



OFFICE OF THE CITY AUDITOR

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GARY L. BURROUGHS, CPA
City Auditor

February 7, 2006

Mr. Gerald Miller
City Manager

Mr. Michael Killebrew
Director of Financial Management

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

Mr. Patrick West
Director of Community Development

We have conducted a review of contract compliance and internal controls related to the City's Lease and Operating Agreements with Long Beach Museum of Art Foundation (the "Foundation") for the management and maintenance of the City's museum and artwork. The City's art collection includes over 2,000 pieces as well as over 3,000 artists videos and is valued in excess of \$10 million. We also reviewed contracts and agreements related to the issuance of \$3 million in bonds by the Long Beach Bond Finance Authority to assist the Foundation in completing a museum renovation and expansion project that included construction of a new museum building and renovation of two existing buildings. The purpose of the review was to determine the adequacy of internal controls and compliance with agreements.

Based on the review performed, we have concluded that security over City assets to ensure proper protection and preservation of the assets requires improvement. In addition, a complete database of artwork and videos should be completed and maintained on an ongoing basis. As of our review, 1,548 objects from the City's collection of over 2,000 had been entered into the Foundation's database system. The City's video collection, considered "internationally world-renowned", has not been inventoried, catalogued, or copied since the collection was acquired prior to 1985. Additionally the works have not been shown in five years; as such, we believe immediate action should be taken to address this collection. It is based on these findings, and others within this report that we have concluded that the Foundation has not fully complied with the terms of their agreements with the City for the operations and maintenance of the collection.

In addition, the Foundation has violated their Pledge Agreement to the City by utilizing \$670,000 derived from their capital campaign (and required for the repayment of bonds secured by the City) to fund operations. The Foundation has used funds from this

account over the last four years without obtaining written approval from the City and without developing a plan to restore these funds.

Other control weaknesses and recommendations for improvement were identified during our review and are detailed in the body of this report.

Sincerely,

GARY L. BURROUGHS, CPA
City Auditor

A handwritten signature in black ink, appearing to read 'Janet Sutter', written over a faint, illegible printed name.

By: Janet Sutter, CIA
Deputy City Auditor

Audit Staff: Janet Sutter, Deputy City Auditor
Neil Escalante, Senior Auditor

BACKGROUND

The Long Beach Municipal Art Center was established in 1950 as a City-operated municipal art facility. In 1985, the City formed a public-private partnership with the Long Beach Museum of Art Foundation (the "Foundation") for the management and maintenance of the City's museum. In exchange, the City agreed to provide a base level of support to the Foundation annually, with the amount subject to approval by the City Council. Since 1999 the contract has been split into two agreements, a Lease Agreement for the property and an Agreement to Manage Art Collection. The Lease Agreement provides for annual rent of \$100 per year. The Agreement to Manage Art Collection outlines the Foundation's obligations to provide management services in relation to the City's art collection and for the annual monetary support by the City. The annual monetary support of the Foundation for the last 5 years has been as follows:

<u>Fiscal Year</u>	<u>Annual Support</u>
2001	\$319,000
2002	\$334,000
2003	\$645,585
2004	\$571,000
2005	\$569,000

City monetary support provided to the Foundation currently represents about 20-25% of their total revenues each year. The Foundation's obligations under the Agreement to Manage Art Collection with the City are to adequately insure, store, register, document, exhibit, and conserve the City's collection.

In 1999, the Foundation requested that the City assist them in securing financing for a \$6.5 million expansion and renovation project. The project budget was estimated to be \$6.5 million and, at the time, the Foundation had secured pledges totaling about \$3.4 million. In October 1999, the Long Beach Bond Finance Authority issued tax exempt, variable rate lease revenue bonds in the amount of \$3.06 million. The bonds were structured with a 10 year maturity and the deal included a Pledge Agreement by the Foundation to raise monies for the future redemption of these bonds.

