

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**LACK OF MANAGEMENT CONTROLS AND
SELF-GENERATED REVENUE HAS LED TO
THE CALIFORNIA EXPOSITION AND
STATE FAIR'S LACK OF FISCAL INDEPENDENCE**

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL

P-490

LACK OF MANAGEMENT CONTROLS AND SELF-GENERATED
REVENUE HAS LED TO THE CALIFORNIA EXPOSITION
AND STATE FAIR'S LACK OF FISCAL INDEPENDENCE

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Auditor General

January 10, 1986

P-490

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the operations of the California Exposition and State Fair (Cal Expo). Poor management controls have contributed to Cal Expo's inability to become financially independent. Specifically, Cal Expo does not have an adequate fiscal reporting system, does not follow proper contracting procedures, does not control its assets to prevent loss or theft, does not follow a program of regular maintenance to prevent its facilities from deteriorating into a state of disrepair, and does not fully promote the rental of its facilities during the period between fairs. However, even if Cal Expo's management corrects the foregoing deficiencies, Cal Expo may not attain self-sufficiency and may continue to require additional financial support.

Respectfully submitted,

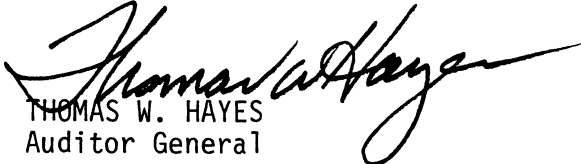

THOMAS W. HAYES
Auditor General

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SUMMARY

The California Exposition and State Fair (Cal Expo) has not been financially self-sufficient and will probably not become financially self-sufficient if it relies on historical sources of income. In fiscal year 1984-85, Cal Expo needed \$1.75 million from the State's General Fund to meet its expenditures. To become financially self-sufficient, Cal Expo must increase its revenues, especially considering that Cal Expo's current repair needs alone total \$4.6 million. To increase its revenues, Cal Expo has recently been pursuing several other alternatives such as simulcast horse races and swap meets. Furthermore, two prime sources of additional revenue are leasing and selling some of the Cal Expo property.

Cal Expo's budget for fiscal year 1984-85 was approximately \$11.54 million, approximately \$1.75 million of which it received from the State's General Fund. Cal Expo's poor management controls have contributed to its failure to become self-sufficient. For example, Cal Expo does not have an adequate fiscal reporting system, does not follow proper contracting procedures, does not control its assets to prevent loss or theft, does not follow a program of regular maintenance to prevent its facilities from deteriorating into a state of disrepair, and does not fully promote the rental of its facilities during the period between fairs. However, even if Cal Expo's management corrects the foregoing deficiencies, Cal Expo may not attain self-sufficiency and may continue to require additional financial support.

Poor Management Controls

Although state law requires Cal Expo to work toward a goal of fiscal independence from the State's General Fund, Cal Expo has not yet achieved this goal but continues to rely on the General Fund. If Cal Expo is to become be fiscally independent, its operating revenues

must exceed its operating expenses. For fiscal year 1984-85, Cal Expo had a \$1.45 million operating deficit. Cal Expo's poor management controls have contributed to its inability to achieve fiscal independence.

Some of Cal Expo's financial problems can be attributed to the fact that Cal Expo does not have a fiscal reporting system that provides adequate information for effective fiscal management. For example, for fiscal years 1982-83 and 1983-84, Cal Expo did not have records of budgeted and actual expenditures. These records could provide accurate and timely information to management to control expenditures. Although Cal Expo began maintaining records of budgeted and actual expenditures during fiscal year 1984-85, these records were inaccurate because staff did not encumber approximately \$570,000 in expenditures related to contracts and purchases of goods and services. Because of the lack of an accurate fiscal reporting system, Cal Expo has been unable to adequately monitor its revenue and control its expenditures. Consequently, Cal Expo overexpended its budget and could not meet its financial obligations. In one instance, Cal Expo had to obtain \$198,000 in emergency funding to prevent a utility company from turning off its electricity. Also, because of staff turnover and the lack of established procedures, various other accounting controls at Cal Expo provide information that is unreliable for management to use in making decisions.

Additionally, Cal Expo is not using proper contracting procedures. Cal Expo does not monitor revenue-producing contracts to ensure that the proper amount of revenue is received from contractors and that contractors' payments to the State are prompt. For example, because it did not monitor a contract, Cal Expo may have lost at least \$100,000 of a \$142,000 obligation from a contractor. Although the contractor provided Cal Expo a letter of credit for \$100,000, Cal Expo did not act to collect the \$100,000 until after the expiration date of the letter of credit. As of October 1985, the contractor had not paid

any of the \$142,000. Also, by not enforcing contract terms to ensure the best interests of the State, Cal Expo may have lost the opportunity for substantial capital improvements required of a contractor. We question at least \$785,800 of improvements that the contractor claims to have made at Cal Expo. Cal Expo also has not consistently followed proper contract administration procedures. Because of its poor contracting procedures, Cal Expo is not always ensuring that the State is legally protected by the terms of its contracts.

In addition, because of poor inventory control procedures, Cal Expo has not properly protected its physical assets against loss or theft. Cal Expo has not fully complied with the equipment accounting requirements of the State Administrative Manual. For example, Cal Expo does not have sufficient procedures to ensure that all equipment is included on the inventory records, that equipment which is disposed of is removed from the listing, that sensitive equipment is properly controlled, that equipment is assigned to locations or responsible officials, and that accounting records are reconciled to inventory records. Because of these weaknesses, 264 pieces of equipment worth approximately \$106,000 were on the inventory listing but could not be located, and 339 pieces of equipment worth approximately \$125,500 were not on the inventory but should have been. Further, we estimate that the value of 290 pieces of equipment on the inventory is understated by approximately \$175,000.

Further, Cal Expo is incurring additional costs because it does not have a program for routine and preventive maintenance. Engineers from the California Department of Food and Agriculture estimated that it will cost \$4.6 million to repair Cal Expo's facilities. Because Cal Expo does not have an adequate maintenance program, some of Cal Expo's facilities are prematurely deteriorating, necessitating additional repair costs and limiting the useful life of the facility.

Finally, although Cal Expo has increased its revenue from renting its facilities over the last two years, Cal Expo's rental practices do not ensure maximum rental revenue. Although certain physical limitations of the facilities may inhibit their use, Cal Expo does not adequately market its facilities, it does not identify its cost of operating rental facilities, and it allows renters too many days to set up and tear down events. These practices have resulted in lost rental revenue.

Alternative Sources of Subsidy

Even if Cal Expo's management corrects the foregoing deficiencies, Cal Expo may not attain self-sufficiency and may continue to require additional financial support. The additional financial support could be provided through one of several alternatives, including continued subsidy from the State's General Fund, revenue from the commercial development and leasing of a portion of Cal Expo's property, or revenue from the sale of some of the Cal Expo property. The Department of General Services' provided us with estimates of the value of leasing or selling some of the Cal Expo property. Additionally, Cal Expo is pursuing several alternatives to increase revenue and become less dependent on the General Fund for support. Initial indications show that one of these alternatives, simulcast horse races, will be a very profitable venture for Cal Expo.

Corrective Action Taken by Cal Expo

Since our audit began, Cal Expo has taken steps to correct some of the deficiencies identified in this report. To improve its fiscal reporting system, Cal Expo's accounting division has set up an allotment expenditure ledger to record budgeted and actual expenditures for fiscal year 1985-86. The accounting division also set up a system to monitor payments received from long-term, revenue-producing contracts. Cal Expo also began using a new contract form to ensure

that the contract division receives completed, signed copies of each contract. Additionally, Cal Expo has taken action to improve its inventory control procedures.

Further, according to Cal Expo's general manager, at least three maintenance projects are scheduled for fiscal year 1985-86, including reroofing the Exposition Center, repairing sidewalks in parking lots, and painting stables in the area behind the racetrack.

INTRODUCTION

In 1980, state law removed the responsibility for the California Exposition and State Fair (Cal Expo) from the California Department of Parks and Recreation and established Cal Expo as a separate, independent entity in state government. Cal Expo is responsible for managing the annual state fair and providing a site for events held during the remainder of the year (interim events). These events include, for example, motorcycle racing, dog shows, auctions, and vehicle shows.

The annual state fair runs, on the average, for 17 days from mid-August to early September. Cal Expo provides a showcase for the agricultural, recreational, and industrial resources of California. The fair provides an arena for the presentation of new ideas and information for the education of the visitor. Also, the fair provides a marketplace for the demonstration, advertisement, and sale of goods and services. Finally, the fair provides a forum for youth programs, such as scouting, 4-H, and Future Farmers of America, to compete in agricultural and livestock events.

Cal Expo opened on its present site in 1968. The site consists of approximately 700 acres along the American River in Sacramento County. Approximately 350 acres of the 700 acres are protected under the Bushy Lake Preservation Act; only a portion of this land may be used and only on a limited basis. The other 350 acres are

used for the state fair and other events. Cal Expo facilities include a racetrack, exposition buildings, an aquatic amusement park, and a concert amphitheater, among others.

Cal Expo is governed by an 11-member board of directors, who are appointed by the Governor with the consent of the Senate. The board serves as the policy-making body for Cal Expo and is responsible for its year-round management and operation. Cal Expo's general manager is appointed by the board. However, the deputy general manager, the program manager, and the marketing manager are appointed by the Governor. As of September 1985, Cal Expo had 33 full-time employees who worked at Cal Expo year-round.

In 1980, state law also required the board of directors to work toward a goal of fiscal independence from the State's General Fund. However, Cal Expo has continued to be reliant on General Fund support. In fiscal year 1984-85, Cal Expo received \$1.75 million from the General Fund.

In addition to General Fund money, in fiscal year 1984-85, Cal Expo received appropriations of \$265,000 from the Fair and Exposition Fund, \$12,000 from the State Fair Police Special Account, and \$179,000 from the Special Account for Capital Outlay. In addition, in fiscal year 1984-85, the state fair provided \$7.23 million in revenue, or 63 percent of Cal Expo's total support. Interim events held during fiscal year 1984-85 provided an additional \$1.48 million.

Cal Expo also received approximately \$621,900 in reimbursements in fiscal year 1984-85. The following table shows the sources of support for Cal Expo for fiscal year 1984-85.

TABLE 1
CALIFORNIA EXPOSITION AND STATE FAIR
SOURCES OF SUPPORT
FISCAL YEAR 1984-85

<u>Source</u>	<u>Amount</u>	<u>Percent of Total Support</u>
State Fair Revenue	\$ 7,233,800	62.6
General Fund	1,751,300	15.2
Interim Event Revenue	1,475,900	12.8
Reimbursements	621,900	5.4
Fair and Exposition Fund	265,000	2.3
Special Account for Capital Outlay	179,000	1.6
State Fair Police Special Account	<u>12,000</u>	<u>.1</u>
Total	<u>\$11,538,900</u>	<u>100.0%</u>

In January 1979, the Office of the Auditor General issued a report on Cal Expo's operations.* At that time, we identified problems similar to some described in this report. The 1979 report cited problems in Cal Expo's contract administration, physical inventory, grounds maintenance, and maintenance budgeting.

In February 1985, Cal Expo's general manager since 1979 resigned, and the board of directors appointed an interim general manager. In September 1985, the interim general manager was appointed as the permanent general manager.

