COUNTY OF MONTEREY

OFFICE OF THE AUDITOR-CONTROLLER

INTERNAL AUDIT DIVISION

LAKE SAN ANTONIO AND LAKE NACIMIENTO OPERATIONS AUDIT

May 2019

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Executive Summary

Pursuant to Monterey County's 2018-19 Internal Audit Plan as approved by the Board of Supervisors (Board) the Auditor-Controller's Internal Audit Division (IAD) has completed its review of the County's activities surrounding Monterey County's Lake San Antonio and Lake Nacimiento operations (Park Operations). Audit testing focused on Resource Management Agency's (RMA) processes and included inquiry, observation, process mapping and controls analysis, data analysis, legal and regulatory review of existing agreement, and review of financial records recorded in the County's CGI Advantage system.

The IAD is preparing to test the operator's books and records. We have contacted the operator and provided our requested documentation and samples for transactions occurring over the prior three years. The operator is currently compiling documentation. Once complete, the IAD will schedule time to perform testing. Additionally, the IAD will observe Park Operations to determine the propriety of staffing, existing operations, and existence and condition of facilities and equipment on-site. We anticipate completing the work and issue a report on this phase by June 2019.

Summary of Observations and Recommendations:

The following summarizes the IAD's audit recommendations resulting from Internal Audit Observations (IAO). IAO's, referenced by number, are categorized as High, Medium or Low Risk in accordance with the IAD Policy and Operation's Manual approved by the Board of Supervisors. These recommendations have been shared with RMA management. RMA management has developed formal responses containing corrective action plans, which are documented in the Internal Audit Observations and Recommendation section of this report. The IAD recommends RMA:

High Risk

1. Require a complete financial statement audit of Basecamp operations be performed by a licensed CPA in accordance with Generally Accepted Auditing Standards. ***(IAO.01)***
2. Ensure effective oversight by enhancing contractual terms that improve compliance and accountability. ***(IAO.02)***
3. Ensure lease agreement properly identifies assets included in agreement and ensures assets are properly insured and maintained. ***(IAO.03)***

Medium Risk

4. Enhance Basecamp's presentation of income statement sub-groupings and related calculations. This will help to enhance analysis. ***(IAO.04)***

Low Risk

5. Enhance measures and monitoring by incorporating trend analysis techniques when interpreting financial results. ***(IAO.05)***

Scope

The Monterey County Office of the Auditor-Controller, Internal Audit Division has completed its review of the County's activities surrounding the 2019 Lake San Antonio and Lake Nacimiento (referred herein as Park Operations) Operations Audit. The audit scope covered financial and operational activity surrounding Park Operations and related oversight and management activities conducted by the County and the County's managing services vendor, Basecamp, formerly known as Urban Parks Concessionaires. The scope also included analysis of financial data from July 1, 2014 through December 31, 2018 and detailed financial and operational review of transactions and related processing from July 1, 2016 through December 31, 2018.

Objectives

The primary objectives of the audit included:

- Ensuring policies, procedures, and practices are in place to help ensure effective management of operations.
- Evaluating the adequacy of RMA monitoring activities designed to oversee activities.
- Ensuring reporting submitted and reviewed by Monterey County's Board of Supervisors is timely and accurate.
- Ensuring adequate reserves are funded and related accounting treatment is in accordance with contract.
- Evaluating the design and implementation of internal controls intended to mitigate risk and ensure effective operations.
- Ensuring compliance with key provisions contained in the vendor contract and related amendments.
- Reviewing the propriety and adequacy of existing pricing, costing and forecasting models used to budget and plan operational activities.

Audit Objectives Results

Audit testing revealed three (3) High Risk Observations that recommend financial statement audits of Basecamp financial records and enhancements to the Management Services Agreement and Leasing Agreement with Basecamp. One (1) Medium Risk Observation recommended enhancements to income statements presentation of revenue subgroupings and related calculation and one (1) Low Risk Observation was noted that encourages implementing financial analysis techniques.

Background

In 1957 construction of the Nacimiento Dam was completed creating a reservoir known as Lake Nacimiento. In 1965 the San Antonio Reservoir, known as Lake San Antonio was created. Both lakes were created for the purpose of providing water to the Salinas Valley and both are owned and operated by the Monterey County Water Resources Agency.

