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GARY L. BURROUGHS, CPA
City Auditor

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LONG BEACH, CALIF.

January 23, 2001

Honorable Mayor and City Council
Long Beach, California

**Subject: LONG BEACH CONVENTION AND ENTERTAINMENT CENTER
RESULTS OF OPERATIONS FOR YEAR ENDED SEPTEMBER 30, 2000**

Transmitted herewith is a report on the results of operations of the Long Beach Convention and Entertainment Center for the year ended September 30, 2000.

RECOMMENDED ACTION:

Receive and file.

Sincerely,


Gary Burroughs
City Auditor

GB:sk



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GARY L. BURROUGHS, CPA
City Auditor

November 30, 2000

Mr. Ron Walker
Special Projects Officer
Department of Community Development

We have applied review procedures to records relating to operations of the Long Beach Convention and Entertainment Center through the year ended September 30, 2000.

The purpose of applying review procedures was to assess the financial results of Center operations. Review procedures included:

- Obtaining and reviewing the facility manager (SMG) and food and beverage concessionaire (FMIC, an affiliate of SMG) financial statements.
- Analyzing the details of selected financial transactions from SMG's and FMIC's general ledgers and financial reports.
- Reading the management and concession agreements to understand key provisions.
- Discussing issues with SMG, FMIC and City personnel.

Based on the results of the procedures performed, after a down year in fiscal 1999, the Center was much improved in fiscal 2000. Total attendance exceeded 1,650,000 and the number of conventions, convention attendance and revenue substantially improved over fiscal 1999. However, Convention Center operations continue to cost the City \$2.5 million a year.

Sincerely,

Earl A. Hobbs
Deputy City Auditor

EH:sk

Background

The Long Beach Convention and Entertainment Center was built with Tidelands Trust funds at a cost of \$51 million and opened in 1978. Center operations have resulted in City financial operating losses of several million a year. Cumulative cash operating losses are in excess of \$60 million.

The Center was expanded at a cost of \$120 million, mostly funded by the Port of Long Beach, which was completed in 1994. The expanded Center more than doubled the amount of exhibit space to over 220,000 square feet. The City is responsible for utilities and debt service for the Center, the cost of which increased by about \$1.4 million a year due to the expansion.

Management Agreement

The City entered into the current management agreement with SMG for the day to day operations of the Convention Center in 1991. The agreement has a term of 31 years and runs through 2022. SMG receives an annual base management fee which started at \$1,500,000 in 1991 and increases by 5% every five years. In 2001 this fee will automatically increase from \$1,575,000 to \$1,653,750.

If operating cash flows are insufficient to cover the annual base management fee, the City must make up any shortfall. If operating cash flows exceed the base management fee, the City receives the next \$300,000 adjusted for inflation to cover City overhead. Annual operating cash flow in excess of this amount is split 75% to the City and 25% to SMG.

The management agreement allows SMG to operate or contract for food and beverage services at the facility. Under either arrangement, the facility receives a percentage of gross revenue. As amended, the percentages are 40% of concession food and beverages and alcoholic beverages, 25% of restaurant food and beverages and 15% of catered services.

In practice, SMG subcontracts food and beverage services to an affiliate company, FMIC. Since the facility receives a percentage of gross revenue, there are no restrictions on profits earned by FMIC. In addition to the base management fee earned by SMG, FMIC had operating profit in excess of \$1.5 million in 1999.

Letter Agreement

In January 2000, the City and SMG reached agreement on how transactions described below at the Center were to be handled.

Jehovah Witness Deferred Revenue

In fiscal 1996, the Jehovah Witnesses exchanged construction services valued at \$850,000 for free rent on use of the facility for the next several years. The \$850,000 was recorded as deferred revenue and converted to actual revenue as the facilities were used. This created a non-cash revenue and resulted in a cash shortfall for the Center as funds were distributed. The parties agreed that for fiscal 1999 and all subsequent years the amount of Jehovah Witness non-cash revenue recorded on the income statement for that year will be deducted from net operating income when calculating the SMG incentive fee and the amount of income to be distributed to the City.

Ice Dog Rebates

The City negotiated with the Ice Dogs on the basis that incentives and rebates would come from the City's 75% interest and not negatively impact SMG's incentive management fee. Therefore the parties agreed for fiscal 1999 and all subsequent years that the amount of Ice Dog rebates will be recorded as an operating expense of the Center and then added back to net operating income in order to calculate SMG's incentive fee. The amount of Ice Dog rebates will not be added back to net operating income when calculating the City's distribution because these rebates are a direct obligation of the City.

