



OFFICE OF THE CITY AUDITOR

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GARY L. BURROUGHS, CPA
City Auditor

June 20, 2006

Phil T. Hester, Director
Department of Parks, Recreation and Marine

We have performed a review of Lease Number 7632, entered into on October 12, 1995, between Indel Engineering, Inc., dba Marina Shipyard (Lessee) and the City of Long Beach. The term of the lease shall continue until June 1, 2007. This lease grants marina Shipyard the right to use the premises for ship service and repair, marine related wholesale and retail sales. Additionally, the Lessee has the right to construct, operate, maintain, repair, and replace boat slips within the leased area. The Lessee shall have the right and option to extend the term of the lease for two (2) additional ten (10) year periods beyond the expiration of the initial term.

The purpose of our review was to determine whether all lease payments to the City received from the Lessee were in conformity with the terms and conditions of the Lease and whether other contractual obligations were fulfilled in compliance with the Lease.

Our audit period was for fiscal¹ years 2002, 2003, and 2004.

Our review procedures included:

- Obtaining an understanding of the lease and its key provisions, including payment of rent, reporting requirements, record keeping, etc.
- Discussions with Parks, Recreation and Marine Department and other City personnel.
- Discussions with the Marina Shipyard personnel.
- Review of Marina Shipyard's schedule of daily cash receipts and monthly sales reports.
- Review of Marina Shipyard's general ledgers, reports, and other supporting documentation to verify reported Gross Receipts.
- Review of Marina Shipyard's Federal Income Tax returns for fiscal years 2002, 2003, and 2004.

¹ Marina Shipyard's fiscal year is from April 1st through March 31st.

Marina Shipyard

June 20, 2006

Page 2 of 5

- Review of Marina Shipyard's lease payments to the City as recorded in the City's accounting system, FAMIS.
- Review of Marina Shipyard's bank statements for the period of April 2002 through March 2005.
- Recalculating the percentage rent paid and comparing the amount paid to the amount due, including monthly minimum rent.

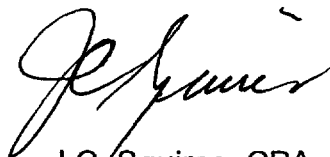
Based on the results of the audit procedures performed, we determined that Marina Shipyard is not in full compliance with the terms of the Lease. Due to time limitations beyond our control, we were unable to complete our full scope audit of Marina Shipyard. Had we been able to complete a full scope audit of Marina Shipyard, additional findings might have been uncovered.

The attached report presents background information on the lease, along with the details of Marina Shipyard's non-compliance with the terms of the Lease. We would like to thank the Parks, Recreation and Marine Department and Marina Shipyard personnel for their assistance and cooperation during this audit review.

Sincerely,

GARY L. BURROUGHS, CPA
City Auditor

By:



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Background

The City Council approved a lease to Marina Shipyard commencing on August 31, 1995 through June 1, 2007 to use the premises located at 6400 Marina Drive in Alamos Bay marina for ship service and repair, marine related wholesale and retail sales. Additionally, Marina Shipyard had the right to construct, operate, maintain, repair and replace boat slips within the leased areas.

The Lease requires a minimum monthly rental payment to the City of \$5,000 due on the first day of each calendar month. Additionally, Lessee will pay the City a percentage rent (as defined below) of gross receipts during each month less the monthly minimum rent paid by the Lessee for the same month. The monthly percentage rent will be equal to the total of:

1. Fifteen percent (15%) of any rent paid by any sublease to Lessee for use and occupancy of any building, or portion, located on the leased premises.
2. Five percent (5%) of the gross receipts derived by Lessee from the operation of the ship repair yard and five percent (5%) of the gross receipts derived from retail sales resulting from the operation of the retail marine supplies store.

Lessee's percentage rent of gross receipts is payable between the 20th day through the 30th day of each month following the month in which gross receipts are received. There are no penalties or interest due for late lease payment made to the City.