SCOPE AND METHODOLOGY

The objective of this audit was to evaluate Cal Expo's management systems and its ability to move toward independence from the State's General Fund subsidies. We reviewed Cal Expo's financial management procedures, contracting procedures, procedures for controlling its assets, maintenance of the facility, and procedures for renting the facility during the period between fairs as a means of generating income. We also reviewed some of Cal Expo's personnel procedures for temporary employees, but we found no material problems. Also, we surveyed other state fairs to obtain information on their operations.

*This report is entitled "A Review of Cal Expo Operations," Report #810, January 1979.

To review Cal Expo's financial management procedures, we examined Cal Expo's accounting records and financial statements through the fiscal year ending June 30, 1984. We also reviewed Cal Expo's internal control procedures, budgeting procedures, and management of revenues and expenditures. In addition, to gain a better understanding of Cal Expo's financial operations, we interviewed personnel from the Legislative Analyst's office and the Department of Finance; we also interviewed Cal Expo's fiscal officer, senior accounting officer, and other Cal Expo personnel.

To evaluate Cal Expo's contracting procedures, we examined its administration of contracts and its compliance with standard contracting procedures. We reviewed state contracting procedures, inspected Cal Expo's contract and accounting files, and interviewed staff at Cal Expo and the Department of General Services. However, we could conduct only a limited review of contracts because Cal Expo's central contracts file did not contain all documentation supporting each contract award. Consequently, when reviewing contracts, we sometimes could not find certain documentation such as Cal Expo's requests for proposal and its criteria and justification for awarding a contract.

To determine the adequacy of Cal Expo's control over its physical assets and its inventory procedures, we hired an independent contractor who conducted a complete physical inventory of Cal Expo's equipment. In addition, our contractor reviewed sections of the State

Administrative Manual pertaining to proper inventory procedures, interviewed Cal Expo's management, obtained the most recent equipment inventory records, and reviewed all purchase documents from July 1, 1981, through January 1, 1985.

To determine the maintenance and repair needs of the Cal Expo facility, we reviewed a recent report issued by the Department of Food and Agriculture's Division of Fairs and Expositions, interviewed personnel at the Division of Fairs and Expositions and at Cal Expo, and reviewed reports previously issued on Cal Expo's maintenance problems. In addition, to determine the expenditures of the maintenance division, we reviewed budgeting and accounting records for the past three fiscal years.

To review the use of the facilities during the interim between state fairs, we identified those facilities that Cal Expo rents and reviewed the rental schedule for April 1, 1984, through March 31, 1985. We compared the available time to the time in which a facility was rented for the three exhibit halls, eight exposition buildings, two outdoor arenas, and one outdoor livestock area. To obtain information on marketing and rental practices, we interviewed the former and current general managers, the deputy general manager, the marketing director and staff, the fiscal manager, and the accounting staff.

Additionally, we considered other possible sources of revenue for Cal Expo, such as leasing or selling some of the Cal Expo property.

To determine the value of leasing or selling property at Cal Expo, we contracted with the Department of General Services, Office of Real Estate Services. Under this agreement, the Department of General Services appraised the Cal Expo property and reported that information to us.

To obtain information on the operations of other state fairs, we sent questionnaires to the auditors general of the 49 other states. We received responses from 37 states. Information from these states' responses is presented in Appendix A of this report.

AUDIT RESULTS

I

POOR MANAGEMENT CONTROLS CONTRIBUTE TO CAL EXPO'S LACK OF FISCAL INDEPENDENCE

Through fiscal year 1984-85, the California Exposition and State Fair (Cal Expo) has not been financially self-sufficient. Although Chapter 1148, Statutes of 1980, directed Cal Expo to work toward financial independence from the State's General Fund, to date Cal Expo has not been able to achieve independence. Cal Expo continues to receive General Fund support because its expenses have been greater than its revenues. Cal Expo's lack of proper management controls has contributed to its inability to become financially independent. For example, Cal Expo does not have an adequate fiscal reporting system, does not follow proper contracting procedures, does not control its assets to prevent loss or theft, does not follow a program of regular maintenance to prevent its physical plant from deteriorating into a state of disrepair, and does not adequately promote the rental of facilities during the period between fairs to increase revenue.

Cal Expo Has Not Become Financially Self-Sufficient

Since 1980, when state law required the board of directors of Cal Expo to work toward a goal of fiscal independence from the State's General Fund, Cal Expo has not been financially self-sufficient.

General Fund support to Cal Expo did decrease between fiscal years 1980-81 and 1981-82. In fact, in fiscal years 1980-81 and 1981-82, Cal Expo was able to allow some of its allotment to revert to the General Fund. In 1982-83, however, despite General Fund support of \$1,318,000, Cal Expo could not meet commitments of approximately \$245,000 for workers' compensation and unemployment insurance.

In fiscal year 1983-84, Cal Expo was able to return \$159,000 to the General Fund. For fiscal year 1984-85, however, Cal Expo had a \$1.45 million operating deficit, for which it received General Fund money. Further, in fiscal year 1984-85, Cal Expo received an additional General Fund allotment of approximately \$300,000 to pay off outstanding commitments from fiscal year 1982-83, plus interest and penalties. The following table shows the amount of General Fund support Cal Expo received for operations in each of the last five years.

TABLE 2
CALIFORNIA EXPOSITION AND STATE FAIR
GENERAL FUND SUPPORT
FISCAL YEARS 1980-81 THROUGH 1984-85

<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>	<u>1984-85</u>
\$2,250,000	\$1,630,000	\$1,318,000*	\$501,000	\$1,751,000**

*This amount does not include commitments of approximately \$245,000 for workers' compensation and unemployment insurance that Cal Expo could not pay this year.

**This includes approximately \$300,000 that Cal Expo used to pay its 1982-83 commitment for workers' compensation and unemployment insurance, plus penalties and interest.

**Cal Expo's Accounting Systems
Do Not Provide Adequate Information
For Effective Management**
For Effective Management

One reason Cal Expo has had financial problems is that Cal Expo does not have a fiscal reporting system that provides adequate information for effective fiscal management. For example, from fiscal year 1982-83 through 1984-85, Cal Expo's fiscal reporting system did not provide accurate information on the status of its expenditures in relation to its budget. Additionally, other accounting controls at Cal Expo provide information that is unreliable for management to use in making decisions. As a result, Cal Expo management has been unable to adequately monitor revenues and control expenditures.

Cal Expo did not have an accurate system to monitor expenditures incurred against budgetary allotments. According to the State Administrative Manual, Section 8300, maintaining an allotment expenditure ledger assists an agency in maintaining fiscal control. An allotment expenditure ledger provides, for each budget item, information on the amount allotted, the unliquidated encumbrances, the expenditures, and the unencumbered balance. Maintaining such a ledger helps an agency control its budget because the ledger shows the amount that the agency has left to spend for each budget item.

Cal Expo's accounting office did not maintain an allotment expenditure ledger in fiscal years 1982-83 and 1983-84. Although the accounting office set up an allotment expenditure ledger in fiscal year 1984-85, management still could not rely on the ledger because it was inaccurate. We found that for fiscal year 1984-85, approximately \$570,000 in expenditures related to contracts and purchases of goods and services were not encumbered. Consequently, Cal Expo had \$570,000 less available for expenditure than its records showed.

According to the accounting officer, the accounting office did not maintain an allotment expenditure ledger in fiscal years 1982-83 and 1983-84 and did not encumber all expenditures in 1984-85 because of high staff turnover and staffing limitations. The staff did not know how or did not have the time to set up and properly maintain an allotment expenditure ledger. The accounting office is presently maintaining an allotment expenditure ledger for fiscal year 1985-86.

The usefulness and accuracy of the fiscal reporting system is further reduced by the fact that expenditures are sometimes arbitrarily charged to incorrect expenditure categories. For example, \$95,400 in labor and material costs for constructing a horse barn was inappropriately charged to maintenance. Because expenses are sometimes arbitrarily charged to incorrect expenditure categories, division managers told us that they cannot use fiscal reports and that they do not know how much money they have in their budgets to spend.

Because Cal Expo does not have a reliable system to monitor expenditures against its budget, there is a risk that Cal Expo will overspend its budget. In fact, Cal Expo has been unable to meet its financial obligations; at the same time, it has also incurred questionable expenditures. For example, in May 1985, Cal Expo needed an emergency loan of \$378,000 from the General Fund to meet May and June payrolls and to pay \$198,000 in past due utility bills. However, during fiscal year 1984-85, Cal Expo spent \$95,400 in state funds to build a 36-stall horse barn and a saddle house on the Cal Expo grounds. In addition to the \$95,400 in state funds to build the barn and saddle house, Cal Expo spent an additional \$124,400 of funds that Cal Expo's major food concessionaire was obligated to invest at Cal Expo under the terms of the concession contract. Cal Expo's board of directors approved these expenditures.

The horse barn is used by a private horse trainer who rents the property from Cal Expo. When the renter proposed coming to

Cal Expo, Cal Expo anticipated receiving monthly revenue of approximately \$2,250 from rent and a percentage of the income the renter would receive from giving riding and training lessons. However, Cal Expo is charging the renter only \$1,550 a month. Further, until June 1985, Cal Expo agreed to offset \$1,053 of the monthly rent in exchange for the renter's care of five horses used by Cal Expo, and to deduct from the rent one-half of the salary of one of the renter's employees who did maintenance work around the barn (\$676 a month): a total monthly offset of \$1,729, or \$179 more than the monthly rent. As a result, for the 23-month period from July 1983 through May 1985, instead of receiving revenue of approximately \$51,750 as originally anticipated, Cal Expo received no revenue from the renter of the horse barn complex. In fact, when we began our audit, the renter was contending that Cal Expo owed her almost \$2,800 because of the offset. Since June 1985, the renter of the horse barn has been paying Cal Expo \$1,550 in monthly rent and has not received an offset.

Although the number of horses used by Cal Expo varied from four to seven, we could determine that Cal Expo owned only one of the horses. The other horses were on loan from their owners. The horses were used periodically by Cal Expo for promotional events, such as parades and horse shows, and at times for security during the state fair. In return for the loan of the horses, Cal Expo was responsible for their care. In May 1985, the general manager of Cal Expo ordered the horses returned to their owners; the horse that was owned by

Cal Expo was sold. According to the renters of the horse barn, the horses are still stabled there, but now the horses' owners are paying for their care.

Even though Cal Expo expected rental income from the horse barn facility, considering Cal Expo's weak fiscal condition, the expenditure of \$95,400 in state funds and an additional \$124,400 in other funds to build a horse barn is questionable. In addition, Cal Expo's decision to rent the facility for less than the amount specified in the rental proposal is questionable. Finally, Cal Expo's assuming the expense for the care of loaned horses that it used only periodically is also questionable.

Another example of questionable expenditures involves the use of promotional funds. Although Cal Expo has limited state funds for promoting the facility, as we discuss later in this report, Cal Expo has made questionable use of other available promotional funds. Cal Expo's contract with its food and beverage concessionaire requires the concessionaire to pay a percentage of its gross receipts to Cal Expo to be used by Cal Expo to promote the state fairgrounds. Under the contract, the concessionaire makes purchases for promotional purposes at the direction of Cal Expo. Cal Expo's board defined "promotional expenses" to include such things that would directly or indirectly enhance the physical appearance and public image of Cal Expo as well as encourage the public to visit and enjoy Cal Expo. According to policy, Cal Expo's board directs the expenditure of these funds.