In July 2016, the County's Resource Management Agency (RMA) Department merged with County's Parks Department and assumed oversight of Park Operations. RMA, reevaluated Park Operations and presented three alternate courses of action for the Board to consider. On January 15, 2019, the Board authorized RMA to pursue a new agreement with Basecamp to continue managing Park Operations at Lake Nacimiento, while the County is to assume managing Park Operations at Lake San Antonio. RMA has since, temporarily extended its existing agreement with Basecamp through June 2019 while continuing to negotiate a more extended agreement.

Overall, RMA has done a commendable job in organizing and establishing processes and practices that provide oversight of Park Operations. However, enhancements are recommended to better ensure financial integrity, safeguarding of assets, and improve operational performance. Although, Park Operations has shown the ability to earn profits, current profit levels are insufficient to cover management fees and costs.

Internal Audit Observations and Recommendations

The following Internal Audit Observations (IAO) detail the criteria (what should be), the condition (what is) and includes corrective action recommendations. These recommendations have been shared with RMA management. RMA management has developed formal responses containing corrective action plans, which are documented within each IAO. Based on audit procedures performed, the IAD noted the following:

IAO.01 – Basecamp's financial results are not audited in accordance with Generally Accepted Auditing Standards (GAAS) as prescribed by the American Institute of Certified Public Accountants (AICPA). *(High Risk)*

Criteria

The fundamental purpose of a financial statement audit is to provide independent assurance that financial results are complete and accurate and that a "true and fair" view of the financial performance and position is presented. This is especially important when a vendor is conducting business on behalf of the County, where the County relies on vendor provided financial information to draw conclusions for current and future operational strategies of the business and calculate fees owed to the vendor. Independent assurance can only be achieved through performance of an annual financial statement audit, by a licensed CPA, in accordance with GAAS, as prescribed by the AICPA.

Condition

The County relies on Basecamp to effectively manage Park Operations and produce financial results that minimize the impact of County subsidies. As a third-party vendor, Basecamp utilizes its own staffing and financial systems and processes to generate financial results, which are then reported to the County in the form of a Balance Sheet and Income Statement.

The current contract terms do require an audit of Basecamp's expenses; however, expenses represent just one segment of financial information. Other important segments such as revenue, assets, liabilities, equity, and cash flows have not been audited. Consequently, the County cannot be confident, through independent assurance, that all financial information reported is complete and accurate and represents a "true and fair" view of Basecamp's financial performance and position.

Cause

Basecamp is a privately held organization that is not required under the current contract terms to obtain financial statement audits.

Effect

The financial records of Park Operations are unaudited and therefore unreliable. Unreliable financial information can lead to flawed business assumptions that may favor Basecamp at County's expense. Further, inappropriate recording and accounting of financial transactions can lead to incorrect financial reporting, over-stated management fee amounts owed by the County, and incorrect conclusions drawn from resulting analysis.

Recommendation

Management should require a complete financial statement audit of Basecamp operations to include Balance Sheet, Income Statement, Statement of Equity, and Statement of Cash Flows, annually. The audit should be performed by a licensed CPA in accordance with GAAS promulgated by the AICPA. This will ensure integrity to the financial information received from Basecamp and establish a baseline. The baseline can then be used for County's future strategy as well as to reconcile and further adjust the management fees paid to Basecamp throughout the year, as necessary.

Management Response

Under the current management agreement that RMA assumed for the Lakes required Basecamp to conduct an annual expenditure audit at the County's request. Prior to RMA assuming this agreement, it was unclear if Parks staff had ever requested such an audit. RMA has since had Basecamp go back three (3) years and issue an Expenditure Audit for fiscal years 2015 through 2017, and the most recent fiscal year 2018. RMA is in compliance with the current agreement's auditing requirements.

RMA issued a formal Request for Proposal (RFP) for a new Lakes management agreement. The agreement is currently under negotiations and is expected to be finalized in June 2019. The agreement includes, as recommended by the Auditor-Controller's Office, an annual financial statement audit performed by a licensed CPA in accordance with Generally Accepted Auditing Standards.

IAO.02 – Ensure effective oversight by enhancing contractual terms that improve compliance and accountability. *(High Risk)*

Criteria

The County's Purchasing Policies define the nature of Professional Service Agreements (PSA) and the means for establishing a contract for related services. Paragraph 4 requires the following terms and conditions be addressed in all PSA agreements:

> **(a) Performance requirements:** Performance requirements should be precise and written in such a way that it can easily be determined if and when the contractor has successfully fulfilled his or her obligations under the agreement. Consequences for noncompliance such as non-payment and/or termination of the contract must also be defined. Scheduled due dates that specify milestone targets must be clearly identified and may include, but not limited to, regular meetings scheduled to evaluate progress, identification of problem areas to determine actions to be taken to resolve any concerns, dates for formal written reports, required oral progress reports, and contract monitoring requirements.
>
> **(b) Performance monitoring:** The department shall monitor the compliance with the terms and conditions of the agreement and applicable laws and regulations.

