



OFFICE OF THE CITY AUDITOR
Long Beach, California

R-13

LAURA L. DOUD, CPA
City Auditor

June 23, 2009

HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

RECOMMENDATION:

Receive and file the attached Queen Mary Capital Improvements Audit, and revisit Save the Queen's performance of capital improvements subsequent to its next benchmark deadline of December 31, 2009.

DISCUSSION

In November 2007 the City signed an agreement with Save the Queen (STQ) in which STQ agreed to make \$5,300,000 of capital improvements through December 31, 2010 in exchange for the City's waiver of percentage rent under the lease. Under the agreement, STQ was required to perform a minimum of \$2,800,000 in capital expenditures by December 31, 2008. We conducted this audit to verify the amount of capital expenditures made by STQ through December 31, 2008 in accordance with the agreement.

According to our audit, Save the Queen completed \$2,039,000 in capital improvements through December 31, 2008, significantly less than their obligation. Furthermore, some improvements deviated from the agreed-to capital plan without management approval, and it is City Management's position that \$73,622 of these improvements be disallowed as outside the agreement. The details of our audit can be found in the attached report, along with the response of Save the Queen and City Management.

Save the Queen has represented to City Management that it intends to meet all of its remaining capital improvement obligations under its agreement with the City. As part of its attached response, Save the Queen notes that ownership of the entity changed in 2009, and that they nonetheless stand by their capital improvement obligations. The Community Development Department has also indicated that it will be working with Save the Queen regarding these improvements to ensure that they are made. We recommend that City Management closely monitor Save the Queen's performance to ensure that an aggregate of \$4,300,000 in improvements are made by the next benchmark date as agreed to in the plan, December 31, 2009. The City Auditor's Office will continue to work with City Management and the City Attorney's Office to ensure that the City's interests in the Queen Mary are protected.

We would like to thank Save the Queen for the time, information, and full cooperation provided to us during this audit.

TIMING CONSIDERATIONS

This item is not time-sensitive.

FISCAL IMPACT

As described in the report, Save the Queen failed to make at least \$761,000 in capital improvements as required by their lease with the City. Save the Queen has represented that it intends to make all improvements required under its lease. The failure of Save the Queen to fulfill its lease obligations would result in a lack of improvements to the City's asset, and undermine the City's goal of improving the visitors' experience and generating additional operation revenue at the Queen Mary.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,

A handwritten signature in blue ink that reads "Laura L. Doud". The signature is written in a cursive, flowing style.

Laura L. Doud, CPA
CITY AUDITOR



**City of Long Beach
Office of the City Auditor**

**Queen Mary Capital Improvements
Audit Report**

June 2009

Laura L. Doud, CPA
City Auditor

Office of the City Auditor

Audit Report

**Queen Mary
Capital Improvements Audit**

June 2009



Audit Staff

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Executive Summary

We recently concluded our audit of Queen Mary capital improvements performed in conjunction with the City Agreement (Agreement) dated November 6, 2007. For consideration of \$5,300,000 in approved capital expenditures, the City of Long Beach (City) agreed to grant rent credits to satisfy Save the Queen's (STQ) obligation to pay Percentage Rent through December 31, 2010. The first benchmark defined in the Agreement required STQ to perform a minimum of \$2,800,000 in approved capital expenditures by December 31, 2008.

The purpose of our audit was to ensure that capital improvements were made in compliance with the Agreement during the period of October 22, 2007 through December 31, 2008. The following briefly highlights the results of our audit:

- Issue #1 – STQ completed \$2,039,000 in capital improvements by December 31, 2008; however, this amount includes expenses that exceeded or were excluded from the Approved Capital Plan totaling \$815,000.
- Issue #2 – STQ's improvements deviated from the Approved Capital Plan without required City approval.
- Issue #3 – There were \$68,400 in duplicate payments and overpayments to vendors for capital improvements. These amounts have since been applied to outstanding invoices as of December 31, 2008 and are included in the \$2,039,000.