Some of the expenditures that we reviewed cannot be considered promotional. Questionable expenditures of these promotional funds include \$1,650 for turkey dinners for employees' Christmas gifts, \$630 for a job applicant's travel to Sacramento for an interview, and \$2,650 for a horse stall vacuum used by the renter of the horse barn. Cal Expo also used this promotional fund to pay \$20,400 for leasing a truck, livestock trailer, and tractor from April 1984 through May 1985. As of June 1985, Cal Expo is no longer paying for the trailer, but still is paying \$1,490 a month for the truck and tractor lease. Further, we question why promotional funds were used for these expenditures when Cal Expo's promotional budget is so limited that it does not allow, for example, information brochures about renting the facility.

In addition to the lack of reliable systems to monitor expenditures, other weak accounting controls at Cal Expo provide data that are unreliable for management to use in making decisions. For example, we found that the June 30, 1984, accounts receivable balance included some uncollectible items and was overstated by at least \$162,313 (27 percent). Additionally, the June 30, 1984, accounts payable balance was understated by at least \$21,217 because accounts payable were not fully accrued at June 30, 1984. Consequently, Cal Expo does not have an accurate assessment of its financial condition. Cal Expo could collect \$162,313 less than its accounting records indicated, and, at the same time, Cal Expo owed at least \$21,217 more than the records showed.

There are other deficiencies in Cal Expo's accounting controls. For example, expenditures from the Revolving Fund are not being submitted for reimbursement promptly. The State Administrative Manual requires that invoices be submitted at least monthly for reimbursement to the Revolving Fund. We found some items that were not reimbursed and were dated as long ago as April 1979. The total amount of checks that were not reimbursed amounted to \$5,020. Cal Expo should determine whether these items are collectible, and uncollectible items should be cleared and the Revolving Fund reimbursed.

In addition, Cal Expo is not cancelling checks that have been outstanding for over two years, as required by the State Administrative Manual. In determining the accuracy of the bank reconciliation and the cash account balance, we found 20 checks totaling \$690 that were outstanding for more than two years. Some of these checks were more than five years old. Additionally, in verifying two other bank accounts that are used for horseracing events, we found checks outstanding over two years that totaled \$3,740.

As a result of conditions such as those described above, Cal Expo does not have an accurate assessment of its financial status and has been unable to manage its expenditures in the most cost-effective manner.

Cal Expo's Contracting Procedures Have Resulted in Lost Revenue to the State

Cal Expo's contracting procedures do not ensure that the State's interests are protected. Cal Expo is not monitoring its revenue-producing contracts to ensure that the State is receiving the proper amount of revenue. Also, by not enforcing contract terms to ensure that the best interests of the State were met, Cal Expo may have lost the opportunity for substantive capital improvements required of a contractor. In addition, Cal Expo has not followed standard state contracting procedures. For example, Cal Expo has not always submitted contracts and contract amendments to the Department of General Services when required. Also, contractors are allowed to start work prior to final approval of the contract. In addition, Cal Expo has entered into verbal agreements with contractors without using formal written documents approved by both the contractor and the State. Further, Cal Expo is improperly amending contracts by failing to sign contract amendments. Finally, although Cal Expo has a central contracts file, not all contracts are located in the file, and each contract file does not contain all documentation supporting a contract award. Cal Expo's poor contract administration has resulted in lost revenue to the State. Further, Cal Expo is not ensuring that the State is fully protected from liability.

Cal Expo Has Not Effectively Monitored
Its Revenue-Producing Contracts

Cal Expo does not monitor revenue-producing contracts to ensure that the proper amount of revenue is received from contractors and that contractors' payments to the State are prompt. Some contractors are required to pay Cal Expo a percentage of the gross sales they earn at Cal Expo. However, Cal Expo does not verify sales reports that are submitted by major contractors in accordance with lease provisions. Since these contractors must pay Cal Expo a percentage of their sales, it is in the State's best interest to verify that the amount of reported sales is correct. Another audit of fairs by the Office of the Auditor General concluded that when contractors' sales reports are not verified, there is an increased likelihood that the contractor may underreport sales and underpay the fair.

During our review of Cal Expo's contracting procedures, we found that Cal Expo staff have not ensured that contractors are paying Cal Expo the appropriate share of their revenue. For example, Cal Expo's contract with its food and beverage concessionaire requires the contractor to submit various sales and commission reports to Cal Expo monthly and yearly. In addition, the contract requires the contractor to pay Cal Expo a certain percentage of the total sales the contractor earns at Cal Expo. Also, the contract allows Cal Expo to examine the contractor's books and records and to periodically check cash register tapes against sales reports to verify the accuracy of the reports. In calendar year 1984, the State received from this

contractor almost \$800,000 in commissions plus \$130,000 for a promotional fund, an amount that is also based on a percentage of sales. However, Cal Expo has not consistently reviewed monthly fiscal reports submitted by the contractor, nor has Cal Expo ever checked cash register tapes against sales reports to verify accuracy and to ensure proper payment. Instead, Cal Expo has relied on the contractor to provide accurate sales reports and to submit the correct amount of payment.

Cal Expo's administration of another major contract provides a similar example. This contractor also pays Cal Expo either a percentage of its total sales or a minimum fee, whichever is greater. Cal Expo staff have not verified sales reports by requesting supporting documents from the contractor. Further, an amendment to the contract requires the concessionaire to keep daily cash register tapes and allows Cal Expo to verify these cash register tapes. According to a representative of this contractor, the contractor did not use cash registers. Cal Expo staff did not require the contractor to use cash registers or otherwise attempt to verify the accuracy of the contractor's sales reports. Cal Expo again relies on the concessionaire to make accurate payments. In addition, the contract requires the contractor to submit annual statements of gross receipts that are to be prepared and certified by a Certified Public Accountant licensed by the State of California in order to verify gross sales. Although this contractor has been at Cal Expo since 1981, as of October 1985, this contractor had not submitted any annual statements of gross

receipts. Cal Expo's management recently requested this information from the contractor. Because Cal Expo's revenues are contingent on the contractor's gross sales, Cal Expo should verify this contractor's sales reports.

A 1983 report issued by the Office of the Auditor General showed that when fair management has not established control procedures to verify gross receipts reported by fair concessionaires, the possibility increases that concessionaires will underreport their revenues.* Because the sponsor fair receives a percentage of concessionaires' gross receipts, by understating their receipts, concessionaires will also underpay the fair management. Controls used by fairs that had procedures to verify gross receipts included the use of undercover employees to observe concession activities to ensure that all sales were recorded and the use of fair employees to record the readings of each concessionaire's cash register every day.

In addition to not verifying sales reports submitted by contractors, Cal Expo staff do not monitor payments from contractors to ensure that payments are submitted promptly. Cal Expo's poor monitoring of contracts may have resulted in a loss to the State of at least \$100,000. One of Cal Expo's contractors owed the State almost \$142,000. Although the payment should have been received by Cal Expo

*This report is entitled "Revenue Reporting Practices of Food and Beverage Concessionaires Contracting With State-Supported Fairs," Report #309, January 1983.

by the end of December 1984, Cal Expo did not send an invoice to the contractor until March 1985. This contractor had posted a \$100,000 letter of credit payable to the State in case of default. However, Cal Expo did not collect on the letter of credit, and it subsequently expired. As of October 1985, the contractor had not paid on the approximately \$142,000 and had not obtained another letter of credit. As a result, the State lost an opportunity to make a claim against the letter of credit at a time when the contractor was in breach of the contract. Further, according to Cal Expo's accounting officer, as of November 1, 1985, this contractor owed Cal Expo over \$323,000.

According to Cal Expo's accounting officer, until March 1985, Cal Expo did not have a system for monitoring the prompt receipt of revenues for the long-term contracts. In March 1985, the accounting division set up a system to monitor receipts on long-term contracts.

Cal Expo May Have Forfeited
Substantive Capital Improvements
Required of a Contractor

Cal Expo's contract with its food and beverage concessionaire requires the concessionaire to spend \$600,000 in the first year of the contract for capital improvements on the Cal Expo grounds. The contract states, "An integral part of this concession contract is concessionaire's commitment and obligation to improve not only the quality and service associated with concessions but to add to and improve the California Exposition and State Fairgrounds." The contract

also requires that furnishings, equipment, and trade fixtures such as price signs, are to be provided at the concessionaire's own expense. Because the contract was approved by the Department of General Services later than expected, Cal Expo's former general manager allowed the concessionaire until July 1985 to complete its capital improvements.

Before starting any capital improvements, the concessionaire was required to submit an investment plan detailing its projected improvements on the fairgrounds. This investment plan was approved by the former general manager. However, many of the capital improvements included in this plan were for furnishings, equipment, and trade fixtures that, as specified in the contract, should have been furnished, installed, maintained, and replaced at the concessionaire's own expense.

We obtained an inventory listing of the concessionaire's capital improvements on Cal Expo grounds and found that the concessionaire is currently claiming about \$916,000 of capital improvements. However, we question the appropriateness of at least \$785,800 of these capital improvements. We found at least \$442,100 of questionable expenditures that include 64 cash registers purchased for \$17,215 and buyouts of used equipment from previous concessionaires totaling \$54,400. According to the contract, these items should have been provided at the concessionaire's expense. In addition to the \$442,100 of questionable expenditures, there is almost \$360,000 worth of unidentified labor, materials, and construction costs on the inventory list.

We requested information from the concessionaire to justify almost \$454,263 of these expenditures, including a \$250,000 item labeled "Cal Expo contract acquisition." However, the concessionaire provided only partial information and for only some of the items requested. For example, the concessionaire did not provide us any documentation supporting the \$250,000 contract acquisition expenditure. The information supplied for some of the other expenditures did not alleviate our concerns about the appropriateness of the expenditures. For example, we reviewed documents supplied by the concessionaire to support a \$56,700 expenditure for unidentified labor and material. Many of the items making up the \$56,700 expenditure were to repair, replace, or maintain existing facilities, all of which should have been done at the concessionaire's expense according to the contract. After reviewing each item of the \$56,700 expenditure, we still question the appropriateness of \$40,300 in expenditures.

Cal Expo's general manager, who at the time was Cal Expo's legal counsel for negotiating the contract, agreed that the intent of the contract was for the concessionaire to make capital improvements on Cal Expo's grounds. He also is questioning whether items that the concessionaire has listed, such as cash registers and nacho warmers, are capital improvements. In addition, the State Administrative Manual Section 8652.2 defines "improvements" as "(1) all structures..., (2) all fixtures permanently attached to structures, and (3) non-structural improvements of a permanent nature such as distribution systems, roads, orchards, etc."

The contract also requires Cal Expo and the concessionaire to conduct an annual inventory of the location and existence of the concessionaire's furnishings, equipment, and trade fixtures. According to the officials at Cal Expo, this has not been done since the start of the contract in July 1983.

Because Cal Expo's former general manager approved the concessionaire's capital investment plan, which included used equipment buyouts and other trade fixtures that should have been provided at the concessionaire's own expense, the State may have lost the opportunity for substantive capital improvements on Cal Expo grounds. In addition, however, the concessionaire has included as capital improvements items that were not approved on the investment plan. For example, the investment plan states that the concessionaire could include the purchase of 39 cash registers in its capital improvements; the concessionaire actually included 64 cash registers in its total of capital improvements. The former general manager stated that he did not approve a number of the items that the concessionaire listed as capital improvements. However, Cal Expo does not have records of items that were approved in addition to those on the investment plan. Further, when we requested information from the concessionaire to justify capital improvement expenditures, we also asked the concessionaire to provide documentation verifying Cal Expo management's approval of the expenditures. The concessionaire did not provide this information to us. Consequently, Cal Expo should conduct a physical

inventory of the capital improvements that the concessionaire is claiming and determine which improvements Cal Expo considers acceptable.