Condition

Review of terms and conditions contained in the existing contract with Basecamp revealed that Basecamp receives compensation through management fees paid at 1.5% of monthly gross revenue and management incentive fees paid at 25% of annual net profits. Basecamp also receives administrative fees of 80K annually and is reimbursed for any losses realized through deficit settlement payments. As noted in the chart below total compensation and reimbursement costs for fiscal years 2016-17 and 2017-18 amounted to .8M and 1.2M, respectively.

Basecamp		
Payments	***FY 2016-17***	***FY 2017-18***
Monthly Deficit Settlements Paid	469,962	669,891
Annual Management Incentive Fees Paid	179,508	326,818
Management Fees Paid	80,687	74,883
Administrative Fees Earned	80,004	80,004
Total Fees and Settlements	**810,161**	**1,151,596**

Despite consideration received, and no risk of loss, Basecamp has not been compliant with Section 10 Annual Budget/Staffing Plan. Per inquiry Basecamp has not consistently submitted Annual Target and Performance Evaluation Plans, or proposals on rates/pricing for visitor services as required by the existing contract.

Cause

The initial contract and related addendums allow for considerable compensation to Basecamp without adequate performance requirements. Key functions such as the Auditor Controller's Office were not involved in reviewing and approving the final agreement.

Effect

Without a concerted effort to assess, plan, and budget Park Operations, Basecamp is not held accountable to established expectations. Further, without meaningful input from Basecamp, established budgets may not be in-line with expected results.

Recommendation

RMA management should ensure the contract allows for adequate oversight and monitoring of Basecamp's compliance with the terms and conditions of the agreement and applicable laws and regulations. RMA management should require as a condition of the new contract, that Basecamp develop and submit annual operational plans and related budgeting. To support the operational plan and rates/pricing proposals of the vendor, the contract should also require the vendor/Basecamp to perform financial trend analysis by each activity segment (see charts at **IAO.05**). Such plans should be reflected in RMA's budget proposals to the Board and should be realistic, achievable and focused on maximizing Park Operations while minimizing the impact to the County's General Fund. Management should ensure the new contract includes consequential terms for non-compliance of agreed upon terms and conditions. Further policy, processes, and procedures should be developed to actively monitor actual results in relation to budget on a routine basis (i.e. at least quarterly).

Management Response

The newly drafted management agreement includes provisions that require Basecamp to develop and submit annual operational plans and related budgeting, as well as, propose rates and pricing for visitor services. The contract will be routed to both County Counsel and the Auditor-Controller's Office, as is customary practice. Management expects the new contract to be signed in June 2019. This draft agreement does not require the vendor to perform financial trend analysis, but trend analysis will be part of monthly and annual financial reviews as needed.

IAO.03 – Inventory of leased property and evidence of insurance not contained within signed agreement. *(High Risk)*

Criteria

When leasing property, best practices include:

1. Completing a lease form or contract that has been reviewed by an attorney or an experienced leasing manager.
2. Providing insurance on the leased property. The lease agreement should specify the type of insurance required and include a properly written indemnification clause. At a minimum insurance should include:
    - Property coverage for the replacement value of, equipment and any improvements, betterments or alterations the tenant assumes in the lease (existing or newly added),
    - General liability coverage of at least $1M for each occurrence and $2M in the aggregate and issued by an insurance company with a rating of no less than "A-" and a financial size category of at least "VII".
    - A certificate of insurance disclosing the limits of coverage provided by the tenant's insurance policy and naming the landlord as additional insured.
3. The lessor should conduct regular inspections to ensure property usage and maintenance are within the lessor's expectations.

Condition

Included in the original Management Services Agreement (MSA) with Basecamp is Attachment D, which is a separate lease agreement. The terms allow Basecamp to lease County vehicles at a cost of $1 per month and requires Basecamp maintain the leased equipment at its (Basecamp's) own cost. The agreement refers to Attachment D as listing the property under lease. Review of Attachment D revealed that a listing of leased assets is not included in the agreement. Only a comment stating, *"Parks Department to complete this information prior to execution of Lease Agreement."* We noted through inquiry that a complete listing of leased assets, although compiled, has not been formally updated within the contract. Further, evidence of insurance was not included with the lease agreement.