Background

History of Queen Mary

The City of Long Beach (City) purchased the Queen Mary in 1967, and has since leased the operations of the ship to several entities. In February 1993, the City entered into a five-year Lease and Operations Agreement (Lease #22697) with RMS Foundation, Inc. (RMS), a non-profit public benefit California Corporation. Lease #22697 included approximately 9.29 acres of water surrounding the Queen Mary, 11.55 acres of water northwest of the Queen Mary and 43.38 acres of land, including the Dome and Queen's Marketplace.

The Chief Executive Officer of RMS incorporated Queen Seaport Development, Inc. (QSDI), a for-profit California entity, as his operation's profit-making arm in 1995. Later that year, the City entered into Lease and Operations Agreement #24121 (Master Lease) to recognize QSDI as the master lessee of the Queen Mary and extend the lease to a 20-year term. QSDI then subleased the Queen Mary's operation back to RMS. As master leaseholder, QSDI managed the entire Queen Mary property including its development, and, in October 1998 the lease with QSDI was extended to a term of 66 years.

In March 2005, QSDI filed for Chapter 11 Bankruptcy protection. Subsequently, the Bankruptcy Court approved the sale of the Trustee's right, title, and interest in the Queen Mary Master Lease. In August 2007, the leasehold interest was auctioned to Save the Queen (STQ), the successful bidder at \$43 million, and the sale closed in November 2007.

The City Agreement

Under the Master Lease, the City is due two types of rent: Base Rent and Percentage Rent, calculated as a percentage of gross receipts. In order to satisfy these obligations, the Master Lease provides for certain types of rent credits through the use of "On-Ship Capital Credits" and use of "Development Costs." However, the City and STQ entered into the City Agreement (Agreement) in November 2007 that allows STQ to make certain approved capital expenditures in exchange for Percentage Rent due to the City.

The Agreement provides that STQ may satisfy its obligations with respect to Percentage Rent through December 31, 2010 by making \$5,300,000 in approved capital expenditures (Approved Capital Plan) under the timeline listed below.

Timeline Benchmarks	Minimum Aggregate Amount of Approved Capital Expenditures
December 31, 2008	\$2,800,000
December 31, 2009	\$4,300,000
December 31, 2010	\$5,300,000

The Approved Capital Plan (Plan) was developed based on a preliminary review of work to be performed. In developing the Plan, the intent of the City and STQ was to enhance visitors' experiences on the Queen Mary, ultimately increasing revenues. Therefore, not all expenditures made with regards to the Plan may be considered true "capital improvements," as capital improvements are typically classified as assets rather than expenses.

The Plan establishes twelve budget categories (Budget Category). Within each Budget Category, budgets are identified for individual line items (Line Item). At the time the Plan was developed, it was understood that actual costs of improvements may vary from the estimated budgeted amounts, and STQ may reallocate funds within Budget Category Line Items. However, as stated in the Agreement, STQ shall seek City approval for variances that either: (i) exceed 15% between Line Items within the same Budget Category, or (ii) reallocates funds to a different Budget Category than set forth in the Plan.

Audit Objective, Scope and Methodology

The objective of our audit was to ensure capital improvements were made in compliance with the Agreement. STQ was to complete a minimum of \$2,800,000 of the total \$5,300,000 in approved capital expenditures from October 22, 2007 through December 31, 2008. Therefore, the scope of the audit was defined as the period from October 22, 2007 to December 31, 2008.

While conducting the audit, we performed the following procedures:

- Reviewed the Agreement and the Plan to gain an understanding of the requirements and expectations of the approved capital expenditures;
- Obtained, reviewed, and scheduled copies of invoices and cancelled checks related to capital improvements made in conjunction with the Agreement during October 22, 2007 through December 31, 2008;
- Gained an understanding of internal controls surrounding the processing of payments and invoices for capital improvements made in conjunction with the Agreement;
- Traced cancelled checks for capital improvements made from October 22, 2007 through December 31, 2008 to bank statements on a sample basis;
- Obtained and reviewed copies of vendor contracts related to capital improvements during October 22, 2007 through December 31, 2008;
- For vendor contracts entered into for the purpose of capital improvements during October 22, 2007 through December 31, 2008, confirmed the following information:
 - Contract date
 - Services performed
 - Payments received by vendor
 - Percent completion;
- Observed capital improvements completed in conjunction with the Agreement, on a sample basis;
- Identified partial payments and duplicate payments made to vendors for capital improvements made during October 22, 2007 through December 31, 2008 in conjunction with the agreement;
- Identified capital improvements and related payments made in conjunction with the Agreement, subsequent to December 31, 2008;
- Identified appropriate Budget Categories and Budget Category Line Items for capital improvements made, as defined in the Plan;