Cal Expo Has Not Followed
Standard State Contracting Procedures

Cal Expo has not followed proper contract administration procedures as required by state law and the State Administrative Manual. For example, Cal Expo has not obtained the required approval from the Department of General Services (DGS) before awarding contracts and has not amended contracts properly. As a result, Cal Expo cannot be certain that the State is always legally protected by the terms of a properly completed contract.

Cal Expo has not always submitted contracts to the DGS for approval and has allowed some contractors to begin work before contracts were approved. Section 10295 of the Public Contract Code states that "all contracts entered into by any state agency for...services, whether or not the services involve the furnishing or use of equipment, materials or supplies or are performed by an independent contractor...are void unless and until approved by the Department of General Services." Also, State Administrative Manual Section 1206 states that contracts over \$10,000, unless otherwise exempted, are subject to approval by the DGS.

However, we found that Cal Expo did not send all contracts to the DGS for approval before the start of the contract term. For example, one contract for \$12,600 a year in revenue was never sent to the DGS for approval. In another instance, Cal Expo entered into a four-year lease-purchase agreement for almost \$84,000 without the DGS' approval. The DGS disapproved the lease package because it determined that the three pieces of equipment to be leased were not necessary. Nevertheless, according to the former general manager, Cal Expo then leased this equipment without the DGS' approval because Cal Expo believed that DGS approval was unnecessary since the equipment was leased with funds from a promotional account provided by Cal Expo's food and beverage concessionaire. Cal Expo therefore did not consider these to be state funds. However, an opinion we requested from the Legislative Counsel states that, although the concessionaire administers the funds, Cal Expo must still go through state contracting procedures for the expenditure of these funds. Presently, Cal Expo does not follow state procedures in expending these funds.

We also found instances in which Cal Expo allowed contractors to begin work before the DGS approved the contract. One contract for over \$51,200 was not approved by the DGS until 89 days after the contractor started providing services. In addition, the DGS did not approve a contract for \$50,000 until nine months after the end of the contract term because the contract was not specific enough about what services the contractor was to provide to the State. Further, Cal Expo did not obtain approval from the DGS for a contract for the

construction and use of the concert amphitheater until after the amphitheater was in use. Although the contract term began in July 1983, the contract was not approved by the DGS until November 7, 1985.

In addition to not always obtaining the required approval for contracts, Cal Expo also has amended contracts improperly. For example, not all contract amendments were initialled by both parties to document that the amended terms were agreed upon. In addition, not all contracts were formally amended. Agreements entered into by Cal Expo should be in writing to ensure that the provisions of the agreement are clearly understood by Cal Expo and the contractor. This helps ensure that Cal Expo is legally protected by a formal written document, and it also helps ensure that other divisions are aware of the terms of the contract. However, in one instance, the former general manager entered into an oral agreement to amend a contract. This agreement raised the rent of the horse barn from \$1,050 to \$1,550 per month and allowed the contractor to offset the rent owed to the State by taking care of horses that had been loaned to Cal Expo, a service that was not included in the contract terms. The accounting division was not notified of the amendment and, therefore, did not make the necessary adjustments to the accounting records. Consequently, Cal Expo's accounting records indicated that Cal Expo would receive more revenue than it actually did. In addition, neither the original contract nor the amendment was approved by the DGS even though the contract required over \$12,600 a year in rent from the contractor. According to a DGS

staff counsel, when expected revenue from a contract exceeds \$10,000, the contract should be reviewed and approved by the DGS.

Additionally, although Cal Expo has a central contracts file, it does not contain all documentation supporting a contract award. Standard documents that should be in a contract file, such as bids for the contract, are not centrally located. For example, of 22 contracts that were included in our sample of contracts over \$10,000, 10 of the actual contract documents could not be found in the contract division's files. Also, contracts with the original signatures of both parties are not always in the contract file, and original copies of contracts are not always in the contract file. In addition, the former contract manager and the accounting officer told us they do not always receive copies of contracts. Because not all appropriate divisions are assured that they receive contracts for review, planning and budgeting for revenues and expenditures are difficult. In addition, without review by the contract division for proper contract terms, Cal Expo cannot ensure that the State is legally protected by the terms set in the contracts.

Another deficiency we found in the contract procedures is that Cal Expo contract division staff have little control over prenumbered contract forms that are used for contracts under \$2,500. While reviewing these prenumbered contracts, we found gaps in number sequences that could not be accounted for in the contract division's log for these contracts. The staff person who is responsible for these

contracts was working six-hour days and kept the contract forms on the top of a desk. Therefore, after this employee left for the day, other staff could take contracts without entering information about their use in the log book.

In August 1985, Cal Expo increased the limit on prenumbered contracts from \$2,500 to \$10,000 and began using a new form to ensure that the contract division receives a completed copy with original signatures of each contract. Presently, Cal Expo staff are working on draft procedures for the contract division.

According to the former contract division manager, Cal Expo's contracting procedures have been poor because there has been a consistent turnover of staff who were assigned to manage the contract division. Since February 1984, three people have been in charge of the contract division. For the periods immediately before, during, and after the 1984 state fair, there was no one working in the contract division. In addition to the staff turnovers, the staff who have been assigned to manage the contract division have not had experience with state contracting procedures. Also, Cal Expo does not have any written guidelines or procedures pertaining to contract administration. Therefore, each person who was assigned to manage the contract division had no instructions from which to work.

Cal Expo Has Not Properly Controlled Its Inventory

Cal Expo has not fully complied with the equipment accounting requirements of the State Administrative Manual (SAM). As a result, Cal Expo's inventory records are inaccurate and cannot be relied upon as a measure of the value of equipment at Cal Expo or as a safeguard to protect state property. We hired an independent contractor to review Cal Expo's inventory control procedures and to conduct a complete physical inventory. Our contractor reported that Cal Expo does not have adequate procedures to ensure that all equipment is included on the inventory records; that equipment which is disposed of is removed from the listing; that pieces of sensitive equipment, such as typewriters and cameras, are properly controlled; that equipment is assigned to locations and/or to responsible officials; and that accounting records are reconciled to inventory records. Because of these weaknesses, 264 pieces of equipment worth approximately \$106,000 were on the inventory listing but could not be located, and 339 pieces of equipment worth approximately \$125,500 were not on the inventory but should have been. Further, our contractor estimates that the value of 290 pieces of equipment on the inventory was understated by approximately \$175,000.

Not All Equipment Was on the Inventory

Many pieces of equipment at Cal Expo are not documented on the inventory records even though the SAM requires them to be. Because

they are not correctly accounted for, control over the equipment is lost, and the value of the equipment at Cal Expo is incorrectly reported.

The SAM requires that equipment be included on the inventory if that equipment has the following attributes: a normal useful life of two years or more; an identity which does not change with use; a nature that makes formal accountability practical; and an approximate unit cost of \$150 or more.

To determine whether Cal Expo was including all new equipment in its inventory listing, our contractor reviewed all purchase documents at Cal Expo for the period between July 1, 1981, and January 1, 1985. He found 47 pieces of equipment worth \$15,972 that were purchased but were not entered on the inventory records. Items omitted included such pieces of equipment as four lawn mowers, two speakers, and four sidewalk blowers. In 1984, Cal Expo began a new procedure to correct this weakness. When a purchase order for equipment is approved, it is stamped "equipment" and a copy of the purchase order is retained until the piece of equipment is recorded on the inventory. Our contractor found only one item purchased in 1984 that should have been included in the inventory listing but was not.

While conducting the physical inventory at Cal Expo, our contractor located 339 pieces of equipment, including the 47 mentioned above, worth approximately \$125,500 that were not listed on the

inventory records but should have been. This equipment included items such as typewriters, dictating machines, refrigerators, and amplifiers.

There are a combination of reasons for the above discrepancies, including oversight during busy periods and lack of understanding of requirements. For example, shop supervisors stated that they sometimes buy equipment and do not get the information to the division responsible for maintaining the inventory documents. Also, some pieces of equipment were not adequately marked, and the inventory records did not contain sufficient information to identify specific pieces of equipment. Thus, some of the equipment that our contractor found that was not in the inventory listing may have been the same property listed in the inventory that he could not find. For example, he found 15 refrigerators that were not listed on the inventory but could not find 16 refrigerators that were listed on the inventory. There was no way to determine that any of these were the same refrigerators, however, because the refrigerators he found did not have identifying numbers, and the inventory records did not have sufficient information on the refrigerators, such as model or serial number.

Because of this lack of control, 339 pieces of equipment worth approximately \$125,500 were at Cal Expo but were not documented on Cal Expo's inventory records. This lack of control results in a potential for loss or theft and in errors on Cal Expo's financial statements.

Records of Disposal of
Equipment Are Not Adequate

Cal Expo has not kept adequate records of its disposal of state equipment. Cal Expo has not maintained adequate records to document why equipment was removed from the inventory listings. In addition, some equipment that it has disposed of has not been removed from the inventory records.

The SAM requires state entities to prepare equipment survey reports whenever they intend to dispose of equipment by sale or trade-in or whenever they determine that equipment has been lost, stolen, or destroyed. The SAM also requires that survey documents be kept for at least two years, but they also must be kept until the next physical inventory.

Our contractor compared the results of the physical inventory conducted by Cal Expo in 1981 to the current inventory listing and found 203 pieces of equipment worth approximately \$102,000 that appeared on the 1981 inventory but did not appear on the 1984 inventory listing. There were no records justifying the removal of this equipment. Further, our contractor located 117 of these pieces of equipment worth approximately \$87,000 when he conducted the physical inventory in July and August 1985.

Cal Expo employees said that they disposed of equipment without completing survey documents or any other paperwork because they

were not aware of the requirement to prepare survey reports. For example, the supervisor of the landscaping shop said that when he came to Cal Expo he disposed of several old worn-out lawn mowers without realizing that any paperwork was necessary. In addition, Cal Expo had not conducted a physical inventory for over three years even though the SAM requires an inventory every three years. Thus, Cal Expo management was not aware of the magnitude of errors in its inventory listing.

Sensitive Equipment Is Not Adequately Controlled

Our contractor could not locate several pieces of sensitive equipment during the physical inventory because Cal Expo does not adequately control this equipment. Furthermore, he found several pieces of sensitive equipment that were not listed in the inventory records.

The SAM defines a "sensitive asset" as any highly desirable and portable item, such as a calculator, a typewriter, or a camera. The SAM states that agencies should keep records of all sensitive equipment and that the records should contain information on the item, including the make, model, serial number, and value. It also states that accountability should be assigned through such procedures as a check-out/check-in system.

Of all the assets at Cal Expo, only 50 office machines, valued at approximately \$18,800, require the use of check-out/check-in cards.

This card file identifies the employee responsible for each machine. However, all other sensitive items are not being controlled through check-out/check-in or other procedures. For example, our contractor found 50 pieces of art on display at Cal Expo. However, Cal Expo had no inventory records of any of the art. Our contractor was able to determine that eight of these art pieces cost Cal Expo a total of \$6,350. Other sensitive pieces of equipment that were not adequately controlled included small calculators, typewriters, and radio equipment. These assets were not assigned to individuals and were not on Cal Expo's inventory listings.

Equipment Is Not Recorded by Location
or Assigned to Responsible Officials

The inventory records maintained by Cal Expo do not contain accurate location information for many pieces of equipment. Furthermore, most equipment is not assigned to responsible officials. Thus, there is loss of control over equipment, lack of accountability, and difficulty in locating specific equipment or taking inventory.