The City's Parks, Recreation, and Marine Department (PRM) was responsible for oversight and administration of this contract until the Lease Agreement and Agreement to Manage Art was transferred to the Community Development Department in August 2005.

FINDINGS & RECOMMENDATIONS

- 1. The Foundation has violated their Pledge Agreement with the City by utilizing funds derived from their Capital Campaign for payment of operating expenses. The Foundation has not obtained written approval from the City nor have they devised a plan of action to ensure the funds are restored.**

In October 1999 the Long Beach Bond Finance Authority issued tax-exempt, variable rate lease revenue bonds in the amount of \$3.06 million to assist the Foundation in completing a renovation and expansion project. The bonds were structured with a 10 year maturity (with principal payable in 2009). While the City is responsible for payment of the bonds, the deal included a Pledge Agreement between the Foundation and the City of Long Beach. The Pledge Agreement states that the Foundation will deposit 50% of monies collected through their Capital Campaign into a Pledged Account to be spent as follows: (1) to pay interest/expenses of the bonds, (2) to pay costs of the improvements in an amount not to exceed \$1 million, and (3) to prepay base rental payments on behalf of the City (i.e. to be applied to redemption of the bonds). The intention and expectation of the parties to this transaction was that when the bonds were payable in 2009, the Foundation would have raised sufficient monies to pay for the bonds in full. Financial statements of the Foundation for fiscal year 2000 outlines the intent of the parties and even includes a schedule for annual payments to the bond redemption account. Subsequent financial statements continue to include information on the intent of the parties to have total principal and interest payments on the bonds be covered by monies raised through the capital campaign; however, the schedule for payments to the bond redemption account is no longer included.

Review of Foundation accounting records indicate a total of \$5.5 million has been collected through Capital Campaign efforts as of September 2004. Of that, \$3.8 million has been spent towards the capital project, leaving a balance of about \$1.6 million. According to these records, \$670,000 has been "borrowed" from these funds to pay for operations over the last several years. While the Foundation obtained letters from donors approving the temporary use of these funds for operations; they have not obtained written approval from the City of Long Beach for the diversion of funds and have not devised a plan for return of the funds.

Recommendation:

We recommend that City management meet with Foundation management immediately to address this issue and devise a plan for resolution

Management Response:

Management concurs that the Foundation has violated their Pledge Agreement. The City had previously been notified of this violation and, consistent with the Pledge

acknowledged and concurred with the Foundation that, post 9-11, charitable giving was significantly redirected to recovery efforts in New York, seriously affecting the Foundation's budget. City and Foundation recognized the need to use these funds, with the full intent of repayment over time, and compliance with the Foundation's obligation to fund the Bond payment in 2009. City and Foundation staff have identified a need to devise a plan for repayment and, in the near term, intend to establish a plan to achieve this goal.

2. City assets stored offsite are not properly secured and cared for to ensure protection from theft and/or deterioration. Controls over security of on-site storage facilities should be improved.

The operating agreement between the City and the Foundation requires all City owned art to be stored in the on-site storage facility; however, some City owned art objects and the City's entire video collection are stored in an off-site facility.

The off-site storage facility is not adequately secured and is not equipped with proper climate controls for protection of the art objects and videos. The off-site storage facility consists of a fenced off area within an industrial warehouse. The area is accessible to anyone in the warehouse. There are limited records as to the location of art objects and both the art objects and the videos are not arranged in any order within the storage area.

Records related to the keys and alarm codes for access to both the museum and the on-site storage area should be improved. Codes and locks are not changed upon employee termination and spare keys are not properly accounted for and secured.

PRM staff have not inquired and/or observed assets to determine that security and protection provided is satisfactory and in compliance with the current lease and operating agreements.

Recommendation:

City management should review these weaknesses with Foundation management and seek to resolve these issues. Any offsite storage should be at a warehouse appropriate for fine art storage and designed to secure and protect art objects.

