



OFFICE OF THE CITY AUDITOR
Long Beach, California

LAURA L. DOUD, CPA
City Auditor

May 24, 2011

HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

RECOMMENDATION:

Receive and file the attached Queen Mary Capital Improvements Audit Phase III.

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 to the Queen Mary through December 31, 2010 in exchange for the City's waiver of percentage rent under the lease. The agreement required STQ to complete these capital improvements in minimum increments over three years as follows:

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

Our previous audits of the Queen Mary Capital Improvements Program, issued in June 2009 and August 2010, covered the first and second incremental periods. The attached audit, dated May 24, 2011, addresses the agreement's final incremental period of April 1, 2010 through December 31, 2010, requiring completion of the final aggregate amount of \$5,300,000 in capital expenditures.

According to our audit, STQ completed \$1,542,000 of capital improvements during the period examined, bringing the total aggregate amount expended to \$5,524,000 through December 31, 2010, thereby exceeding the required amount by \$224,000.

The details of our audit can be found in the attached report, along with the response of STQ and City Management.

HONORABLE MAYOR AND CITY COUNCIL

May 24, 2011

Page 2

We would like to commend STQ for their efforts to enhance the guest experience and improving the Queen Mary while maintaining its historical significance and physical integrity. Furthermore, we appreciate the time, information, and cooperation provided to us by STQ during the audit.

TIMING CONSIDERATIONS:

This item is not time-sensitive.

FISCAL IMPACT:

Approving this action would have no fiscal impact.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,



Laura L. Doud, CPA
CITY AUDITOR



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

**Queen Mary Capital Improvements
Audit Report
Phase III**

May 2011

**Laura L. Doud, CPA
City Auditor**

Office of the City Auditor

Audit Report

**Queen Mary
Capital Improvements Audit
Phase III**

May 2011



Audit Staff

City Auditor: Laura L. Doud
Assistant City Auditor: Deborah K. Ellis
Deputy City Auditor: Terra Van Andel
Senior Auditor: Jessica Machado
Staff Auditor: Richard Araiza

Table of Contents

Executive Summary	1
Background	1
Objective, Scope and Methodology	2
Audit Results	3
STQ completed an aggregate amount of \$5,524,434 in capital improvements, exceeding the required \$5,300,000 by \$224,434.....	3
Management's Response	
Save the Queen.....	Appendix A
City of Long Beach.....	Appendix B

Executive Summary

We recently concluded our third 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 Agreement required STQ to complete, in increments, \$5,300,000 in approved capital expenditures by December 31, 2010.

The purpose of our audit was to ensure capital improvements were made in compliance with the Agreement during the final incremental period of April 1, 2010 through December 31, 2010, which includes determining if STQ performed the total required \$5,300,000 in approved capital expenditures. Our audit identified that STQ completed an aggregate amount of \$5,524,434 in capital improvements, exceeding the required \$5,300,000 by \$224,434.

We would like to commend STQ for their efforts to enhance the guest experience and improving the Queen Mary while maintaining its historical significance and physical integrity. Furthermore, we appreciate the time, information, and cooperation provided to us by STQ during the audit.

Background

In November 2007, the City signed the Agreement with STQ in which STQ agreed to make \$5,300,000 of capital improvements, as set forth in the Approved Capital Plan (Plan), to the Queen Mary through December 31, 2010, in exchange for the City's waiver of percentage rent under the Master Lease. The Agreement required STQ to complete the capital improvements in minimum increments over three years as follows:

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 Plan was developed based on a preliminary review of work to be performed and with the intent to enhance visitors' experiences on the Queen Mary, ultimately increasing revenues. Twelve budget categories (Budget Category) were established within the Plan and at the time it was understood that actual costs of improvements may vary from estimated budgeted amounts with City approval.

In January 2010, STQ received City approval for a reallocation of funds among Budget Categories. The reallocation of renovation amounts enabled STQ to target improvements specifically to enhance the guest experience aboard the Queen Mary as an attraction and hotel, while maintaining its historical significance and physical integrity.

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 \$5,300,000 in approved capital expenditures by December 31, 2010. Phase I and Phase II audits covered the period of October 22, 2007 through March 31, 2010. The scope of this audit, Phase III, was defined as the period from April 1, 2010 to December 31, 2010.