The SAM requires that state entities maintain record cards on equipment. These cards should provide information on each item including the date acquired, cost, identification number, and location. The SAM also requires that equipment be assigned to responsible officials.

Of the 1,300 pieces of equipment listed on Cal Expo's inventory, only 310 of them included location codes. Further, these location codes could not be used because the codes are based on budget codes that change each year. Also, except for the 50 office machines discussed above, Cal Expo has not assigned custody of equipment to individuals.

Since most equipment was not assigned to locations or to individuals, our contractor conducted the physical inventory by looking throughout the Cal Expo facility for each item. For the pieces of equipment that he could not locate, he had no information to help narrow the search. This lack of information also made it difficult for Cal Expo employees when they attempted to find the equipment he could not find. They would have the same difficulty if they were to conduct a physical inventory or if they had to locate specific pieces of equipment.

These problems result in lack of control over equipment and create a potential for loss of equipment. They also make it difficult to locate equipment, either when conducting an inventory or when seeking specific pieces of equipment.

Inventory Records Are Not Reconciled With Accounting Records

The SAM requires that accounting records be used as a control to ensure accuracy of the inventory listing. However, instead of using

the accounting records as a control, Cal Expo adjusts the equipment balance in the accounting records at the end of each year to conform with the total value shown on the inventory records. In addition, the SAM requires equipment to be valued at its cost or at fair market value. However, our contractor found that 290 pieces of equipment were either valued at \$1 or were recorded with no value. Based on the average value shown for equipment in the same asset classes as those with no value or valued at \$1, our contractor estimated that the inventory was understated by approximately \$175,000 for these 290 pieces of equipment.

Since our contractor completed his review of Cal Expo's inventory control procedures, Cal Expo has taken steps to improve its inventory control. Cal Expo has developed written procedures defining responsibilities of employees. Additionally, Cal Expo has begun action to identify all of the art pieces at Cal Expo and include it on the inventory list, to survey and delete from the inventory list those items that could not be located, and to maintain check-out/check-in cards for sensitive equipment.

Cal Expo Has Not Followed An Adequate Maintenance Program

Cal Expo does not have a regular maintenance program or a preventive maintenance program. In the past three years, the maintenance staff has been reduced by 21 full-time positions or 70 percent. In addition, the maintenance budget was reduced from

\$1.2 million in fiscal year 1983-84 to \$820,400 in fiscal year 1984-85. As a result of the reduced maintenance program, the Cal Expo site is in need of major repair. Department of Food and Agriculture engineers estimate that the Cal Expo facility needs almost \$4.6 million worth of maintenance and repair work. In recognition of the pressing need for maintenance work, the maintenance budget for the six-month period of July 1, 1985, to December 31, 1985, was increased to \$1,568,743, which includes \$500,000 for deferred maintenance.

In March 1985, the engineering staff from the California Department of Food and Agriculture's Division of Fairs and Expositions (CDFA) completed a survey of Cal Expo's facilities. The CDFA conducted this survey at the request of Cal Expo's management. The engineers evaluated the physical conditions of Cal Expo's facilities to determine the extent of maintenance problems on the grounds and the associated costs of maintenance. The engineers also addressed maintenance staffing and scheduling, utility plans, and other recordkeeping activities of Cal Expo's maintenance staff.

The CDFA engineers determined that Cal Expo needs almost \$4.6 million worth of health, safety, structural, electrical, and maintenance work on the grounds and an additional \$272,000 for energy conservation improvements. The engineers also suggested ways to beautify and architecturally enhance the facilities; they estimate that this work would cost an additional \$470,500.

According to Cal Expo's maintenance supervisor, Cal Expo has not established a regular program of preventive maintenance because of a lack of funds budgeted to the division and because of drastic reductions in the maintenance division work force. Cal Expo budgeted approximately \$820,400 in fiscal year 1984-85 for its maintenance operations and reported expenditures for maintenance of approximately \$1,122,000. However, we found that the expenditure figure is inaccurate and that actual expenditures for maintenance were lower than those reported. For example, in July 1984, the maintenance division budget was charged \$95,400 for labor and material used to build horse stalls. The fiscal officer and the maintenance supervisor agreed that some expenditures that were not necessarily for maintenance of the facilities were charged to the maintenance division's budget; however, they could not determine what the exact expenditures were for the division.

In fiscal year 1984-85, Cal Expo allocated 8 percent of its total budget for maintenance. However, according to the CDFA report, other fairs allocate 25 percent to 29 percent of their total budgets for maintenance. The CDFA study included nine other fairs such as Los Angeles County, Alameda County, Oregon State, and Arizona State fairs. All of these fairs have annual budgets ranging from \$4 million to \$20 million.

Along with reductions in the maintenance budget, the maintenance staff has also been reduced. In fiscal year 1982-83,

Cal Expo had 30 full-time positions for the maintenance division; in fiscal year 1984-85, the maintenance staff was cut to 12 full-time positions. However, only 9 of the 12 positions were filled. Based on a ratio of acres on the fairgrounds to maintenance staff, the CDFA concluded that Cal Expo needs 33 maintenance staff to adequately maintain the facility. CDFA engineers found that there is a direct correlation between the ratio of maintenance staff to fairground size and the overall general appearance of a fairground.

According to the CDFA report, there are some major structural deficiencies on Cal Expo's grounds that the CDFA engineers estimate would cost almost \$1.7 million to repair. For example, the dormitory that is used during the state fair as sleeping facilities for competitors, such as 4-H participants, needs work to comply with standards set by the State Fire Marshal and to comply with regulations set for handicapped individuals. In addition, the CDFA notes many other structural problems with the dormitory and recommends that the building be brought up to standards or that it be replaced, perhaps with a more versatile building. The CDFA engineers estimate it would cost \$280,000 to demolish and reconstruct the building. The CDFA also found structural deficiencies at the aquatic amusement center, including deteriorated wood decking that has fallen into disrepair. They estimate it would cost \$17,600 to correct these structural deficiencies.

The CDFA also found maintenance and repair problems that endanger the public's health and safety. These repairs, estimated to cost almost \$388,300, would correct potential hazards to the public, such as severe cracks and depressions in the concrete sidewalks. The engineers also cited a safety need to construct a fence surrounding a canal that runs through the facility.

Other maintenance needs that are not associated with health, safety, and structural deficiencies include painting throughout the grounds (estimated to cost \$783,000) and landscaping throughout the grounds, especially in highly visible areas such as the main entry areas.

In the area of energy conservation, the CDFA recommends changing the racetrack lighting from its present high consumption lighting to a more energy-efficient method of lighting. The CDFA report states that this lighting conversion would pay for itself within a few years as a result of reductions in utility bills. The CDFA estimates that the cost of electricity could be reduced from \$500,000 in 1984 to \$335,000 a year if the lighting conversion is completed. The savings, therefore, would be approximately \$165,000 (33 percent) a year at present rates. Additionally, small incandescent lights that are used throughout the fairgrounds should be replaced with more efficient and economical lights.

The CDFA engineers also noted that there is a lack of recordkeeping on maintenance and repairs at Cal Expo, including records on the installation and location of underground utilities and sewer lines and on repairs made to them. These records are important in the event of an emergency, such as a water main break, in order to locate the source of the problem.

The CDFA report concludes that in order "to generate additional revenue, [Cal Expo] should have an attractive and well-maintained physical plant that will encourage the public to utilize its facilities. Unmaintained, [Cal Expo] will experience difficulties in marketing and promoting interim usage." In addition to detracting from Cal Expo's ability to market the facility, if deficiencies are not corrected, the State may be liable for the health and safety of the public who use the fairgrounds.

During the audit, we also noted the results of the lack of preventive maintenance. Water leaked through the ceiling of at least two of the offices in Cal Expo's administration building. Further, according to Cal Expo's Chief of Plant Operations, all of the roofs on the eight buildings known as Exposition Center also leak.

According to Cal Expo's general manager, at least three maintenance projects are scheduled for fiscal year 1985-86, including reroofing the exposition center, repairing sidewalks in parking lots, and painting stables in the area behind the racetrack. These projects

are estimated to cost about \$294,000. Cal Expo is also planning to repair pavement throughout the facility. Cal Expo was planning to modify the racetrack lighting using some of the deferred maintenance funding that Cal Expo received for fiscal year 1985-86. However, according to the general manager, the Department of Finance disapproved this expenditure because it considered replacing lamps at the racetrack a capital improvement and not deferred maintenance.

Cal Expo's Facility Rental Practices Do Not Ensure Maximum Revenue

Cal Expo has indoor and outdoor facilities that can be rented during the interim between state fairs. Although revenue from rentals has increased during the last two fiscal years, Cal Expo's rental policies and practices do not ensure maximum revenue. We examined the rate of rental use for some of the Cal Expo facilities from April 1984 through March 1985. The indoor facilities that we reviewed were rented from 43 to 60 percent of the time and the outdoor facilities were rented 22 percent of the available time or less. Because we could find no comparable facility in the Sacramento area, we cannot say how often Cal Expo facilities feasibly could be rented. However, based on our review of Cal Expo's existing rental policies and practices, we believe that Cal Expo could increase the rental use of its facilities. There are several reasons why Cal Expo does not receive maximum rental revenue from these facilities. First, there are physical considerations that limit rental of the facilities. In addition, however, Cal Expo does limited marketing of these facilities; Cal Expo

has not determined its costs of operating these facilities, so it does not know if its rental rates are sufficient to recover its costs; and Cal Expo provides too many days to renters to set up and tear down events. For these reasons, Cal Expo is not able to generate the maximum potential income from the rental of these facilities during the interim between state fairs. Since Cal Expo is mandated to work toward a goal of fiscal independence from the State's General Fund, it needs to increase its revenue from the use of these facilities.

Facilities Are Not Being Fully Used Between Fairs

We reviewed Cal Expo's rental practices for 11 indoor facilities and 3 outdoor facilities for the period between April 1, 1984, through March 31, 1985. These facilities include three exhibit halls (Buildings A, B, and C) that surround an outdoor area referred to as the beer garden. Buildings A and B are connected by a common concessionary and restroom area, and each has a mezzanine of 8,600 square feet in addition to a main floor of 27,700 square feet. Building C has 27,900 square feet but does not have a mezzanine and is not connected to any other buildings. In addition to the exhibit halls, Cal Expo has an Exposition Center that consists of an outdoor plaza surrounded by eight buildings; one building is 6,100 square feet and the remaining seven are 7,600 square feet each. In addition to the indoor facilities, we reviewed rental use of three outdoor areas: the rodeo arena, the horse show arena, and the livestock area. Also located in the livestock area are stalls and livestock pens. Cal Expo

has other areas that can be rented; however, we did not include them in our analysis of facility use because they are either under long-term contract or their main purpose is not as a rental facility. An example of such a facility is a parking lot, which could be rented for \$300 a day.

We compared the time the facilities were rented (including the time used to set up or tear down events) to the total time during which the facility could be rented. Therefore, we did not count as possible rental days those days that Cal Expo used either to prepare for the state fair or to host it. We also did not consider rental possibilities for any outdoor facilities during the poor weather months of October through March, and we did not consider Building C, the livestock area, or the horse show arena when they are being used to present the 52nd District Agricultural Association Fair. In addition, whenever the marketing staff advised us of rental restrictions because of the facilities' physical limitations, we incorporated those restrictions into our analysis. For example, because Buildings A and B share a common area and cannot be closed off, and because they are close to the beer garden, we considered these three areas as one facility. Therefore, if any one of these sites was rented, we counted all three as rented. Also, because the eight buildings of Exposition Center are located close to each other, we considered the center 50 percent used if any building was rented, and we considered the center fully used if five or more of these buildings were rented. Consequently, our estimates of how often these facilities were rented are generous.