Cause

There are no formal policies in place that provide direction on lease arrangements in which the County is the Lessor. The omission of the leased asset listing and insurance documentation appears to be the result of a lack of oversight and follow-through in ensuring that all terms and conditions have been finalized, reviewed, and approved prior to executing the final contract.

Effect

Potential for loss, damage, or misstatement of assets and related expenditures. By omitting a complete listing, or descriptions, of assets leased, and evidence of insurance, the County may be at risk of losing the assets.

Recommendation

RMA management should ensure that all property leased to Basecamp is completely inventoried and listed in a schedule of leased property within the vendor contract. RMA management should also ensure evidence of insurance is obtained and scheduled maintenance plans developed by the vendor and included in the lease agreement. Lastly, to ensure all provisions are compliant with best practices and that financial reporting and related disclosures are accurate, management should ensure that all lease arrangements are properly reviewed and approved by County Counsel, and the Auditor-Controller's Office.

Management Response

RMA management is currently negotiating a new contract with Basecamp. As part of the new contract a new lease agreement will be executed. Management will ensure the new lease agreement contains a complete list of leased assets and related insurance and maintenance requirements are properly included. RMA management will ensure the new lease agreement is reviewed and approved by County Counsel and the Auditor-Controller's Office. Management expects the new contract to be signed in June 2019.

RMA complies with the Auditor-Controller's annual inventory review, which includes all assets at the Lakes, whether leased to Basecamp or otherwise. The insurance requirements under this agreement are defined by County Counsel Risk Management.

IAO.04 – Enhance Basecamp's presentation of income statement sub-groupings and related calculations. *(Medium Risk)*

Criteria

Proper classification, presentation, and calculation, of revenue components is critical to understanding the mix of products and services and their related contributions to generating revenue and profit. Products and services should be grouped in a way that is meaningful to understanding operations of differing business segments. Groupings should contain sub-totaled data for that grouping only.

Condition

Income Statements submitted by Basecamp do not provide meaningful revenue information of items listed. Although all revenue categories are included in the Total Revenue amount, the current presentation does not differentiate products and services into meaningful sub-groupings that would provide a clearer understanding of revenue contributions and profitability.

Cause

RMA was leveraging the data files received from Basecamp choosing to retain the existing format and calculations.

Effect

Inefficient use of financial information. By not presenting appropriate revenue groupings and their related subtotals, financial information and related analysis is less meaningful, making it more difficult to interpret results.

Recommendation

RMA management should work with Basecamp to ensure that revenues are grouped in ways that adequately portray key business segments. Further management should ensure that groups are segregated and that related sub-totals are properly calculated.

Management Response

RMA is currently working with Basecamp on their expenditure groupings, to encourage groupings by revenue generating activity. This will allow RMA to better understand individual business operations and their profitability. Although this is not finalized, some of the business groups recommended are boat rentals, fuel, moorage, store, lodging, camping, and swimming. This new information will be used to help managers make more informed business decisions. This is an improvement RMA has been interested in implementing prior to this audit.

IAO.05 – Enhance measures and monitoring by incorporating trend analysis techniques when interpreting financial results. *(Low Risk)*

Criteria

Proper classification and presentation of financial information is critical to producing effective and meaningful financial analysis. For example, analyzing an entity's Gross Profit Margin overtime provides insight into understanding an entities profitability or lack thereof. Changes in gross profit margin trends provide useful information concerning an entity's ability to manage labor and supplies in the production of its goods or services.

Condition

While performing Gross Profit Margin analysis of Lake Nacimiento's and Lake San Antonio's fiscal 2017-18 financial results we noted large fluctuations and negative contributions of gross profit margins within individual product and service lines. The following charts highlight those results:

Lake Nacimiento – Profit Margin Ratio Analysis												
Revenue	**7/31/2017**	**8/31/2017**	**9/30/2017**	**10/31/2017**	**11/30/2017**	**12/31/2017**	**1/31/2018**	**2/28/2018**	**3/31/2018**	**4/30/2018**	**5/31/2018**	**6/30/2018**
Rooms	88%	87%	88%	76%	69%	48%	18%	43%	66%	65%	88%	92%
Camping	95%	95%	91%	92%	94%	28%	-142%	72%	92%	88%	93%	95%
Marina	86%	85%	75%	50%	-31%	-192%	-3051%	-1034%	-6%	42%	47%	72%
Activities	89%	95%	100%	100%	100%	100%	100%	100%	100%	100%	100%	77%
Admission / Parking	-201%	-195%	-192%	-154%	-619%	-2478%	-1422%	-1010%	-442%	-593%	-327%	-215%
Other F&B	67%	34%	16%	-197%	1527%	0%	0%	0%	0%	-1608%	-180%	-37%
Grocery	50%	50%	79%	50%	-7%	129%	50%	50%	50%	50%	50%	66%
Taxable Merchandise	44%	44%	16%	-83%	12%	44%	44%	44%	44%	44%	44%	86%
Apparel	52%	52%	55%	52%	52%	52%	52%	52%	52%	52%	52%	31%
Ice	68%	71%	78%	83%	100%	-1292%	100%	-470%	100%	-1%	55%	71%
Fuel	59%	21%	40%	48%	26%	81%	30%	146%	172%	61%	6%	80%
Lake San Antonio – Profit Margin Ratio Analysis												
Rooms	126%	50%	-21%	0%	42%	63%	0%	-107%	47%	84%	83%	99%
Camping	95%	94%	0%	90%	87%	75%	68%	71%	77%	91%	97%	96%
Marina	-8189%	-6817%	-3547%	-113400%	-29175%	-65650%	-24083%	-6907%	-832%	-6274%	-214%	46%
Moorage	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Admission / Parking	42%	4%	-12%	-229%	-54%	-106%	-72%	-8%	8%	39%	-27%	-22%
Other Income	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Other F&B	100%	61%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Grocery	50%	50%	124%	61%	497%	1172%	51%	50%	50%	50%	50%	16%
Taxable Merchandise	0%	-50%	-59%	357%	-440%	-2198%	-4998%	-1306%	-1467%	-524%	-4%	-243%
Apparel	52%	52%	100%	64%	52%	0%	0%	52%	52%	52%	52%	173%
Ice	72%	55%	97%	57%	100%	69%	100%	144%	100%	-438%	100%	81%
Fuel	41%	31%	38%	50%	39%	-2933%	31%	-3262%	115%	-56%	-17%	5%

Since the Gross Profit Margin represents the mark up an entity can make on its sales, the relationship/ratio should be consistent or trending in a positive consistent fashion. For example, Marina at Lake San Antonio shows very high loss/negative profit margin throughout the year giving clear indication that the demand for this activity is very low or non-existent. A similar loss/negative profit margin is reflected for Admission/Parking operations at Lake Nacimiento. Such analysis shows which areas are in no/low demand and helps formulate future operations strategy accordingly.

Cause

Although RMA has a mechanism to track and report financial activity, they have not used, nor required Basecamp to use financial analysis techniques to better assess, understand, and explain changes in financial activity.

Effect

Without meaningful analysis, financial reporting alone does not provide executive management and the Board with robust information concerning the status and trending of Park Operations.

Recommendation

RMA management should improve existing monitoring activities by incorporating or have Basecamp incorporate, trend analysis techniques when analyzing and interpreting financial results. Future contract terms should require the vendor to analyze each service segment in a similar fashion. Management should use these techniques periodically (at least quarterly) and should obtain detailed explanations for significant changes in business activity. This will help to improve RMA's understanding of business activity at a micro level and better equip them to identify and respond to changes in trends.

Management Response

RMA has requested Basecamp provide more detailed financials, to allow for better financial analysis, including profit margins by revenue generating activity. Management understands the value of utilizing profit margins to determine whether service level modifications are needed or should be temporarily or permanently suspended.

RMA Finance is interested in learning more about financial analysis tools and techniques for business, profit-driven entities. However, management will need to weigh the benefits of more complex ratios and analysis against the benefits. RMA has limited staffing and only pertinent, truly value-added work will be undertaken. RMA would like to better understand some of the radios the Internal Auditor is recommending and encourages the Auditor-Controller's Office to provide county-wide training.

Distribution

Monterey County Board of Supervisors
Lew Bauman, County Administrative Officer (CAO)
Dewayne Woods, Assistant CAO
Shawne Ellerbee, RMA Deputy Director of Administrative Services
Neville Pereira, Acting RMA Deputy Director of Public Works
Jessica Cordiera-Martinez, RMA Finance Manager II
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Audit Team

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Issued this __3___ day of ___June____, 2019,

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