, 2011 through July 31, 2012

Dana Point Jet Ski (DPJS) operates a jet ski and kayak center at Dana Point Harbor through a sublease under the lease agreement between County of Orange (County) and Dana Point Shipyard. DPJS reports gross receipts and pays rent to Dana Point Shipyard (DPS). DPS includes DPJS gross receipts in its gross receipts statement and reports the combined total to the County and pays percentage rent. We audit the underlying books and records to ensure reported gross receipts are supported and rent is properly paid as defined by the lease and sublease agreements. During the nine-month audit period of November 1, 2011 through July 31, 2012, DPJS reported approximately $654,000 in gross receipts and the County received approximately $64,000 in rent. Currently, DPJS is on a month-to-month sublease term with DPS. Over the 35-year lease term between the County and the Dana Point Shipyard (subject to completion of lease required upgrades), the lease and sublease agreements are estimated to generate approximately $16.6 million in rent to the County.

The Internal Audit Department found that Dana Point Jet Ski’s records adequately supported reported gross receipts and rent owed to Dana Point Shipyard was properly paid except we identified five (5) Control Findings related to unreported rental loss charged for a damaged jet ski, pre-numbering forms and gift certificates, retaining supporting documentation for void and refunds, and submitting required financial statements.

**Audit No: 1233**
**Report Date: June 10, 2013**

**Auditors:**
- **Director:** Dr. Peter Hughes, MBA, CPA, CIA
- **Senior Audit Manager:** Alan Marcum, CPA, CIA
- **Audit Manager:** Lily Chin, CPA, CGMA

**RISK BASED AUDITING**
- American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government
- GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management
- 2009 Association of Certified Fraud Examiners’ Hubbard Award For the Most Outstanding Article of the Year
- 2008 Association of Local Government Auditors’ Bronze Website Award
- 2005 Institute of Internal Auditors’ Award for Recognition of Commitment to Professional Excellence, Quality, and Outreach
Internal Audit Department


*Providing Facts and Perspectives Countywide*

**RISK BASED AUDITING**

**Dr. Peter Hughes**  
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Certified Information Technology Professional (CITP)  
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To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: [www.ocgov.com/audit](http://www.ocgov.com/audit)

**OC Fraud Hotline (714) 834-3608**
The Internal Audit Department is an independent audit function reporting directly to the Orange County Board of Supervisors.

Transmittal Letter

Audit No. 1233  June 10, 2013

TO:  Brad Gross, Director  
OC Dana Point Harbor

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

SUBJECT:  Revenue Generating Lease Audit:  
OC DPH/Dana Point Jet Ski, Sublease of  
Dana Point Shipyard, HA78H-24-2.02

We have completed our revenue generating lease audit of Dana Point Jet Ski, a sublease of the lease agreement with Dana Point Shipyard, for the period November 1, 2011 through July 31, 2012. The final 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 2012-13 Audit Plan and Risk Assessment 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.
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 recommendations.

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 listed on the OC Internal Auditor’s Report on page 3.
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Dana Point Jet Ski
Audit No. 1233

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TO: Brad Gross, Director
OC Dana Point Harbor

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

SUBJECT: Revenue Generating Lease Audit:
OC Dana Point Harbor/Dana Point Jet Ski, Sublease of Dana Point Shipyard, HA78H-24-2.02

OBJECTIVE
We have performed an audit of certain records and documents of Dana Point Jet Ski for the period from November 1, 2011 through July 31, 2012. Dana Point Jet Ski is a sub-lessee, as assigned, under the lease agreement (Lease Agreement) between the County of Orange (County) and Dana Point Shipyard, dated November 1, 2011. The Lease Agreement is primarily for the operation of the Dana Point Shipyard facilities and services located at Dana Point Harbor. Dana Point Jet Ski, through a sublease with Dana Point Shipyard, operates a jet ski and kayak center to provide sales, service, rentals and storage of personal watercraft and sale of related parts and accessories. Our audit objectives were:

(1) The primary objective of our audit is to determine whether Dana Point Jet Ski’s records adequately supported gross receipts reported to the County and paid rent owed.