- Calculated variances, if any, between actual costs of capital improvements and budgeted amounts identified in the Plan;
- Calculated total capital improvements made from October 22, 2007 through December 31, 2008 in conjunction with the Agreement; and
- Identified whether capital improvements made from October 22, 2007 through December 31, 2008 met the first minimum capital expenditure benchmark as defined in the Agreement.

We noted certain internal control matters over the capital improvements payment process that we communicated to STQ management in separate correspondence dated June 5, 2009.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Issues and Observations

Issue #1: STQ completed \$2,039,000 in capital improvements by December 31, 2008; however, this amount includes expenses that exceeded or were excluded from the Plan totaling \$815,000.

Per the Agreement between the City and STQ, if STQ or Lenders make \$5,300,000 in capital expenditures in accordance with the Plan, the City would grant rent credits to satisfy STQ's obligation to pay Percentage Rent through December 31, 2010. The first benchmark required STQ to complete \$2,800,000 in approved capital expenditures by December 31, 2008. Completed capital improvements made by STQ represent actual expenditures for improvements as of December 31, 2008 that have been paid and performed/received.

Our audit revealed that STQ completed \$2,039,000 in capital improvements by December 31, 2008; however, this amount includes expenses that exceeded or were excluded from the Plan totaling \$815,000 (Table 5). Table 1 depicts a summary of completed improvements by Budget Category. A comprehensive schedule of total capital improvements by Budget Category and Budget Category Line Item as of December 31, 2008 is presented at Appendix A.

Additionally, we identified \$292,000 of services and/or products received for which no payment had been made as of December 31, 2008. As such, those amounts have not been included in the total capital improvements of \$2,039,000. The \$292,000 represents improvements such as kitchen equipment, door locks, television mounts, carpet, bed frames, and technology. Of the \$292,000, \$123,000 has been paid as of March 31, 2009.

Issue #2: STQ's improvements deviated from the Approved Capital Plan without required City approval.

As stated above, the Plan was developed based on a preliminary review of work to be performed. It was understood by both parties that actual cost of improvements may vary from estimated budgeted amounts. However, per the Agreement, City approval should be sought for variances that either:

- (i) exceed 15% between Line Items within the same Budget Category; or
- (ii) reallocates funds to a different Budget Category other than as defined in the Plan.

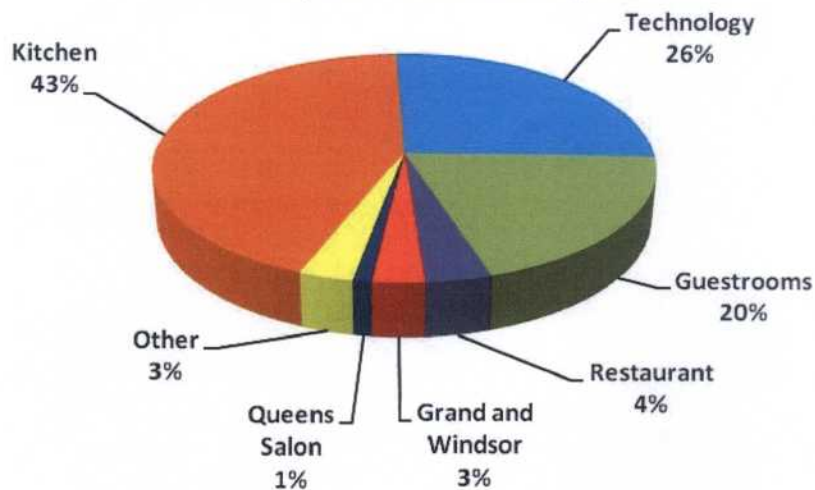
The Plan establishes twelve Budget Categories (Table 1). Within each Budget Category, budgets are established for individual Line Items. For example, Line Items within the Queens Salon are carpet, decorative lighting, stack chairs, artwork, artifacts, etc.