While conducting the audit, we performed the following procedures:

- Reviewed the Agreement, the Plan, and the 2010 revised budget to gain an understanding of the requirements and expectations of the approved capital expenditures;
- Gained an understanding of internal controls surrounding the processing of payments and invoices for capital improvements made in conjunction with the Agreement;
- Obtained, reviewed, and scheduled copies of invoices and cancelled checks related to capital improvements made in conjunction with the Agreement during April 1, 2010 through December 31, 2010;
- Obtained and reviewed copies of vendor contracts related to capital improvements during April 1, 2010 through December 31, 2010 and confirmed the services performed and payments received;
- Observed capital improvements completed in conjunction with the Agreement on a sample basis;
- Identified partial payments made to vendors for capital improvements made as of December 31, 2010, in conjunction with the Agreement; and
- Identified whether capital improvements made as of December 31, 2010, met the required minimum aggregate amount of \$5,300,000 in approved capital expenditures as defined in the Agreement.

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.

Audit Results

STQ completed an aggregate amount of \$5,524,434 in capital improvements, exceeding the required \$5,300,000 by \$224,434.

Per the Agreement, STQ committed to performing \$5,300,000 of approved capital expenditures to the Queen Mary by December 31, 2010. Our audit revealed that STQ completed a cumulative amount of \$5,524,434 in capital improvements as of December 31, 2010, exceeding the required amount by \$224,434. Table 1 depicts a summary of completed improvements by Budget Category as of December 31, 2010.

The completed capital improvements total of \$5,524,434 represents actual expenditures for improvements as of December 31, 2010, that have been paid and performed/received. During our audit, we identified an additional \$130,363 in services and/or products received that were excluded from the capital improvement total. This included \$111,167 of services and/or products received for which no payment had been made as of December 31, 2010. We also observed \$19,196 of items such as lamps, frames and display boards that have been residing in storage since the prior Phase II audit (as of March 31, 2010) and were not being utilized.

Furthermore, STQ represents additional improvements were performed during the audit period that are not reflected in the totals discussed above. However, because complete documentation for those improvements was not provided during the audit and amounts could not be substantiated, we excluded these items from total capital improvements.