(2) The secondary objective of our audit is to determine whether Dana Point Jet Ski complies with certain other financial provisions of the Lease Agreement.

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

RESULTS
Objective #1: We found that Dana Point Jet Ski’s records adequately supported reported gross receipts and rent owed was properly paid, except for a rental loss charged for a damaged jet ski was not reported as gross receipts. We identified one (1) Control Finding where additional rent was owed and three (3) Control Findings where recordkeeping should be enhanced to support gross receipts.

Objective #2: We found that Dana Point Jet Ski complied with certain other financial provisions of the Lease Agreement; however, one (1) Control Finding was identified where the required financial statements were not submitted.
The following *Summary of Findings and Recommendations* shows our findings and recommendations for this audit. See further discussion in the *Detailed Findings, Recommendations and Management Responses* section of this report. See Attachment A for a description of Report Item Classifications.

<table>
<thead>
<tr>
<th>Finding No.</th>
<th>Finding Classification - See Attachment A</th>
<th>Finding Description</th>
<th>Recommendation</th>
<th>Agreement by Management?</th>
<th>Page No. in Audit Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Control Finding</td>
<td>DPJS did not report $500 in rental loss charged for a damaged jet ski as gross receipts.</td>
<td>OC DPH require DPJS report the rental loss charged for damaged personal watercraft as gross receipts and pay rent owed.</td>
<td>Yes</td>
<td>p. 4</td>
</tr>
<tr>
<td>2.</td>
<td>Control Finding</td>
<td>Gift Certificates are not pre-numbered.</td>
<td>OC DPH require DPJS to use sequentially pre-numbered gift certificates and maintain a log of issued and unissued gift certificates.</td>
<td>Yes</td>
<td>p. 4</td>
</tr>
<tr>
<td>3.</td>
<td>Control Finding</td>
<td>Business operational forms related to gross receipts were not pre-numbered.</td>
<td>OC DPH require DPJS to sequentially pre-number business operational forms used in gross receipts activities.</td>
<td>Yes</td>
<td>p. 5</td>
</tr>
<tr>
<td>4.</td>
<td>Control Finding</td>
<td>Supporting documentation for void and refunds were not retained.</td>
<td>OC DPH require DPJS to retain all supporting documents (cash register receipts) related to voided, refund or canceled transactions along with reasons noted.</td>
<td>Yes</td>
<td>p. 5-6</td>
</tr>
<tr>
<td>5.</td>
<td>Control Finding</td>
<td>Financial statements were not submitted as required by the lease agreement.</td>
<td>OCDPH require DPJS submit financial statements and audited gross receipts statements in compliance with the lease agreement.</td>
<td>Yes</td>
<td>p. 6</td>
</tr>
</tbody>
</table>

**BACKGROUND**

The County entered into a 30-year lease agreement with Dana Point Shipyard, dated June 29, 1982, for the operation of shipyard facility and other related services, located at Dana Point Harbor. This original lease agreement was terminated when the County entered into a new lease agreement with Dana Point Shipyard, dated November 1, 2011.

Dana Point Shipyard entered into a sublease agreement with Dana Point Jet Ski (DPJS) commencing May 1, 2002, as revised and superseding the prior agreement dated March 1, 1990, for the operation of a jet ski and kayak center to provide the sales, service, rentals and storage of personal watercraft, and sale of related parts and accessories. This sublease agreement expired on June 30, 2012, and DPJS is currently on a month-to-month term with Dana Point Shipyard. The sublease agreement has set forth terms and conditions that were consistent with the lease agreement between the County and Dana Point Shipyard in the areas of definition of gross receipts, rent payment procedure and accounting, and records and accounts maintenance.

During the nine-month audit period from November 1, 2011 through July 31, 2012, Dana Point Jet Ski generated approximately $654,000 in gross receipts and the County received approximately $64,000 in rent.
SCOPE
Our audit was limited to certain records and documents that support Dana Point Jet Ski’s gross receipts reported to Dana Point Shipyard and remitted to the County for the nine-month audit period from November 1, 2011 through July 31, 2012. Our audit included inquiry, auditor observation, and limited testing for assessing the adequacy of documentation and ensuring completeness of reported gross receipts.