Table 1
Approved Budget Category Amounts
and Capital Expenditures

Budget Category	Approved Category Amount	Capital Expenditures as of 12/31/08
Technology	\$ 1,125,008	\$ 530,508
Guestrooms	900,750	401,643
Kitchen	806,438	887,816
Guest Bathrooms	600,077	12,508
Major Mechanical	500,000	12,260
Restaurant	281,183	75,762
Exposition Hall	249,920	-
Entrance	180,000	14,660
Banquets	169,000	-
Britania Salon	150,001	7,539
Queen Salon	149,933	21,612
Elevator, Escalator	50,000	3,597
Grand and Windsor Salons	-	64,638
Wedding Chapel	-	6,749
Total:	\$ 5,162,310	\$ 2,039,292

The pie chart below illustrates all capital improvements made from October 22, 2007 through December 31, 2008 by Budget Category. Expenditures of \$15,000 or less are combined in the pie chart as "Other" and include the following Budget Categories: Guest Bathrooms, Major Mechanical, Entrance, Britania Salon, Elevator/Escalator, and Wedding Chapel. As evidenced below, 89% of capital improvements were performed in the Technology, Guestrooms, and Kitchen Budget Categories.

Total Capital Improvements
October 22, 2007-December 31, 2008



We identified several instances in which Budget Category Line Items exceeded the allowed amount by over 15% (Table 2). Additionally, capital expenditures were made in Budget Categories (Table 3) and Line Items (Table 4) outside of the Plan. Furthermore, STQ represented City approval was not sought for some variances to the Plan, as required by the Agreement.

Variances Greater Than 15% Between Line Items

Instances in which Budget Category Line Items exceeded the allowed amount by more than 15% are illustrated in Table 2.

**Table 2
Budget Line Item
Variances Greater Than 15%**

Budget Category	Budget Category Line Item	Amount Allowed per Approved Capital Plan	Amount Allowed plus 15%	Amount Expended	Variance Over Budget
Kitchen	Equipment	\$ 327,250	\$ 376,338	\$ 702,079	\$ 325,741
Guestrooms	Mattress/Box Springs	52,500	60,375	180,091	119,716
Kitchen	Plumbing Installation	40,000	46,000	100,223	54,223
Technology	Hardware	60,000	69,000	117,141	48,141
Technology	Property Management System	135,000	155,250	184,564	29,314
Guestrooms	Linen & Bed Coverings	30,000	34,500	51,206	16,706
Restaurant	Carpet	20,125	23,144	38,744	15,600
Restaurant	Interior Design soft costs	18,824	21,648	31,254	9,606
Guest Bathrooms	Interior Design soft costs	6,994	8,043	12,508	4,465
Queens Salon	Interior Design soft costs	3,423	3,936	4,370	434
Total:		\$ 694,116	\$ 798,234	\$ 1,422,180	\$ 623,946

Included in the Kitchen equipment purchases were \$131,000 in serving dishes, glassware, and silverware and a \$25,000 Southern Pride smoker that we observed during the audit on the Queen Mary premises, in the nearby village across from the ship.

Improvements Made Outside the Approved Capital Plan

Table 3 depicts \$71,387 of capital improvements made in Budget Categories not included in the Plan.

**Table 3
Budget Categories Not On Plan**

Budget Category	Budget Category Line Item	Amount Expended
Grand and Windsor Salons	Carpet	\$ 60,268
Grand and Windsor Salons	Interior Design Soft Costs	4,370
Wedding Chapel	Carpet	6,749
	Total:	\$ 71,387

Table 4 depicts \$120,036 of costs incurred for Line Items not included in the Plan.