Capital Improvement Fund

SMG is required to make an annual payment to the Capital Improvement Fund. The management agreement ignored this payment when calculating SMG's incentive fee and the City's distribution of income. The parties agree for Fiscal 1999 and all subsequent years that the annual contribution to the Capital Improvement Fund will be deducted from net operating income when calculating SMG's incentive fee and the amount of income to be distributed to the City.

Facility Activity

The following schedules summarize facility event activity for the past three fiscal years. The schedules include number of events, attendance and event income. After declining in fiscal 1999, the number of conventions and convention attendance rebounded in 2000. Event revenue was up sharply in fiscal 2000 due mainly to the increase in convention event revenue.

Long Beach Convention Center
Activity Comparison

Number of Events	2000	1999	1998
Family shows	18	15	13
Sports	47	49	60
Concerts	10	14	9
Conventions	123	101	128
Trade Shows	32	56	45
Public/Gated	55	67	58
Performing Arts	139	113	91
Meetings/Seminars	53	32	18
Civic/Graduations	9	16	14
Religious	61	46	36
Banquets/Food	9	11	11
Testing	39	17	6
Dance	3	3	4
Miscellaneous	24	21	22
Total	<u>622</u>	<u>551</u>	<u>515</u>

Attendance	2000	1999	1998
Family Shows	70,659	77,639	81,650
Sports	370,281	362,837	359,044
Concerts	56,517	48,078	32,691
Conventions	249,165	134,602	240,921
Trade Shows	96,165	120,025	167,589
Public/Gated	203,931	244,410	210,870
Performing Arts	89,790	62,059	113,607
Meetings/Seminars	23,668	12,317	9,344
Civic/Graduations	11,590	8,610	14,634
Religious	442,882	383,740	321,718
Banquets/Food	5,136	5,941	4,302
Testing	9,232	4,799	13,619
Dance	4,536	2,220	3,113
Miscellaneous	18,361	19,179	10,213
Total	<u>1,652,569</u>	<u>1,486,458</u>	<u>1,583,323</u>

City Net Operating Cost

As previously mentioned, the City is responsible for utilities, debt service and reimbursing SMG for the cost of operating the Center energy plant. The City's recent net annual operating losses have ranged between \$2.5 and \$3.0 million.

Convention Center City Net Operating Costs

Expenses

	<u>2000</u>	<u>1999</u>
Utilities	\$2,155,859	\$1,863,084
Energy Plant	854,986	772,091
Debt Service	986,226	523,169
Insurance	89,882	92,786
Ice Dogs	-	137,546
Base Management Fee	-	240,330
Other	187,737	178,697
	<hr/>	<hr/>
Total Expenses	4,274,690	3,807,203

Revenue

Hyatt	\$207,089	253,122
Interfund Transfer	493,113	523,169
City Overhead	352,083	-
Profit Sharing	446,000	-
Audit Recoveries	201,500	-
	<hr/>	<hr/>
Total Revenue	1,699,785	776,291
	<hr/>	<hr/>
Net Operating Loss	\$(2,574,905)	\$3,031,412

Event Revenue	2000	1999	1998
Family Shows	125,272	191,986	175,151
Sports	-324,803	-93,075	412,684
Concerts	202,342	117,112	99,898
Conventions	2,915,702	1,631,987	2,198,792
Trade Shows	1,342,250	1,421,158	1,359,563
Public/Gated	1,328,395	1,438,524	1,270,187
Performing Arts	263,522	153,794	271,181
Meetings/Seminars	188,654	80,806	59,270
Civic/Graduations	3,088	17,220	19,605
Religious	735,108	278,262	207,605
Banquets/Food	21,067	27,036	34,075
Testing	228,599	159,306	72,444
Dance	28,085	20,245	19,486
Miscellaneous	137,447	183,536	107,137
Total	7,194,728	5,687,897	6,307,378

Income Distribution

The following table details the operating income distribution from the Convention Center for the last three fiscal years. In fiscal 1999, the City paid SMG \$240,328 in order for them to receive the guaranteed base management fee. Based on operating improvements in fiscal 2000, the City will receive \$801,632 in overhead reimbursement and profit sharing. In addition to the base management fee, SMG will receive an incentive management fee of \$286,757.