Management Response:

Management concurs with the Auditor's recommendation. Staff will confer with the Foundation to review existing controls, the adequacy thereof, and improvements thereto. Management believes that pursuing these efforts will adequately address the Auditor's recommendation. City Council recently approved an agreement with the Getty Museum for transfer of the video art collection to the Research Library at the Getty Research Institute. The Institute will restore and transfer the tapes to a stable format.

- 3. The City's internationally renowned video collection, including over 3,000 items, has not been inventoried, catalogued, or copied. In addition, the videos have not been shown in five years.**

Review of the Museum Accreditation Self Study document and discussion with Foundation staff noted that the City's permanent collection is augmented by the "largest collection of artists videotapes in the country". The "internationally renowned" collection includes over 3,000 works. Since acquisition of these works, there has not been an adequate effort made to inventory, catalog or copy the works. In addition, the works have not been shown in five years, as required by the lease agreement.

Recommendation:

City management should review these weaknesses with Foundation management and develop controls to periodically monitor compliance with contract terms and requirements for the protection of City assets.

Management Response:

Management concurs with the Auditor's recommendation that contract compliance requires monitoring. Foundation staff advise that many videos are not in a format that allow them to be viewed. Those videos that are in a proper format for viewing have experienced a degradation of video quality as a result, compelling the Foundation to limit viewing in order to preserve the collection. To address these limitations, City and Foundation staff are working to complete a transfer of the video collection to the J. Paul Getty Trust. This would result in the secured and environmentally static storage of the collection, while allowing the Foundation access to the collection for exhibition purposes and sharing equally with the Foundation in any profits generated as a result of the commercial use of the collection. Management believes that pursuing this effort will adequately address the Auditor's recommendation.

- 4. Since the Foundation took over operations a complete database of artwork with their respective locations has not been completed and maintained. The Foundation has entered 1,548 of over 2,000 objects into an inventory system.**

The Agreement between the City and the Foundation requires that the Registration Office maintain location records on each piece of artwork. The Foundation's collections management policies require the creation of an itemized list of objects that identifies each object's physical location. In 1998 the Foundation purchased an inventory software system with grant funds provided by the Getty Museum; however, as of May 2005, a complete database of items had not been created.

Recommendation:

City management should require that the Foundation make this a priority. A complete database with object location should be created and controls should be implemented to ensure maintenance of this database system.

Management Response:

Management concurs with the Auditor's recommendation. Foundation staff have indicated that its staff time have been appropriately allocated to completion of the database as evidenced by the inputting of nearly 80% of the City's collection. City and Foundation staff shall continue to work diligently to complete and maintain the database system.

5. **Annual asset inventories of the City's collection are not always completed and returned as required. Discussion with Foundation staff and review of documentation related to the loss of two pieces of artwork indicate that staff certifying the annual inventory listings may not actually be physically inspecting the objects listed. Discussion with City staff responsible for obtaining the annual inventories indicated that no follow-up has been performed.**

City policies and procedures require annual inventory of City assets. Assets are classified into two categories, assets over \$5,000 and assets under \$5,000. PRM staff have sent inventory listings to the Foundation each year and requested that an inventory be performed and certified on the listing and returned to staff. Review of these inventory requests and discussion with Foundation management indicated the following:

- The Foundation had not performed the required annual inventory of assets under \$5,000 for the years 2003 and 2004.
- Foundation staff indicated that to perform a complete physical inspection of all assets is too cumbersome as most objects are individually wrapped and sealed inside crates.
- Review of Foundation documentation surrounding the loss of two pieces of artwork owned by the City noted that the items had been "certified" in an annual inventory; however, staff responsible for the certification had later indicated that a physical inspection was not actually performed.

PRM staff failed to follow-up on these requests for inventory certification. Additionally, revisions to the inventory listing made by Foundation staff are not updated in the system by PRM staff.