We found that Cal Expo does not fully use the facilities that we reviewed during the interim between state fairs. We found that the exhibit halls (Buildings A, B, and C) were rented about 60 percent of the available time, and at least one of the buildings at Exposition Center was rented 43 percent of the time. Cal Expo rented five or more buildings at Exposition Center only 6 percent of the time. The outdoor arenas and livestock areas were rented 22 percent or less of the available time.

Cal Expo does not compare the rate of rental use of its facilities from year to year. Since we began this audit, the marketing division has begun to issue monthly marketing reports that compare the number of event days and the revenue generated in the current month to the same data from the same month one year ago. However, Cal Expo does compare revenue generated from the rental of buildings for each fiscal year. These records show that the revenue from building rentals decreased in fiscal year 1982-83 but increased in each succeeding year. Based on unaudited figures from Cal Expo's accounting division, revenue from building rentals increased 40 percent in fiscal year 1983-84. Part of the reason for the increased revenue in fiscal year 1983-84 is that Cal Expo raised its rental rates during that time. However, revenue from building rentals increased only an additional 3 percent in fiscal year 1984-85. For fiscal year 1984-85, the accounting division reported \$375,100 in revenue from building rentals.

Although Cal Expo's marketing division reported a 25 percent increase in revenue from renting its facilities in fiscal year 1984-85, we find this figure somewhat misleading for several reasons. Cal Expo's figure includes revenue not only from building and stall rents, but also from parking and food and beverage sales. The marketing division also included "reimbursable costs" in its figure. Since reimbursable costs are those costs paid by the renter to reimburse Cal Expo for additional services it provides (such as security personnel), we consider reimbursables as cost recovery and not revenue. Further, during 1984, Cal Expo increased its rates not only for building rent but also for reimbursables. Consequently, including these figures further inflates the percentage of revenue increase. Also, the accounting division and the marketing division acknowledged that there were errors in the source data the marketing division used to develop its revenue figures. Although it is unlikely that Cal Expo could ever fully rent its facilities, we believe that, by improving its rental practices, Cal Expo could increase both the use of its facilities and its revenue from renting facilities during the interim between state fairs.

Cal Expo does not rent its facilities more frequently for several reasons. First, the facilities have physical limitations that keep them from being fully used. For example, most of the buildings at Cal Expo do not have full kitchen facilities. Therefore, renters who want kitchen facilities may be forced to go elsewhere or to incur the extra cost of renting portable kitchens. Additionally, parking at

Cal Expo is generally not close to buildings where events are held. Another reason that there is limited use of the facilities is that the facilities are not always maintained in optimal condition. For example, the livestock pen had a leaky roof, which interfered with a renter's ability to keep animals there.

In addition to the physical limitations of the facility, however, Cal Expo's procedures for promoting rental of the facility have not maximized its rental use. For example, Cal Expo does limited marketing of the facility for interim events. Cal Expo does not have an adequate marketing plan to promote the rental of Cal Expo facilities. A marketing plan is a planning tool that formally identifies the market--in this instance, the organizations most likely to rent the Cal Expo facilities--and then specifies the actions to be taken to increase the rental use. Cal Expo has not developed a marketing plan since 1983. Further, the 1983 marketing plan has general goals but no specific plans on how to achieve these goals. Cal Expo has produced a variety of marketing documents that have general goals such as maximizing promoters' use of the facilities, increasing state fair revenues, better targeting the marketing, and replacing low revenue producers with higher producers. However, none of these documents identifies the possible users of Cal Expo, nor do they state specific plans on how to accomplish the goals. Cal Expo marketing staff could provide us with no specific plan for promoting the interim use of Cal Expo facilities, for analyzing the appropriate

rental rates, for keeping informed of the industry and local market trends, or for analyzing the present or potential users of the Cal Expo facilities.

In addition, Cal Expo has had a limited budget for marketing interim events. The marketing staff told us that they need, but do not have, an accurate map of the facilities, promotional brochures, or descriptive films. The former general manager stated that he was not convinced that expenditures for such promotional material are necessary. He also stated that the board of directors of Cal Expo has not approved a bigger budget for marketing because there has been no real marketing program. However, for fiscal year 1985-86, Cal Expo budgeted \$50,000 from the promotional fund provided by its food and beverage concessionaire for purposes such as creating a brochure.

Another reason why Cal Expo does not rent its facilities more often is that there is limited coordination among Cal Expo staff regarding rentals. For example, the staff do not agree on which facilities are available to be rented. When we questioned whether the arcade building was available for rent, the marketing staff did not know and referred us to the deputy general manager, who also did not know and referred us back to the marketing staff. Further, staff differed in their opinions as to whether a log cabin on the premises was available for rent.

Cal Expo Does Not Know
Its Cost To Rent Facilities

Cal Expo does not have information to determine whether its rental rates cover the costs to Cal Expo of renting the facilities. In order to determine whether the revenue from renting facilities covers the costs incurred, Cal Expo needs to know what its costs are in renting facilities. However, Cal Expo has not kept sufficient data to determine the cost for each event. Although for some events, such as a community service event, Cal Expo's main concern may not be financial, for most events Cal Expo should know whether its rental rates cover costs.

Cal Expo has two types of costs: the reimbursable and the nonreimbursable costs. The reimbursable costs are the costs that are paid by the renter, in addition to the rent, for additional services provided by Cal Expo. Reimbursable costs include costs for security, equipment rental, cleaning, and personnel to sell tickets. Nonreimbursable costs, the costs that Cal Expo incurs when it rents a facility, include the costs of utilities and may include costs for parking attendants and other additional personnel. Cal Expo keeps track of the reimbursable costs, but does not keep track of the nonreimbursable costs for each event.

The following example illustrates the net loss that Cal Expo incurs partly because it does not consider all its costs in renting its facilities. Cal Expo converts Building C to an indoor arena during the

winter for about two months. This indoor arena is referred to as Cutler Arena and is used primarily for horse and livestock events. The rent for Building C is \$1,100 per day, whereas the rent for the Cutler Arena is \$400 per day plus a percentage of admission receipts. Cal Expo staff estimate that it costs \$3,200 to convert Building C to Cutler Arena and then back to Building C, and this conversion takes four days to complete. Only two of the nine events held in the arena last winter were rental events; the remaining events were sponsored by Cal Expo. The total revenue for the events held in the Cutler Arena was approximately \$2,550, or \$650 less than the cost of converting the building. However, in addition to the conversion costs, Cal Expo does not know what its costs were for gas and electricity for the events held in the Cutler Arena. Also, Cal Expo does not consider the cost of the damages done to the asphalt floor and the ventilation system due to the type of events held in the Cutler Arena. Without considering these additional costs, Cal Expo cannot know its true cost to rent the Cutler Arena. Additionally, by converting to the Cutler Arena, Cal Expo loses the opportunity to rent Building C (which has a higher rental fee) for approximately two months.

The former general manager stated that he and the former fiscal manager calculated the costs of renting facilities a couple of years ago, and they found that rental rates covered the costs. The current fiscal officer, however, does not have any information on that study. Although we did find evidence that Cal Expo conducted a

year-long study of its electrical consumption, we were unable to find evidence that this study resulted in any cost analysis for the facilities.

We also discussed with the marketing director how rental rates are established. He said that Cal Expo does not have information on the cost of operating facilities, and, therefore, he could not establish rates based on these costs. He stated that in 1984 he raised the previous rent by 10 percent based on a best guess of costs.

Cal Expo Provides Too Many Days To Renters To Set Up and Tear Down Events

Cal Expo provides too many days to renters to set up or tear down the events. Of the total number of days that facilities were scheduled, 52 percent of the days were used to set up or tear down the activities or to clean the facilities. Since Cal Expo's rental revenue is based on the number of days during which the event is held, Cal Expo loses potential revenue when it provides an excessive number of days to renters to set up or tear down an event.

Cal Expo rental policy gives every renter three days to set up or tear down an activity. Thus, a one-day show can tie up a facility's use for four days, even though Cal Expo's income is based on the one day of the event. Also, Cal Expo usually reserves an additional day for every event that requires a thorough cleaning afterwards, such as events with animals. Cal Expo receives no additional money for the

setup days, the teardown days, or the cleaning days. If renters need more than three days, Cal Expo's policy is to charge 25 percent of the daily rental rates for the extra days.

Cal Expo's marketing director stated that allowing three days to set up and tear down events is a long-standing practice, and it is comparable to the practices of other facilities. We compared Cal Expo's practice with that of other facilities in the area and found that other facilities are more flexible and that Cal Expo provides more setup and teardown days than others. Another major local rental facility gives three setup/teardown days for no additional charge only if the event is at least three days long. The guideline for this facility is that the setup/teardown days cannot exceed the number of days in which the event takes place. However, if the facility is not being rented prior to an event, the hours in which the facility is available to the renter may be extended. If a renter requires additional days, this facility rents those days at 50 percent of the established rental rate. We also contacted other facilities that rent ballrooms or convention space, and these facilities' representatives stated that the setup time is negotiable but usually involves some fee.

We determined the total number of days on which events were scheduled at Cal Expo, the number of days used for setting up or tearing down activities, and the number of days used for cleaning each facility. We found that, of the total number of days that facilities were rented, 52 percent of the days were used to set up or tear down

the activities or to clean the facilities. Between April 1984 and March 1985, there were 250 days on which events were held and 266 days to set up or tear down the event or do additional cleaning. For the 266 setup, teardown, and cleaning days, Cal Expo charged a 25 percent fee for only 4 days; for the remaining 262 days, Cal Expo charged no additional fee. We also found that, for Buildings A, B, and C, 25 percent of the setup, teardown, or cleaning days fell on Friday, Saturday, or Sunday, when, according to the general manager and the marketing director, the facilities are most in demand.

We also noted that there were 13 one-day events held at Cal Expo that generated rental revenue. These 13 events used the facilities a total of 55 days. The 55 days included 13 event days, 38 setup or teardown days, and 4 cleaning days. Since rental revenue is based on the number of event days, the total revenue from these 55 days was based on the 13 event days, or only 24 percent of the total time the facilities were used.

II

CAL EXPO MAY NEED ALTERNATIVE SOURCES OF FINANCIAL SUPPORT

As stated earlier, Cal Expo has continued to be reliant on the State's General Fund for financial support. The management weaknesses discussed in the preceding section of this report have contributed to Cal Expo's poor financial condition. However, even if Cal Expo corrects its management weaknesses, it is still possible that Cal Expo may not be able to become financially self-sufficient. Cal Expo may require additional financial support that could be provided through several sources, including the State's General Fund, revenue from lease proceeds from the commercial development of a portion of Cal Expo's property, or revenue from the sale of some of Cal Expo's property. Recognizing the need for additional revenue, Cal Expo management is also pursuing several other alternatives to increase revenue.

Although the state fair has been held for over 130 years and Cal Expo has been at its present site since 1968, it was not until 1980 that state law directed Cal Expo to strive toward financial independence from the State's General Fund. Both the former general manager and the current general manager have stressed that making a profit is not Cal Expo's exclusive goal. They have stated that Cal Expo also has other goals, such as providing educational, recreational, and community service events for the people of California. These other goals frequently are not profitable ventures

for Cal Expo. The former general manager stated that, given these other goals, Cal Expo cannot make a profit. According to the current general manager, although Cal Expo should be managed in as businesslike a manner as possible, profit cannot be the sole criterion, and Cal Expo may never be a profitable operation because of its other goals.

