Revenue Generating Lease Audit: OC DANA POINT HARBOR/ DANA POINT JET SKI

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

> **\$654K GROSS RECEIPTS** FOR 9-MONTH AUDIT PERIOD **\$64K RENT TO THE COUNTY**

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 ninemonth 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

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

RISK BASED AUDITING





AICPA 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

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Corange county board of supervisors' Internal Audit Department

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

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

Dr. Peter Hughes	Ph.D., MBA, CPA, CCEP, CITP, CIA, CFE, CFF, CGMA
Director	Certified Compliance & Ethics Professional (CCEP)
	Certified Information Technology Professional (CITP)
	Certified Internal Auditor (CIA)
	Certified Fraud Examiner (CFE)
	Certified in Financial Forensics (CFF)
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To access and view audit reports or obtain additional information about the OC Internal Audit Department, visit our website: <u>www.ocgov.com/audit</u>



OC Fraud Hotline (714) 834-3608

Letter from Dr. Peter Hughes, CPA





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 <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 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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OC Internal Auditor's Report



June 10, 2013

Audit Highlight

Dana Point Jet Ski (DPJS) operates a jet ski and kayak center at Dana Point Harbor through a sublease under the lease agreement between the County of Orange and Dana Point Shipyard (DPS).

DPJS reports gross receipts and pays rent to DPS, who includes DPJS gross receipts and reports the combined total to the County. DPJS reported approximately **\$654,000** in gross receipts for the ninemonth audit period, and the County received about **\$64,000** in rent. Over the 35-year lease term between the County and DPS (subject to completion of lease required upgrades), the lease and sublease agreements are estimated to generate about **\$16.6** million in rent to the County.

The Internal Audit Department found that DPJS's records adequately supported reported gross receipts except for unreported rental loss charged on a damaged jet ski, enhancing recordkeeping, and submitting financial statements.

Audit No. 1233

- TO: Brad Gross, Director OC Dana Point Harbor
- FROM: Dr. Peter Hughes, CPA, Director Internal Audit Department

eflightes

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

<u>Objective #1</u>: 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.

<u>Objective #2</u>: 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.

OC Internal Auditor's Report



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.

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

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 ClassificationsAttachment 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 prenumbered 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 prenumber 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.

Detailed Findings, Recommendations and Management Responses

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 <u>internal controls</u>, <u>compliance issues</u>, or <u>efficiency/effectiveness</u> <u>issues</u> 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.



ATTACHMENT B: OC Dana Point Harbor Responses

	DanaPointHarbor	Brad Gross, Director 24650 Dana Point Harbor Driv Dana Point, CA 9262 Telephone: (949) 933-2230
ſ	Aemorandum	Telephone: (949) 923-223 Fax: (949) 923-379
April 3, 2	013	
To:	Dr. Peter Hughes, CPA, Director OC Internal Audit Department	
From:	Brad Gross, Director	
Subject:	Draft Report on Revenue Generating Lease Audit No. 123	33 of Dana Point Jet Ski
the Contr Report or The Cour to each re its subter Internal A with OC I Recomm DPJS rep rent owed		ented in the attached Draft PJS), Audit No. 1233. na Point Harbor's responses na Point Shipyard (DPS) has recommendations from the endations 1 through 5, along arbor requires DPS to have
The attac charged f Point Har	Point Harbor Response: Concur hed letter from OC Dana Point Harbor requires DPS to h or the damaged personal watercraft as gross receipts and bor will hand deliver this letter and shall follow up with l late of this letter to verify compliance.	pay rent owed. OC Dana
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	endation No. 3: We recommend OC Dana Point Harbor rec	



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-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.

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:

es: 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



ATTACHMENT B: OC Dana Point Harbor Responses (continued)

June, 2013 Catherine Cope Dana Point Shipyard 34671 Puerto Place Dana Point, CA 92629 Re: Audit #1232 for Dana Point Shipyard 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 Shipyard 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 Shipyard 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 DPS and five (5) Findings for DPIS, along with respective Recommendations for both DPS 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'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	CDanaPointHarbor	Brad Gross, Director 24650 Dana Point Harbor Drive Dana Point, CA 92629 Telephone: (949) 923-2236
Catherine Cope Dana Point, Shipyard 34671 Puerto Place Dana Point, CA 92629 Re: Audit #1232 for Dana Point Shipyard 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 Shipyard 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 Shipyard 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 DPS and five (5) Findings for DPJS, along with respective Recommendations for both DPS 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		
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