**Table 4
Budget Line Items Not on Plan**

Budget Category	Budget Category Line Item Not on Plan	Amount Expended
Technology	Software	\$ 65,305
Guestrooms	Clocks	29,016
Guestrooms	Interior Design Soft Costs	25,015
Guestrooms	Coat Hangers	700
	Total:	\$ 120,036

**Table 5
Summary of Expenses
Exceeding or Excluded from the Plan**

Expenses Exceeding or Excluded	Amount
Table 2: Budget Line Item Variances Greater than 15%	\$ 623,946
Table 3: Budget Categories Not on Plan	71,387
Table 4: Budget Line Items Not on Plan	120,036
Total:	\$ 815,369

Issue #3: There were \$68,400 in duplicate payments and overpayments to vendors for capital improvements. These amounts have since been applied to outstanding invoices as of December 31, 2008 and are included in the \$2,039,000.

While performing fieldwork we identified a \$65,800 duplicate vendor payment for kitchen equipment and an overpayment to a vendor for shipping charges of \$2,600. These amounts have since been applied to outstanding invoices as of December 31, 2008 and are included in the \$2,039,000.

Recommendations

- Issue #1 Devise a comprehensive plan to ensure remaining capital improvements are performed in the amounts and by the dates as defined in the Agreement as listed below:
- Aggregate amount of \$4,300,000 by December 31, 2009
 - Aggregate amount of \$5,300,000 by December 31, 2010
- Issue #2 Obtain advance City approval in writing for variances to the Approved Capital Plan to avoid ambiguity.
- Issue #3 Strengthen internal controls surrounding the processing of capital improvement payments to prevent duplicate payments and overpayments to vendors.

We request the City and STQ advise the City Council and City Auditor as to progress and plans for implementation of the above recommendations in 90 days, six months, and one year from the filing date of this report.

Appendix A
Total Capital Improvements
By Budget Category and Budget Category Line Item
as of December 31, 2008