However, state law directed Cal Expo to work toward financial independence, and, to date, Cal Expo has not been able to achieve this goal. In fiscal year 1984-85, Cal Expo operated at a \$1.45 million deficit. The weaknesses discussed in the preceding section of this report, such as an inadequate fiscal reporting system, questionable expenditures, failure to monitor revenue-producing contracts, and failure to maximize rental income, have directly affected Cal Expo's financial condition. Although it is not possible to estimate the total effect if Cal Expo corrects its management weaknesses, even if Cal Expo corrects these problems, Cal Expo still may not be financially self-sufficient. It is even less likely that Cal Expo could become financially self-sufficient in the near future considering how much money Cal Expo needs to correct its current maintenance and repair deficiencies. As noted earlier in this report, the Department of Food and Agriculture estimated that it would cost \$4.6 million to complete the maintenance and repair work needed at Cal Expo.

Considering this situation, there are several alternative sources of funds for Cal Expo. The first option is continued support from the State's General Fund. This support could be either continued

yearly appropriations or a one-time appropriation to meet Cal Expo's existing maintenance and repair needs, after which Cal Expo would become financially independent.

Two other options include leasing or selling some of the property at Cal Expo. To determine the value of leasing or selling property at the Cal Expo site, we contracted with the Department of General Services' (DGS) Office of Real Estate Services to appraise the Cal Expo property. The DGS appraised the value of the property if sold in total, and it also appraised the value of five sub-parcels within the site and estimated the annual rent that could be derived from the first lease period of a long-term lease of each of the five sub-parcels. The DGS appraised five sub-parcels that include areas of Cal Expo known as Lot A, Lot E separately, Lot E and the horse show arena, an area along Ethan Way that includes a row of horse stalls, and a triangular area of Lot 17. These sub-parcels are shown on a map of Cal Expo in Appendix B of this report. According to the general manager, it would be possible to sell or lease these sub-parcels without significant negative effect on Cal Expo's ability to hold the state fair. The valuations in this report do not include a 350-acre area of Cal Expo known as Bushy Lake.

In developing its estimates of the property value, the DGS examined 33 comparable real estate transactions, which it divided into five groupings. The five groupings are the Greater Cal Expo Area, South Natomas, North Natomas, Highway 50 Large Acreage, and Highway 50

Commercial and Hotel Sites. The sales that the DGS analyzed are all land sales with no improvements that contribute any value to the site.

In addition, the DGS determined the land value based on the "highest and best" use of the property. The DGS defined the highest and best use as that use which may reasonably be expected to produce the greatest net return to the land over a given period of time. The DGS considered Lot A a major hotel site. It considered Lot E separately, Lot E and the horse show arena, and the area that includes the horse stalls as office sites. According to the DGS, Cal Expo is surrounded by some of the best commercial and professional office areas in Sacramento. The DGS considered the sub-parcel in Lot 17 an inferior piece of property that would be more practically used as a warehouse or storage site. The DGS determined that the improvements currently on the Cal Expo property add no value to the real estate. In fact, the DGS included in its report the cost of demolishing existing improvements. Finally, the DGS appraised the property free and clear of any and all leases and concessionaire agreements.

Based on the comparisons, assumptions, and limitations described above, the DGS determined that as of June 1985, the 350-acre Cal Expo site had a fair market value of \$104 million. This total reflects the almost \$2.8 million that it would cost to demolish Cal Expo facilities. Table 3, on the next page, shows the value of the five sub-parcels evaluated by the DGS.

TABLE 3

**CALIFORNIA EXPOSITION AND STATE FAIR
FAIR MARKET VALUE OF PROPERTY**

<u>Sub-Parcel</u>	<u>Value</u>
Lot A	\$12,150,000
Lot E	\$ 4,700,000
Lot E & Horseshow Arena	\$10,460,000
Ethan Way with Horse Stalls	\$12,810,000
Portion of Lot 17	\$ 1,700,000

In determining the value of leasing the Cal Expo property, we asked the DGS to prepare estimates based on lease periods of 15, 40, and 55 years. The DGS reported that the 15-year term is unrealistic for any type of use that would involve substantial improvements, such as a hotel or office site, because investors could not recoup their investment over such a short time period. The DGS stated that a 15-year lease could not be tied to a percentage of the land values that exist at Cal Expo today.

The DGS further concluded that the 40-year and 55-year leases would be of equal value. The DGS derived these lease values from the appraised value of each of the sub-parcels at 10 percent return each year, adjusting annual rent according to the Consumer Price Index at the first agreed-upon adjustment date, usually every three to five years. The following table lists annual rents that could be charged

for the first lease period of a long-term lease (40 to 55 years) for each of the five sub-parcels.

TABLE 4
CALIFORNIA EXPOSITION AND STATE FAIR
ESTIMATED LEASE VALUE OF PROPERTY

<u>Sub-Parcel</u>	<u>Annual Rent</u>
Lot A	\$1,215,000
Lot E	\$ 470,000
Lot E and the Horse Show Arena	\$1,046,000
Ethan Way with Horse Stalls	\$1,281,000
Portion of Lot 17	\$ 170,000

Cal Expo management is currently pursuing several other methods of increasing revenue. For example, Cal Expo entered into an agreement with a contractor to hold weekly swap meets at Cal Expo. These swap meets began in September 1985. Cal Expo receives a percentage of the revenue the contractor makes on the swap meets. For the first five swap meets, Cal Expo reported revenue of \$10,985 from the contractor. Also, in October 1985, Cal Expo began participating in simulcast horse races. Cal Expo receives broadcasts by satellite of horse races held at other racetracks, allowing patrons in Sacramento to bet on these races. Cal Expo receives a percentage of the total amount bet each day, a percentage of the revenue received by the food and

beverage concessionaire, and the admission fee of \$2 per person. For the first ten days of simulcasting, Cal Expo estimated its net income at \$37,333. Cal Expo may also receive an additional \$54,986 for this 10-day period because of an agreement with officials of the Department of Food and Agriculture (DFA). The DFA will receive approximately 4.5 percent of the total amount of money bet on the simulcast horse races. However, according to Cal Expo's general manager, the DFA agreed for one year to return the money it receives to Cal Expo through the Fair and Exposition Fund. Cal Expo's general manager also noted, however, that there is a question whether the DFA has the authority to make this decision or whether legislative action may be necessary before Cal Expo can receive the money from the DFA. Finally, Cal Expo is considering holding more concerts, which, in fiscal year 1984-85, proved to be an additional source of income.

III

CONCLUSION AND RECOMMENDATIONS

To date, the California Exposition and State Fair (Cal Expo) has not been able to become financially independent from the State's General Fund. Poor management controls have contributed to Cal Expo's inability to achieve financial independence. However, even if Cal Expo corrects its management weaknesses, Cal Expo may not be able to become self-sufficient and may require additional financial support.

Some of Cal Expo's financial problems can be attributed to the fact that Cal Expo does not have a fiscal reporting system that provides accurate and timely information for effective fiscal management. For example, in fiscal years 1982-83 and 1983-84, Cal Expo did not maintain an allotment expenditure ledger to monitor expenditures against its budget. In fiscal year 1984-85, Cal Expo began using an allotment expenditure ledger, but we found that it was inaccurate. Additionally, other accounting controls are unreliable for management to use in making decisions. As a result of an unreliable fiscal reporting system, Cal Expo does not have an accurate assessment of its financial condition and has been unable to adequately monitor revenue and control expenditures.

Also, Cal Expo's contracting procedures do not ensure that the State's interests are protected. Cal Expo has not monitored

revenue-producing contracts to ensure that the proper amount of revenue is received from contractors and that contractors' payments to the State are prompt. A previous Auditor General report showed that when receipts from concessionaires are not verified by the fair management, the possibility increases that concessionaires will underreport their revenues, which in turn reduces the fair's revenues from the concessionaires. Additionally, by not monitoring a contract, Cal Expo may have lost at least \$100,000 of \$142,000 that a contractor owed Cal Expo. Until March 1985, Cal Expo did not have a system for monitoring the prompt receipt of revenues relating to long-term contracts.

In addition to improper monitoring of revenue contracts, Cal Expo may have forfeited substantive capital improvements required of its food and beverage concessionaire. The concessionaire's initial investment plan, which was approved by Cal Expo's former general manager, contained items that, according to the contract, were to be provided by the concessionaire at its own expense. Consequently, we question at least \$785,800 of investments the concessionaire claims to have made on the Cal Expo grounds.

Cal Expo also has not consistently followed proper contract administration procedures as required by state law and the State Administrative Manual. As a result, Cal Expo cannot always ensure that the State is legally protected by the terms of its contracts.

In addition, because of poor inventory control procedures, Cal Expo has not properly controlled its physical assets against loss or theft. Specifically, Cal Expo does not have sufficient procedures to ensure that all equipment is included in the inventory records, that equipment which is disposed of is removed from the listing, that sensitive equipment is properly controlled, that equipment is assigned to locations and/or responsible officials, and that accounting records are reconciled to inventory records. Because of these weaknesses, 264 pieces of equipment worth approximately \$106,000 were on the inventory listing but could not be located, and 339 pieces of equipment worth approximately \$125,500 were not on the inventory but should have been. Further, we estimate that the value of 290 pieces of equipment on the inventory is understated by approximately \$175,000.

Cal Expo also does not have a regular maintenance and preventive maintenance program. Over the past three years, the maintenance division's staffing and budget have been severely reduced. As a result of the inadequate maintenance program, the Cal Expo site is in need of major repair, including the need to correct structural deficiencies and health and safety deficiencies. Department of Food and Agriculture engineers who surveyed the conditions of the Cal Expo grounds to determine its maintenance needs estimate that the facility needs approximately \$4.6 million of maintenance and repair work. The engineers also suggested ways to beautify and architecturally enhance the facility, which they estimate would cost an additional \$470,500. According to Cal Expo's general manager, at least three maintenance

projects are scheduled for fiscal year 1985-86, which include reroofing the Exposition Center, repairing sidewalks in parking lots, and painting stables in the area behind the racetrack.

Finally, although revenue from renting its facilities has increased over the last two years, Cal Expo's rental policies and practices do not ensure maximum rental revenue. In addition to the physical limitations of the facilities, which may inhibit their use, Cal Expo does not adequately market its facilities, it does not identify its cost of operating rental facilities, and it gives too many days to set up and tear down events. These practices have resulted in lost rental revenue.

However, even if Cal Expo's management corrects the foregoing deficiencies, Cal Expo may not attain self-sufficiency and may require additional financial support. The additional financial support could be provided through one of several alternatives, including subsidy from the State's General Fund, revenue from lease proceeds from commercial development of a portion of Cal Expo's property, or revenue from the proceeds of selling some of Cal Expo's property. Cal Expo management is also undertaking several other methods to increase revenue, such as broadcasting simulcast horse races.

Recommendations

To improve its fiscal reporting system and to provide more effective fiscal management, we recommend that Cal Expo take the following actions:

- Maintain an allotment expenditure ledger to ensure that Cal Expo has up-to-date records of budgeted and actual expenditures. All expenditures should be encumbered and charged to appropriate budget categories.
- Determine the amount of, and monitor payments due from, revenue-producing contracts, and collect revenue promptly. Invoices should be prepared as promptly as possible after amounts are due.
- Review accounts receivable on a regular basis to determine whether accounts are collectible. Collection procedures described in the State Administrative Manual, Section 8710.1, should be followed, and accounts should be written off when necessary.
- Accrue all amounts that should be included in the accounts payable at year end.