For fiscal years 2002, 2003, and 2004, Marina Shipyard earned Gross Receipts of and made payments to the City as follows:

	<u>Gross Receipts</u>	<u>Payments to the City</u>
2002	\$ 2,738,379.22	\$ 152,172.76
2003	2,657,112.75	149,888.06
2004	<u>2,795,120.79</u>	<u>153,835.04</u>
Total	<u>\$ 8,190,612.76</u>	<u>\$ 455,895.86</u>

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ISSUES AND RECOMMENDATIONS

Number 1 – Bank Deposits are Greater than Reported Revenue to the City

The following results were noted when we compared Marina Shipyard's reported gross receipts to their bank deposits:

Year	Revenue Reported To City	Bank Deposits	Difference Between Rpt. Revenue & Bank Deposits
2002	\$2,738,379.22	\$3,079,276.27	\$ 340,897.05
2003	2,657,112.75	2,939,123.71	282,010.96
2004	2,795,120.79	3,031,114.34	235,993.55
	<u>\$8,190,612.76</u>	<u>\$9,049,514.32</u>	<u>\$ 858,901.56</u>

Several verbal and written requests were made to Marina Shipyard and to their CPA for a reconciliation of these differences with supporting documentation to assist in determining the source of these excess deposits over reported revenue. We received a copy of their general ledger (G/L) cash account(s), however, the G/L did not provide the source of the deposits.

Recommendation

The City should make one last final demand for a reconciliation of these differences with supporting documentation to assist in determining the source of these excess deposits over reported revenue. If the source of the excess deposits cannot be determined, in a reasonable amount of time, the City should treat the excess deposits as gross receipts, calculate the percentage rent due the City, and invoice Marina Shipyard for the additional percentage rent owed the City.

Number 2 – Gross Receipt Recognition by Marina Shipyard is Not in Compliance with the Lease Agreement

Section 3.4, entitled Definition of Gross Receipts, states, "Gross Receipts²" means the aggregate selling price of all merchandise and services sold in, upon, or from the Leased Premises by Lessee, its Subtenants, licensees, and concessionaires, etc.

Based upon discussions with Marina Shipyard's CPA, and review of supporting documentation, we determined that gross receipts are not used for the basis of computing the monthly percentage lease payment to the City. The CPA uses gross

² In lay terms, gross receipts means when received.

revenue earned as the basis of computing the monthly percentage lease payment to the City. Gross revenue earned is different from gross receipts, in that advance deposit payments are excluded from the monthly percentage lease computation. Advance deposits are included in gross revenue earned during the month the advance deposit is applied to the customer's work order. The net effect of this revenue recognition procedure is to delay payment to the City by 30 to 60 days for gross receipts earned on advance customer deposits for service.

Recommendation

The City should work with the lessee to enforce the terms of the lease agreement or negotiate a change to the gross receipts language in the agreement.

Number 3 – Minimum Monthly Least Payments have been Routinely Paid Late

Marina Shipyard's monthly lease payments to the City have been routinely paid after the due date. For fiscal years 2002, 2003 and 2004, the lease payments have been paid late, on average, as listed below:

- Minimum Monthly Rent – Paid on average, 27 days late
- Percentage Monthly Rent – Paid on average, 83 days late

The Lease agreement between the City and Marina Shipyard does not contain any penalty nor require any interest on lease payments made to the City after the due date. As a result, there is no incentive for Marina Shipyard to make their lease payments on time, as required by the Lease.

Marina Shipyard's Comments

Marina Shipyard state that their shipyard crane broke down several times during the past three years, effectively shutting down their operations. As a result, Marina Shipyard experienced a severe cash flow shortage and was unable to pay their lease payments to the City in a timely manner as required by the Lease.

Recommendation

The City should consider using potential charges discussed in issue number 2 above as a way of adding penalty language to the agreement for any late payments received.