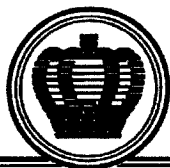
Budget Category	Budget Category Line Item	Budget Amount (per Approved Capital Plan)	Capital Improvement Amount Expended as of 12/31/08	Dollar Variance (Over)/Under Budget	Percent Variance (Over)/Under Budget
Britania Salon	Soft Costs, HVAC	v	1,270.00	v	v
Britania Salon	Soft Costs, Interior Designer	v	6,269.16	v	v
	Britania Salon Total:	\$ 150,001.48	\$ 7,539.16	\$ 142,462.32	95%
Elevator Escalator	Elevator & Escalator Upgrade	50,000.00	3,597.00	46,403.00	93%
	Elevator Escalator Total:	\$ 50,000.00	\$ 3,597.00	\$ 46,403.00	93%
Entrance	Safety Rails & Walking Surface	25,000.00	14,660.00	10,340.00	41%
	Entrance Total:	\$ 180,000.00	\$ 14,660.00	\$ 165,340.00	92%
Grand and Windsor Salons	Carpet	*	60,267.57	(60,267.57)	*
Grand and Windsor Salons	Soft Costs, Interior Designer	*	4,370.03	(4,370.03)	*
	Grand and Windsor Salons Total:	*	\$ 64,637.60	\$ (64,637.60)	*
	Grand Salon Total:	*	\$ 4,370.03	\$ (4,370.03)	*
Guest Bathrooms	Soft Costs, Interior Designer	6,993.90	12,507.73	(5,513.83)	(79%)
	Guest Bathrooms Total:	\$ 600,076.62	\$ 12,507.73	\$ 587,568.89	98%
Guestrooms	Clocks	*	29,016.00	(29,016.00)	*
Guestrooms	Coat Hangers	*	699.85	(699.85)	*
Guestrooms	Door Locks	54,750.00	20,211.65	34,538.35	63%
Guestrooms	Linen & Bed Coverings	30,000.00	51,206.40	(21,206.40)	(71%)
Guestrooms	Mattress/Box Springs	52,500.00	180,091.04	(127,591.04)	(243%)
Guestrooms	Soft Costs, Interior Designer	*	25,015.42	(25,015.42)	*
Guestrooms	Television Sets	127,500.00	95,402.90	32,097.10	25%
	Guestrooms Total:	\$ 900,750.00	\$ 401,643.26	\$ 499,106.74	55%
Kitchen	FF&E, Equipment	327,250.00	702,079.14	(374,829.14)	(115%)
Kitchen	FF&E, Walk-in Cooler	119,000.00	49,467.00	69,533.00	58%
Kitchen	Installation, Plumbing	40,000.00	100,223.10	(60,223.10)	(151%)
Kitchen	Installation, Floor/Deck Repairs	100,000.00	35,249.87	64,750.13	65%
Kitchen	Soft Costs, Permit Fees	3,506.25	796.92	2,709.33	77%
	Kitchen Total:	\$ 806,437.50	\$ 887,816.03	\$ (81,378.53)	(10%)
Major Mechanical	Air Handler Modifications	140,000.00	12,260.25	127,739.75	91%
	Major Mechanical Total:	\$ 500,000.00	\$ 12,260.25	\$ 487,739.75	98%
Queens Salon	Carpet	20,125.00	17,242.06	2,882.94	14%
Queens Salon	Soft Costs, Interior Designer	3,423.13	4,370.04	(946.91)	(28%)
	Queens Salon Total:	\$ 149,933.24	\$ 21,612.10	\$ 128,321.14	86%
Restaurant	Carpet	20,125.00	38,743.89	(18,618.89)	(93%)
Restaurant	Installation, HVAC	10,000.00	5,763.75	4,236.25	42%
Restaurant	Soft Costs, Interior Designer	18,823.95	31,253.98	(12,430.03)	(66%)
	Restaurant Total:	\$ 281,182.79	\$ 75,761.62	\$ 205,421.17	73%
Technology	Software	*	65,305.25	(65,305.25)	*
Technology	Wiring, Antenna & Infrastructure/Networks	45,000.00	13,660.64	31,339.36	70%
Technology	Internet Technology	120,000.00	17,556.41	102,443.59	85%
Technology	Hardware	60,000.00	117,141.15	(57,141.15)	(95%)
Technology	Parking Gates & System	500,000.00	6,171.47	493,828.53	99%
Technology	Point of Sales System	75,000.00	65,875.02	9,124.98	12%
Technology	Property Management System	135,000.00	184,563.74	(49,563.74)	(37%)
Technology	Sales & Catering Software/Hardware	90,000.00	60,233.91	29,766.09	33%
	Technology Total:	\$ 1,125,008.00	\$ 530,507.59	\$ 594,500.41	53%
Wedding Chapel	Carpet	*	6,749.49	(6,749.49)	*
	Wedding Chapel Total:	*	\$ 6,749.49	\$ (6,749.49)	*
	GRAND TOTAL:		\$ 2,039,291.83		

v Approved Capital Plan does not include Budget Category Line Items for the Britania Salon
 * Budget Category and/or Line Item not included in Approved Capital Plan

Appendix B

Management's Response

Save the Queen



THE QUEEN MARY.

Save the Queen, LLC
c/o Garrison Investment Group
1350 Avenue of the Americas
9th Floor New York, New York 10019
212-372-9500 Fax: 212-372-9525

May 29, 2009

Office of the City Auditor
c/o Terra Van Andel, CFE
Audit Manager

Re: Queen Mary Capital Improvements Audit

To City Auditor's Office:

Attached you will find the comments to the Capital Improvements Audit submitted by Hostmark, the management company for Save the Queen, LLC. As you know, Garrison Investment Group was not the acting ownership prior to the period January 28, 2009 and did not have any control over the actions taken by the prior ownership. Having said that, we look forward to being given the opportunity to uphold the City Agreement, as it pertains to the capital expenditures. We have provided a plan to the City of Long Beach to satisfy the obligations under the City Agreement for 2008 and 2009 by year end 2009. We are also in the process of formalizing a process where variances and duplicate payments will be prevented in the future. We look forward to a continued partnership with the City of Long Beach and maintaining the integrity of the Queen Mary as one of Long Beach's greatest assets.

Please feel free to contact me with any questions or concerns.