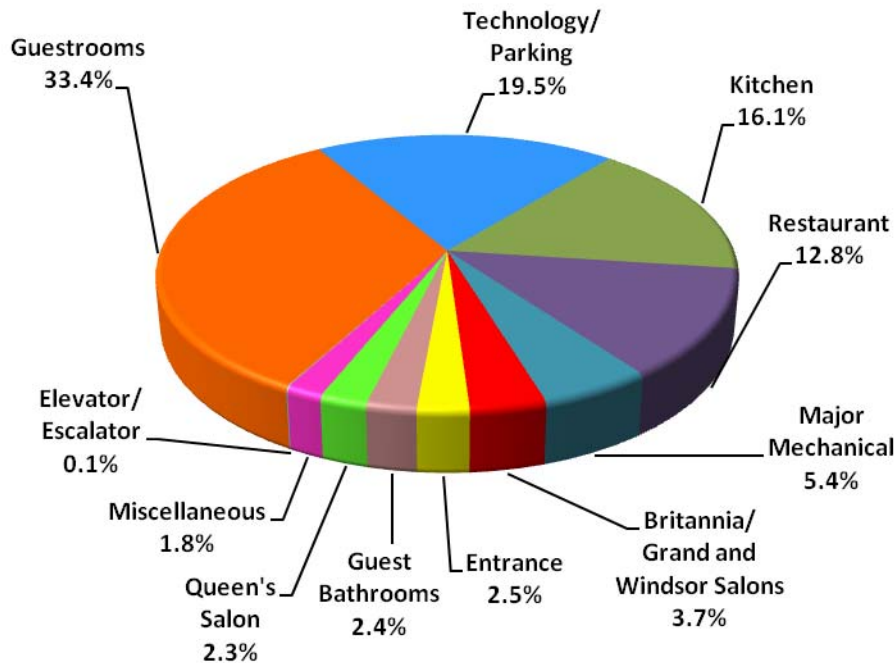
**Table 1
Total Capital Expenditures**

Budget Category	Capital Expenditures 10/22/07 - 12/31/08	Capital Expenditures 01/01/09 - 03/31/10	Capital Expenditures 04/01/10 - 12/31/10	Total Aggregate Amount as of 12/31/10
Guestrooms	\$ 346,912	\$ 717,657	\$ 782,142	\$ 1,846,711
Technology	530,508	512,744	33,135	1,076,387
Kitchen	887,816	-	-	887,816
Restaurant	63,332	372,388	271,446	707,166
Major Mechanical	12,260	-	286,200	298,460
Britannia/Grand and Windsor Salons	72,177	131,969	-	204,146
Entrance	14,660	45,174	78,890	138,724
Guest Bathrooms	6,994	73,813	53,330	134,137
Queen's Salon	20,665	90,951	16,243	127,859
Miscellaneous	6,749	72,493	20,189	99,431
Elevator/Escalator	3,597	-	-	3,597
Totals:	\$ 1,965,670	\$ 2,017,189	\$ 1,541,575	\$ 5,524,434

Note: The Budget Category for Exposition Hall was not included in Table 1 because no expenditures were performed in this Budget Category.

The pie chart below illustrates all capital improvements made from October 22, 2007 through December 31, 2010, by Budget Category. As evidenced below, 82% of capital improvements were performed in the Guestrooms, Technology/Parking, Kitchen, and Restaurant Budget Categories.

Total Capital Improvements
October 22, 2007 - December 31, 2010



As stated above, capital improvements were to be performed within specified Budget Categories. Table 2 illustrates how improvements were performed in comparison to the budgeted amounts per the reallocation approved in January 2010. While improvements performed were over or under amounts allowed in nearly each Budget Category, City management represents they were in communication with STQ regarding their plan for improvements and that the improvements met the intent to enhance the Queen Mary experience.

**Table 2
Budget vs. Actual**

Budget Category	Revised Budget Category	Capital Expenditures as of 12/31/10	Variance Over (Under) Budget
Queen's Salon	\$ 127,250	\$ 127,859	\$ 609
Britannia/Grand and Windsor Salons	205,982	204,146	(1,836)
Exposition Hall	46,935	-	(46,935)
Guestrooms	1,672,072	1,846,711	174,639
Guest Bathrooms	99,995	134,137	34,142
Kitchen	906,316	887,816	(18,500)
Restaurant	545,364	707,166	161,802
Technology	1,109,676	1,076,387	(33,289)
Entrance	91,867	138,724	46,857
Major Mechanical	317,560	298,460	(19,100)
Miscellaneous	173,386	99,431	(73,955)
Elevator/Escalator	3,597	3,597	-
Totals:	\$ 5,300,000	\$ 5,524,434	\$ 224,434

Appendix A

Management's Response

Save the Queen

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

April 28, 2011

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

Re: Queen Mary Capital Improvements Audit Phase III

To City Auditor's Office:

Thank you for the opportunity to respond to the draft audit report. We are pleased that our continued commitment to the Queen Mary is evident in the audit results. As your report noted, there were additional improvements that were not reflected in the audit. Since STQ had satisfied its obligations to the City, we believe it is in the best interest of all parties to close the audit and move forward.

STQ encourages all members of the community and elsewhere to visit the Queen Mary to see the positive changes that have taken place. We look forward to continuing our progress and building upon our strong partnership with the City of Long Beach.

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




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

Appendix B

Management's Response

City of Long Beach



Date: April 26, 2011
To: Laura L. Doud, City Auditor
From: Michael P. Conway, Director, Department of Public Works 
Subject: Response to Queen Mary Phase 3 CIP Audit Comments

Thank you for the opportunity to review the draft Queen Mary Capital Improvements Phase III Audit. We are in general concurrence with the audit findings and results. We greatly appreciate your efforts and that of your staff in this regard.

We likewise look forward to working with the City's tenant, Save the Queen (STQ), LLC on continuing additional improvements to the Queen Mary that will further enhance the guest experience and help to preserve and restore this important historic City asset for future generations to enjoy.

Please do not hesitate to contact Victor Grgas, Asset Management Bureau Manager at extension 8.6705 should you have any questions.