Convention Center Income Distribution

	2000	1999	1998
Gross Operating Income	7,708,026	6,259,542	6,370,240
Operating Expenses	-4,868,151	4,583,321	4,328,553
Income From Operations	2,839,875	1,676,221	2,041,687
Other Income (Expense)			
Jehovah's Non-Cash Revenue	-59,125	226,800	-
Capital Imp. Contribution	-117,361	114,749	-
Base Management Fee	-1,575,000	-1,575,000	-1,575,000
City Contribution	-	240,328	-
City Overhead Reimbursement	-352,083	-	-329,747
Incentive Management Fee	-286,757	-	-136,940
City's Share of Profits	-449,549	-	-
	0	0	0

Parking Revenue Related

Parking revenue is one of the major sources of event income for the Convention Center. As shown in the following table, parking revenue currently comes from four different locations. The Pine lot is the site of the future Queensway Bay Project and will be lost to the Convention Center when groundbreaking takes place.

Parking Area	Number Of Stalls	FY 2000 Revenue
Terrace Parking Structure	800	\$ 171,058
Promenade Parking Structure	420	588,907
Main Lot	3,245	1,155,298
Pine Lot	1,300	639,845
Total	5,765	\$2,555,108

The current parking charge at the Convention Center is \$7. One of the seven dollars was implemented as a funding source for a City bailout of the Civic Light Opera (CLO). After the CLO ceased operations, the charge remained and is paid monthly by SMG to the City.

Another one of the seven dollar charge was implemented to fund the Convention Center's participation in the Parking and Traffic Management Organization (PTMO). The PTMO includes the Convention Center, Queen Mary, Hyatt Hotel, Aquarium of the Pacific and Shoreline Village. The Convention Center's share of the annual cost of this organization is not to exceed \$200,000. The purpose of the organization is to coordinate parking resources south of Ocean Boulevard.

ISSUES AND RECOMMENDATIONS

No. 1 – Diversion of Tidelands Trust Revenue

The Tidelands trust was legislatively created by statutes enacted by the California legislature in 1911, 1925 and 1935. The discovery and production of oil in the 1930's greatly assisted in the development of the Port of Long Beach, but strained relations between the City and State. Legislation passed in 1951 declared that 50% of all past and future oil revenue belonged to the State. A taxpayer lawsuit made its way to the California Supreme Court which held that the 1951 legislation effected a partial revocation of the trust. (Mallon v. City of Long Beach, 44 Cal. 2d 199)

The City and State continued to litigate trust boundaries and other issues until enactment of Chapter 138 in 1964. This legislation paved the way for unitized

development of the offshore oil islands and the Long Beach Unit and clarified trust uses and purposes for expenditure of trust funds which were "found to be matters of state, as distinguished from local interest and benefit."

The City Charter establishes the Tidelands Operating Fund to which all revenue from Tidelands assets outside the Harbor District are to be deposited. Expenditures are authorized consistent with trust purposes as contained in the State statutes.

In accounting terminology, the Tidelands Operating Fund is a fiduciary fund. "Fiduciary funds are used to account for assets when a governmental unit is functioning either as trustee or as an agent for another party. Because the governmental unit is functioning in a fiduciary capacity, the authority to employ, dispose of, or otherwise use the assets is determined not by a legislative body or oversight board, but by the public laws and private agreements that created the trustee or agency relationship." (Source: 2000 Miller Governmental GAAP Guide)

As previously mentioned, the City instructed SMG to increase parking charges at the Convention Center to provide funding for the CLO. SMG continues to collect this parking charge and to pay it directly to the City which deposits it into the Special Advertising and Promotion Fund. This practice appears contrary to the statutory trust, general trust law, the City Charter and generally accepted accounting principles.

Recommendation

The appropriateness of diverting Convention Center parking revenue to other City funds and purposes should be referred to the City Attorney for additional review.

No.2 – Administrative Regulations 24-3

In 1981, the City Manager authorized Administrative Regulation 24-3 titled Accounting Procedure for Non-Trust Events - Long Beach Convention and Entertainment Center. The regulation requires the City's General fund reimburse the Tidelands trust for all losses from non-trust events. Events are conclusively deemed "non-trust" events unless the City Attorney makes a written determination that it is a trust event. In a 1982 audit report, the City Auditor's Office found that the administrative regulation was not being followed, which continues to be the case today.

Recommendation

The current applicability of Administrative Regulation 24-3 should be reviewed by both management and the City Attorney. If still applicable, it should be followed. If not, it should be revised or rescinded.