Andy Kwon
Vice President
Garrison Investment Group
c/o Save the Queen, LLC

RESPONSE TO AUDIT COMMENTS
Management STQ

1: On page 9 of the audit it states that the approved amount for the Kitchen was exceeded by 41% and that approved Kitchen budget was exhausted without addressing several Line items within the Budget Category. The City's Inspection Department's records will show this is inaccurate. When STQ purchased the Leasehold from RMS there were at least 25 items that were deemed health code violations and were the reason that the line items in the original 'approved' budget were listed: i.e. Floor Deck repairs; Painting and Decorating; Plumbing; Electrical; Mechanical/HVAC and Technology upgrades. All of these items were fixed and the Kitchen received a 100% passing report from the City Inspectors prior to February, 2008. All of these items were done by the Queen Mary Engineering Staff. Hostmark approved the purchase of \$636,292 in kitchen equipment, merely doing what was necessary to improve the Queen Mary Food Service department with monies saved from not having to outsource the Floor Deck repairs; Painting and Decorating; Plumbing; Electrical; Mechanical/HVAC and Technology upgrades. (Of note is that the only budget Hostmark has shows \$446,250 listed in FF&E for the kitchen; not \$327,250. Hostmark has no document with \$327,250 in its possession.)

2: In May, 2008, Hostmark met with the Managing Director of STQ and associates of jBrice, the Designer. At this meeting presentations were made which were to be submitted to the City for its approval by June 4. According to the Renovations Agreement any modifications to the Original approved budget required City approval. Scott Whyte reported to Hostmark in July that all City approvals had been granted to the renovations plan and Decorators design and Hostmark was free to approve the Designer to bid the FF&E. The Design work included the shift in focus to the Grand and Windsor Salon's and elimination of any renovation to the Britannia and Exhibition Hall because of all the loss of revenue in the Grand and Windsor venues. Additionally more focus was needed on the Wedding Chapel based on loss business reports. Having been told that the City had approved the color boards, which showed the work to be done in the Grand, Windsor, Wedding Chapel, as well as the guestrooms themselves, Hostmark proceeded to submit draws to STQ for the scope of work contained in the designs.

3: The original budget assumed replacing 1/3 of the mattresses each year at an approximate cost of \$52,500 per year. Ownership and Management had been told by RMS that all mattresses were new from 2000. After the closing Hostmark determined that only 36 new mattresses were purchased in 2000 and that the rest of the mattresses were over 20 years old. Since many potential guest demand generators had blackballed the Queen Mary because of the mattresses, all new mattresses were purchased to cover all of the inadequate mattresses. Additionally the rooms had little flair, so I-Pod docking clock radios similar to those of a Hyatt standard were purchased to give the sales department something to highlight when trying to sell the rooms. No one disagrees that this should have been submitted to the City for their approval, however Hostmark was working on the premise that it had \$900,000 in the guestroom 'category' and proceeded on that basis.

4: The property management system, which is a part of \$1,125,000 in the Technology category was upgraded to provide for services that didn't exist in September 07 when the original budget was created and presented to STQ Ownership and the City of Long Beach. Hostmark agrees that the variance exceeds 15%, but the value of the installed system far surpasses that which could be purchased for the lesser sum. The same issue applies to the Property Management System Hardware, in that every hotel department aboard the Queen Mary required new hardware and that wasn't anticipated during the initial analysis.

5: On page 8 at the bottom it states: Included in the Kitchen equipment purchases was a \$25,000 Southern Pride smoker that is currently stored in the nearby village and \$131,000 in serving dishes, glassware, and silverware. Building permits were requested for the Southern Pride Smoker use. After installation the requirements for building a new building were cost prohibitive, so use was stopped, except for permitting for special events. These special events generate revenue to the ultimate benefit of the City of Long Beach. It is not stored in the nearby village.

IN SUMMARY: all of the dollars expended in the \$1,971,000 were expended to the benefit of the Landlord and were within the tolerances allowed for 'categories'. None of these observations is being presented by management to indicate that the City of Long Beach was remiss in the process, but rather to insure that everyone is fully advised of the good faith exhibited by STQ and its agents in the renovation process.



Date: June 1, 2009
To: Andy Kwon, Vice President, Garrison Investment Group
From: Laura L. Doud, City Auditor *ld*
Subject: Queen Mary Capital Improvements Draft Audit Report - Save the Queen Management Comments

Thank you for your response to the Queen Mary Capital Improvements Audit draft report. We have reviewed your response and made adjustments to the draft report based on comments #1, 2, & 5. In addition, we would like to take this opportunity to provide clarification regarding other comments included in your response.