We performed a separate lease audit of Dana Point Shipyard and the results of the audit are presented in a separate report (Audit No. 1232).

ACKNOWLEDGEMENT
We appreciate the courtesy and cooperation extended to us by the personnel at Dana Point Jet Ski, OC Dana Point Harbor and OC Public Works (OCPW) Accounting Services. If you have any questions regarding our revenue generating lease audit, please call me directly at (714) 834-5475, or Alan Marcum, Senior Audit Manager at (714) 834-4119.

Attachment A: Report Item Classifications
Attachment B: OC Dana Point Harbor Responses

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Michael B. Giancola, County Executive Officer
- Steve Eldred, Interim Deputy County Executive Officer
- Paul Lawrence, Operations Manager, OC Dana Point Harbor
- Jonathan Bordeaux, Real Property Officer, OC Dana Point Harbor/Real Estate
- Howard Thomas, Section Manager, OC Public Works/Accounting
- Jeanette Tyler, Senior Accountant/Auditor I, OCPW/OC Dana Point Harbor Accounting
- Foreperson, Grand Jury
- Susan Novak, Clerk of the Board of Supervisors
- Vavrinek, Trine, Day & Co., LLP, County External Auditor
1. **Unreported Rental Loss Charged for Damaged Jet Ski (Control Finding)**

Lease Agreement Clause 12 states that gross receipts include all admission, entry, rental and other fees charged by tenant.

**Finding No. 1:** In our sample month June 2012, we found one instance which DPJS charged jet ski rental customer repair cost for damages caused to one jet ski. DPJS also charged the customer four (4) days of rental loss totaling $500 for the damaged jet ski. The $500 rental loss received by DPJS was not reported as gross receipts resulting in underpaid rent of $100 received by the County. DPJS informed us that this was a one-time incident as the substantial damage was caused by customer misuse, and it occurred during the summer peak season.

**Recommendation No. 1:** We recommend that OC Dana Point Harbor require DPJS report rental loss charged for the damaged personal watercraft as gross receipts and pay rent owed.

**OC Dana Point Harbor Response: Concur**

The attached letter from OC Dana Point requires DPS to have DPJS report rental loss charged for the damaged personal watercraft as gross receipts and pay rent owed. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

2. **Gift Certificates Not Pre-Numbered (Control Finding)**

Clause 13.A of the Lease Agreement requires DPJS to keep records of all business activities supported by pre-numbered sequentially issued sales slips, cash register tapes, sales books, ledgers, sales tax returns, bank deposit receipts, purchase invoices or other pertinent documents. DPJS shall issue serially numbered tickets for each admission or rental and shall keep an adequate record of said tickets, both issued and unissued.

**Finding No. 2:** DPJS sells gift certificates for kayak and jet ski rental and maintains a log of gift certificates sold. The log contains gift certificate numbers sequentially issued at the time of sale, date sold, purchaser, and the amount sold. However, these gift certificates are not pre-numbered. The number is issued when sold.

**Recommendation No. 2:** We recommend that OC Dana Point Harbor require DPJS to use sequentially pre-numbered gift certificates and maintain a log of issued and unissued gift certificates.

**OC Dana Point Harbor Response: Concur**

The attached letter from OC DPH requires DPS to have DPJS to use sequentially pre-numbered gift certificates and maintain a log issued and unissued gift certificates. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.
3. **Business Operation Forms Not Pre-Numbered (Control Finding)**

Clause 13.A of the Lease Agreement requires DPJS at all times keep or cause to be kept true and complete books, records and accounts of all financial transactions in the operation of all business activities. Records must be supported by pre-numbered sequentially issued sales slips, cash register tapes, sales books, ledgers, sales tax returns, bank deposit receipts, purchase invoices, or other pertinent documents reasonably acceptable to the County. 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. 3:** DPJS uses various business forms related to business operations. Rental forms for personal watercraft (i.e. jet ski, kayak and surfboard/stand-up paddleboard) are used to document the customer’s understanding of rules and regulations and waiver of liability. Other forms are also used to document detailed repair orders, wholesale of parts, and kayak sales. While DPJS uses a cash register to record all sales transactions, we found that these forms were not pre-numbered. Utilizing sequentially pre-numbered rental forms would help ensure gross receipts are completely reported to the County.