Recommendation:

City management should work with Foundation management to develop reasonable expectations and procedures for the periodic physical inventory of assets. Staff

responsible for contract oversight should ensure that inventories are returned and changes to the inventory system reflected in the City system. Management should consider having City staff perform periodic inventories of City assets.

Management Response:

Management concurs that development of reasonable procedures for periodic inventory of assets is appropriate. While the annual asset inventory is not required under the Agreement to Manage Art Collection, a City policy does require an annual inventory of City assets. While it is clearly the obligation of the Foundation to comply with inventory requirements, it is equally clear to Management that the Foundation is inadequately staffed to perform an annual inventory audit due to budgetary constraints. As a result, staff will work with Foundation to develop reasonable and responsible inventory controls and periodic inspections to ensure the security and protection of City's assets.

6. Required annual reports and budgets are not prepared and submitted to the City.

According to the lease agreement, the Foundation is required to submit the following reports each year:

- Annual report of museum activities, goals and objectives met during the previous year, including statistics on the number of visitors and volunteers and all fees charged for uses of the premises.
- Annual budget for the operation and maintenance of the premises.

These reports have not been prepared or submitted. Staff responsible for contract oversight have not performed follow-up to obtain these reports.

Recommendation:

City management should develop procedures to ensure required reports are submitted and reviewed by staff.

Management Response:

Management concurs with the Auditor's recommendation. City staff have met with the Foundation on a number of occasions beginning on July 13, 2005 to discuss, among other items, annual reporting to the City. On October 25, 2005, as required in the Agreement to Manage Art Collection, the Foundation submitted its Annual Report for fiscal year ending September 30, 2005, including a financial report. City staff will continue to monitor performance to ensure compliance.

7. **The cost of property insurance provided by the City (\$6,897 per year) is not passed on to the Foundation as indicated in the Agreement. In addition, City staff responsible for contract oversight have not performed reviews to ensure that the Foundation is providing adequate coverage as required by the Agreement.**

The lease agreement states that the Foundation shall maintain, at its cost, property insurance or that, at the option of the City, the City may include this property insurance in its general property insurance program, in which case, the Foundation "...shall pay the proportion of premium costs applicable to the property insurance required..."

Discussion with staff responsible for oversight of this contract noted the following exceptions:

- Staff was not familiar with the insurance requirements of this contract (which include property insurance, worker's compensation insurance, Fine Arts insurance, and an Honesty Bond). As such, staff had not obtained copies of insurance policies and reviewed them for sufficiency.
- The proportionate cost of property insurance charged to PRM for museum buildings (\$6,897) is not passed on to the Foundation as required by the lease agreement.

Recommendation:

Management should develop procedures to ensure reviews are performed to verify adequate insurance is obtained as required by the agreements. In addition, management should ensure that costs are passed on to the Foundation for insurance provided through the City's policies.

Management Response:

Management concurs with the Auditor's recommendation that procedures to ensure periodic review of insurance adequacy be implemented. Additionally, City staff will ensure that the proportionate allocation of property insurance expense be reimbursed by the Foundation.

8. **The City and the Foundation should agree as to a reasonable frequency for obtaining updated appraisals of artwork. The agreement requires annual updates of value; however, an appraisal has not been performed since 1999 and these appraisals are prohibitively expensive.**

The Agreement between the City and the Foundation to manage the art collection indicates that the City "will provide a current appraisal of value...and the Foundation will conduct annual reviews to update values." An appraisal of all of the City's significant artwork was performed in 1999; however, no appraisals have been performed since that time and values have not been updated. The Foundation has indicated that appraisals

are too costly to have performed annually but did not indicate that any periodic schedule has been set for updating appraised values.

Recommendation:

City management and the Foundation should agree as to a reasonable frequency for obtaining appraisals of City artwork.

Management Response:

Management concurs with the Auditor's recommendation to determine and agree upon a reasonable frequency for appraising the City's collection.