Subsequent to our distribution of the draft report for management comments, Hostmark provided evidence of the application of both the duplicate payment and overpayment as well as evidence of a recent payment towards an outstanding invoice from 2008. Therefore, we have adjusted the numbers throughout our report to reflect this activity.

Office of the City Auditor (OCA) Response to STQ Response #1:

In Table 2 on page 8 of the report, we refer to an amount allowed per the Approved Capital Plan (Plan) for Kitchen Equipment of \$327,250. This amount represents the Equipment line item budget of \$275,000 plus \$52,250 for the 19% allowance for sales tax and estimated freight as allowed by the Plan. The \$446,250 includes the Walk-In Cooler budgeted amount, including sales tax and estimated freight of \$119,000. See the table below for details.

Per the Approved Capital Plan			
Furniture, Fixtures, & Equipment	Budgeted Amount	Sales Tax & Freight	Total
Equipment	\$275,000	19%	\$327,250
Walk-in Cooler	\$100,000	19%	\$119,000
Total	\$375,000		\$446,250

OCA Response to STQ Response #2 & #4:

We state in our report that City approval was not sought for some variances to the Plan. It is ultimately the City's decision whether to allow expenses that exceeded or were excluded from the original Plan.

OCA Response to STQ Response #3:

Per the Plan, the total budget for Guestrooms is \$900,750, of which \$52,500 was specifically earmarked for Mattress/Box Springs. As stated above, it is the City's decision whether to include expenses that exceeded or were excluded from the original Plan.

June 1, 2009

Page 2

OCA Response to STQ Response #5:

During our audit, we physically observed the Southern Pride smoker on the Queen Mary premises, in the village located across from the ship.

cc: Jay Primavera, General Manager, Hostmark
Suzanne Frick, Assistant City Manager
Dennis J. Thys, Director of Community Development
Charles Parkin, Principal Deputy City Attorney
Amy Bodek, Manager, Redevelopment Bureau
Victor S. Grgas, Manager, Property Services Bureau

Appendix C

Management's Response

City of Long Beach



Date: May 19, 2009
To: Laura L. Doud, City Auditor
From: Dennis Thys, Director, Department of Community Development
Craig Beck, Director, Development Services Department
Subject: Response to Queen Mary CIP Audit Comments

A handwritten signature in black ink, appearing to be "Dennis Thys", written over the "From:" field.

Thank you for the opportunity to review the draft audit report and the Response to Comments provided by the City's tenant, Save the Queen (STQ), LLC.

In general, we are in concurrence with the comments provided by STQ that the expenditures incurred to date meet the spirit and intent of the requirements in the City Agreement (i.e., to provide certain capital improvement upgrades to enhance the guest experience and generate additional operational revenue). We are, however, disappointed that STQ deviated from the Approved Capital Plan without obtaining the required City approvals. As such, we are prepared to reaffirm the approval processes and to require additional communication between STQ and the City to prevent further unauthorized deviations. It is also strongly suggested that STQ management institute internal controls with its selected operator, Hostmark, to prevent further deviations, and to provide proper oversight of these expenditures.

With respect to details of the draft Auditor Report, we believe that the following variances do not meet the spirit and intent of the Approved Capital Plan and we would respectfully request they be disallowed:

1.) Table 2—Variances Greater Than 15%

Interior Design Soft Costs for:

a. Guest bathrooms	\$ 5,514
b. Restaurant	\$12,430
c. Queen's Salon	<u>\$ 947</u>
	\$18,891

2.) Table 4—Budget Line Items Not on Plan

Guestrooms:

a. Clocks	\$29,016
b. Interior Design Soft Costs	\$25,015
c. Coat Hangers	<u>\$ 700</u>
	\$54,731

Thank you, again, for the opportunity to provide these comments. Please do not hesitate to contact Victor Grgas at extension 8.6705, or Amy Bodek at extension 8.6479, should you have any questions.