**Recommendation No. 3:** We recommend OC Dana Point Harbor require DPJS to sequentially pre-number business operation forms used in gross receipts activities.

**OC Dana Point Harbor Response: Concur**
The attached letter from OC DPH requires DPS to have DPJS use sequentially pre-number business operation forms used in gross receipts activities. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

4. **Supporting Documentation for Voids and Refunds (Control Finding)**

Clause 13.A of the Lease Agreement requires DPJS at all times keep or cause to be kept true and complete books, records and accounts of all financial transactions in the operation of all business activities. Records must be supported by pre-numbered sequentially issued sales slips, cash register tapes, sales books, ledgers, sales tax returns, bank deposit receipts, purchase invoices, or other pertinent documents reasonably acceptable to the County.

**Finding No. 4:** During our testing, we found the supporting documents (cash register receipts) for voided or refund transactions were not consistently retained, and reasons for such transactions were not noted.

**Recommendation No. 4:** We recommend that OC Dana Point Harbor require DPJS to retain all supporting documents (cash register receipts) related to voided, refund or canceled transactions along with reasons noted.
OC Dana Point Harbor Response: Concur
The attached letter from OC DPH requires DPS to have DPJS retain all supporting
documents (cash register receipts) related to voided, refund or canceled transactions
along with reasons noted. OC Dana Point Harbor will hand deliver this letter and shall
follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

5. Financial Statements Not Submitted (Control Finding)

Clause 13.C of the Lease Agreement requires that within ninety (90) days after the end of
each accounting year, DPJS submit a balance sheet and income statement prepared by a
Certified Public Accountant (CPA) reflecting business transacted on or from the premise
during preceding accounting year. The CPA must attest that the balance sheet and
income statement submitted are accurate representation of DPJS’s records as reported for
income tax purposes. At the same time, DPJS shall submit an audited statement of gross
receipts.

Finding No. 5: We found that DPJS did not submit a balance sheet and income
statement to the County or the audited gross receipts statement (via Dana Point Shipyard)
in accordance with the lease agreement. DPJS informed us that Dana Point Shipyard did
not request the required statements.

Recommendation No. 5: We recommend that OC Dana Point Harbor require DPJS
submit financial statements and audited gross receipts statements in compliance with the
lease agreement.

OC Dana Point Harbor Response: Concur
The attached letter from OC DPH requires DPS to have DPJS submit financial statements
and audited gross receipts statements in compliance with the lease agreement. OC Dana
Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days
from the date of this letter to verify compliance.
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:**
  Audit findings or a combination of Significant Control Weaknesses that represent serious exceptions to the audit objective(s) and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

- **Significant Control Weaknesses:**
  Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require 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.
April 3, 2013

To: Dr. Peter Hughes, CPA, Director
OC Internal Audit Department

From: Brad Gross, Director

Subject: Draft Report on Revenue Generating Lease Audit No. 1233 of Dana Point Jet Ski

OC Dana Point Harbor appreciates the support provided by Internal Audit and we concur with the Control Findings and Recommendations (1 through 5) as presented in the attached Draft Report on Revenue Generating Lease Audit of Dana Point Jet Ski (DPJS), Audit No. 1233.

The County Executive Office has reviewed and approved of OC Dana Point Harbor’s responses to each recommendation, which responses are intended to ensure Dana Point Shipyard (DPS) has its subtenant, Dana Point Jet Ski (DPJS), fully comply with all recommendations from the Internal Audit Department. A summary of Internal Audit’s recommendations 1 through 5, along with OC Dana Point Harbor’s responses, are as follows:

**Recommendation No. 1:** We recommend that OC Dana Point Harbor requires DPS to have DPJS report rental loss charged for the damaged personal watercraft as gross receipts and pay rent owed.

**OC Dana Point Harbor Response: Concur**
The attached letter from OC Dana Point Harbor requires DPS to have DPJS report rental loss charged for the damaged personal watercraft as gross receipts and pay rent owed. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

**Recommendation No. 2:** We recommend that OC Dana Point Harbor requires DPS to have DPJS to use sequentially pre-numbered gift certificates and maintain a log of issued and unissued gift certificates.

**OC Dana Point Harbor Response: Concur**
The attached letter from OC DPH requires DPS to have DPJS to use sequentially pre-numbered gift certificates and maintain a log of issued and unissued gift certificates. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

**Recommendation No. 3:** We recommend OC Dana Point Harbor requires DPS to have DPJS use sequentially pre-number business operation forms used in gross receipts activities.
Detailed Findings, Recommendations and Management Responses

ATTACHMENT B: OC Dana Point Harbor Responses (continued)

Page 2
Audit No. 1233 - DPJS
April 3, 2013

OC DPH Response: Concur
The attached letter from OC DPH requires DPS to have DPJS use sequentially pre-numbered business operation forms used in gross receipts activities. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Recommendation No. 4: We recommend that OC Dana Point Harbor requires DPS to have DPJS retain all supporting documents (cash register receipts) related to voided, refund or canceled transactions along with reasons noted.

OC DPH Response: Concur
The attached letter from OC DPH requires DPS to have DPJS retain all supporting documents (cash register receipts) related to voided, refund or canceled transactions along with reasons noted. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Recommendation No. 5: We recommend that OC Dana Point Harbor requires DPS to have DPJS submit financial statements and audited gross receipts statements in compliance with the lease agreement.

OC DPH Response: Concur
The attached letter from OC DPH requires DPS to have DPJS submit financial statements and audited gross receipts statements in compliance with the lease agreement. OC Dana Point Harbor will hand deliver this letter and shall follow up with DPS within thirty (30) days from the date of this letter to verify compliance.

Thank you and should you have any questions, please call me at 949-923-3798.

Enclosures: Audit No. 1233 of DPJS
Draft Letter from OC Dana Point Harbor to Dana Point Shipyard

cc: Steven Eldred, Interim Deputy, CEO
    Susan Nestor, Senior Internal Auditor
    Lily Chin, Audit Manager, OC Internal Audit Department
    Paul Lawrence, Operations Manager, OC Dana Point Harbor
    Jonathan Bordeaux, Real Property Officer, OC Dana Point Harbor
June __, 2013

Catherine Cope
Dana Point Shipyards
34671 Puerto Place
Dana Point, CA 92629

Re: Audit #1232 for Dana Point Shipyards and Audit #1233 for Dana Point Jet Ski

Dear Mrs. Cope,

As you know, the County’s Internal Audit has conducted their audit of the financial records and reporting by the Shipyards and your sublessee, Dana Point Jet Ski, in accordance with your Lease that commenced on November 1, 2011. Please find the attached Audit #1232 and Audit #1233, as provided by Internal Audit, as well as our responses to their Findings and Recommendations.

Overall, the Shipyards and Jet Ski records adequately support reported gross receipts, and rent owed was properly paid. However, Internal Audit reports there are four (4) Findings for DES and five (5) Findings for DPJS, along with respective Recommendations for both DES and DPJS to make necessary adjustments in their financial reporting. Please make these necessary adjustments to your financial reporting as soon as possible. As required by County policy, a follow up will be conducted by Internal Audit within six (6) months from the date of their Audit report to ensure all adjustments are meeting Internal Audit’s Recommendations.

Thank you and should you have any questions, please contact Jonathan Bordeaux at 949-923-3787.

Sincerely,

Brad Gross, Director
OC Dana Point Harbor

CC: Susan Nestor, Senior Internal Auditor, OC Internal Audit
    Lily Chin, Audit Manager, OC Internal Audit
    Paul Lawrence, Operations Manager, OC Dana Point Harbor
    Jonathan Bordeaux, Real Property Officer, OC Dana Point Harbor