- Review unreimbursed expenditures made from the Revolving Fund to determine which are collectible. Cal Expo should send invoices immediately for those expenditures found to be collectible; the uncollectible ones should be cleared and the Revolving Fund reimbursed. Procedures should be established to present monthly invoices for reimbursement as stated in the State Administrative Manual, Section 8112.5.

- Cancel outstanding checks more than two years old and remit those amounts to the Special Deposit Fund. Outstanding checks should be reviewed on a regular basis.

To correct the deficiencies in its contracting practices and thus to ensure that the State is legally protected, Cal Expo should take the following actions:

- Follow all state laws and guidelines pertaining to the administration of contracts and all standard contracting procedures. Cal Expo should develop an instruction manual for contracting and train its staff on proper contracting procedures.

- Submit contracts to the Department of General Services for approval to comply with state requirements. Cal Expo should also ensure that contracts are prepared early enough to submit them to the Department of General Services for approval.

- Keep all documentation relating to a contract award in a central contracts file. The documentation should include requests for proposals and bids received, Cal Expo's justification for the contract award, all amendments related to the contract, and an original signed copy of the contract.

- Ensure that the contract unit reviews all contracts before they are signed by the contractor. In addition, the contract unit should ensure that all appropriate divisions receive copies of the contract, particularly the accounting division.

- Ensure that all contracts and agreements are formalized in writing.

- Monitor contractors' sales reports and periodically check cash register tapes to ensure that the State is receiving the correct amount of revenues. Cal Expo should also require contractors to submit annual statements prepared and certified by an independent accountant when the contract includes this provision.

- Adhere to the provisions set forth in its contracts to ensure that contractors are providing the correct services for which they contracted and to ensure that contracts are administered in the best interest of the State.

- Conduct a physical inventory of the capital improvements claimed by the food and beverage concessionaire. Cal Expo should then determine whether these items meet the provisions of the contract. In addition, Cal Expo should ensure that future capital improvements made by the concessionaire are approved by Cal Expo and are not items that are to be provided at the concessionaire's own expense, as specified in the contract.

To improve its control over its physical assets, Cal Expo should take the following actions:

- Correct the inventory records by including the additional pieces of equipment located during the physical inventory and removing those pieces of equipment that could not be located.
- Ensure that the inventory listing is kept accurate. Specifically, Cal Expo should ensure that all new equipment purchases are included in the inventory listing, that all dispositions are properly reflected on survey documents, and that surveyed equipment is removed from the inventory records.
- Maintain survey records on all equipment removed from inventory records for three years or until the next inventory, as required by the State Administrative Manual.

- Assign a value to all equipment on the inventory. If the exact value of a piece of equipment is unknown, it should be appraised, or an estimate should be made of its value.
- Exercise greater control over sensitive equipment. Equipment cards should be maintained on all sensitive equipment. These cards should be kept current and accurate. Special care should be taken to ensure the safekeeping of the art pieces and other pieces of sensitive equipment at Cal Expo.
- Maintain location codes on the inventory records for sensitive equipment and for other equipment that can be controlled in this manner, and assign equipment to responsible officials when practical to ensure accountability and control.
- Put identification numbers on all equipment, and record these numbers on inventory records.
- Use accounting and inventory records as controls for each other. These records should be reconciled each year.

To improve the physical condition of the Cal Expo facility and to reduce the State's liability for the health and safety of the public who use the Cal Expo facility, Cal Expo should take the following steps:

- Determine which projects identified by the Department of Food and Agriculture should be addressed immediately, such as health and safety hazards and structural deficiencies. In addition, Cal Expo should identify and undertake projects that will bring immediate cost savings for the facility, such as replacing the lighting at the racetrack.
- Develop and implement a preventive maintenance plan to reduce the cost of repairs in the future.

In order to more fully use its facilities during the interim between state fairs and to maximize rental revenue, Cal Expo should:

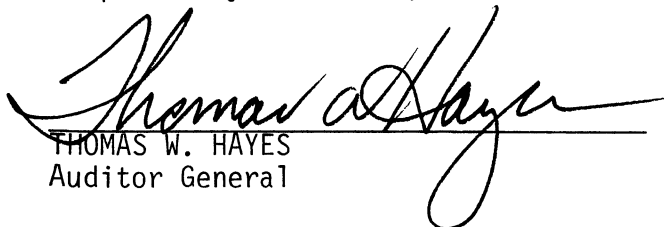
- Develop marketing plans for both short-term and long-term periods. These plans should include an identification of the market (both the frequent and potential renters), objectives for the marketing division (with specific steps and schedules to carry out the objectives), and a proposed budget for the marketing activities.
- Ensure staff coordination regarding the availability of facilities to rent.
- Accurately estimate and record the costs for each event during the interim between fairs.

- Change its rental policy of giving every renter three days to set up and tear down events. Cal Expo should assess renters' needs for these days and its own cost of operations and provide setup and teardown days only when it is cost beneficial to Cal Expo to do so.

To meet the State's directive to become less financially dependent on the State's General Fund, Cal Expo management should continue to explore alternatives to increase revenues. Cal Expo should implement practical alternatives to gain additional funding as soon as possible.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



THOMAS W. HAYES
Auditor General

Date: January 6, 1986

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December 13, 1985

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**California
State Fair**

Dear Mr. Hayes:

Thank you for the opportunity to review and comment on the draft of your report entitled "Lack of Management Controls and Self-Generated Revenue have led to California Exposition and State Fair's Lack of Fiscal Independence". Generally, for the period audited, we found the report to be factual and objective. As noted in your report, the end of the audit period coincides with the change in management. Since that change, several new systems and procedures have been implemented which address some of your recommendations. Therefore, we are limiting our comments to a synopsis of the actions taken or actions we propose to take to remedy the problems identified.

In the fiscal reporting system, six recommended actions are proposed.

1. Although not all accounting problems have been overcome, the priority has been to ensure that allotments, expenditures and encumbrances are now appropriate and increasingly timely.
2. Revenue collecting systems and invoicing time frames are not yet satisfactory. While invoices are being prepared more promptly, delays in submitting back-up documents from maintenance or set-up have not yet been overcome. We are directing our efforts to improve this function.
3. The accounts receivable recommendation has been adopted and implemented in two parts. First a system has been devised to review accounts receivable on a regular basis. This process has been designed to meet the requirements of the State Administrative Manual. Second, all present overdue accounts receivable have been reviewed for special handling. Some are disputed amounts, others need proper collection procedures while others may eventually require being "written-off", it is anticipated that this will be accomplished in 2 - 3 months.
4. We are presently working on the recommendation to accrue accounts payable in conjunction with a proper encumbrance system.

5. It is recognized that procedures need to be established to review unreimbursed Revolving Fund expenditures. However, to properly design the necessary procedures some review will be necessary for documenting emergency expenses necessary to proceed with an event. We are presently revising our procedure in this regard.
6. A system is now in place to ensure compliance in the cancelling of outstanding checks.

In the area of contracting practices, eight recommended actions are proposed.

These actions are being reviewed as part of a total re-evaluation of Cal Expo's contracting procedures for revenue contracts, permit agreements and service contracts. Furthermore, Cal Expo is aware that as part of the contract process a review of the methods of monitoring revenue must occur.

In the area of control over physical assets, eight recommendations are proposed.

1. All equipment has now been scheduled. This process identifies, numbers, values, locates and records the serial number of all equipment.

The removal of equipment that could not be located is in process through General Services. Not all equipment has been included since some equipment has since been located.

2. At present a rudimentary system for inventory listing has been devised utilizing our word process capabilities. This is similar to a manual system and therefore is very cumbersome to provide updated master lists, however, the information is recorded. Procedures have been developed and reviewed for the surveying (disposing of obsolete equipment) of equipment. These procedures still require implementation in some areas.
3. Survey procedures will become part of the procedures manual.
4. All equipment has now been assigned a value.
5. The equipment cards have been developed for sensitive equipment, procedures have been written to monitor the card system and are presently under review.
6. Location codes on inventory records have been completed during the scheduling process. Additionally, where practical, equipment is also identified by assignment to an individual.
7. The tagging of equipment process is presently being accomplished. It is anticipated that this will be completed by February 1986.
8. At present, we are devising a system to ensure accurate entry of equipment purchases by our accounting section, and the notification of the accounting section of surveyed equipment. It is anticipated that a working system for reconciliation can be developed over the next few months.

In the area of the physical plant, two recommendations are made addressing the improvement of conditions to reduce the State's potential liability for the health and safety of the public.

1. Since the 1985-86 budget for Cal Expo has been divided into two six-month periods, a \$1 million appropriation for deferred maintenance has been split into two \$500,000 amounts. During the first six months, \$500,000 has been spent addressing the projects identified by the Department of Food and Agriculture. Another \$500,000 worth of projects have been identified from the Department of Food and Agriculture list for the second six months. The execution of these projects rests upon continued expenditure authorization.
2. In 1980 the management consultant firm of Cresap, McCormick and Paget developed a voluminous report entitled "Assistance for Developing a Maintenance Plan and Management System". This report identifies maintenance requirements and related resources. This plan is sufficient to meet the goal of a preventive maintenance plan. However, Cal Expo does not have the necessary resources to satisfy the requirements of this maintenance plan. As a high priority, we are making concerted efforts to increase the emphasis on maintenance.

In the area of utilization of the facilities between State Fairs, four recommendations are proposed.

1. Historically Cal Expo has lacked the expertise to develop and implement long and short term marketing plans. However, Cal Expo is now committed to develop a comprehensive, realistic and professional marketing plan.
2. Proper procedures need to be developed and implemented to ensure coordination of staff, not only for the availability of facilities but to ensure availability of required services.
3. At present time Cal Expo does not have a cost accounting system. However, Cal Expo does recognize the need to cost interim events. Presently Cal Expo is investigating a computer software program designed for Cal Expo's type of industry. This system has a job cost system that can be adapted to an event cost subsystem. Without an automated system, the above cost accounting system is highly labor intensive; pending the acquisition of this cost accounting system we will perform cost analyses on a select basis.
4. The rental policy will be revised to selectively review the needs of the individual renter.

The final recommendation addresses the financial solvency of Cal Expo and states:

"To meet the State's directive to become less financially dependent on the State's General Fund, Cal Expo management should continue to explore alternatives to increase revenues. Cal Expo should implement practical alternatives to gain additional funding as soon as possible."

At present Cal Expo is actively exploring alternatives to increase revenues. Examples within the last ten months are the amphitheatre, the swap meet and

the simulcasting of horse racing. We are presently preparing to issue a Request for Proposal for commercial leasing of part of our property not directly necessary to conduct the State Fair.

In addition all program budgets have been reviewed to reduce costs. This process must be carefully tempered so as not to impact the ability to conduct a quality State Fair, to support revenue producing operations or to maintain the physical needs of our facilities.

Finally, efforts are ongoing to obtain both additional and alternative methods of future funding. Ideas such as corporate sponsorships, and revised marketing practices to attract additional renters are just the beginning of a new business-like approach to the management of Cal Expo.

We look forward to continuing our cooperation with your review over the next several months as we proceed to implement many of your recommendations.



Ralph Scurfield
Chairman, Board of Directors
California Exposition and
State Fair

THE OPERATIONS OF FAIRS IN OTHER STATES

We were asked to gather information about the operation of state fairs in other states. In particular, we attempted to determine whether other state fairs are financially profitable and whether those fairs are a part of state government or are organizationally independent.

Thirty-seven of the 49 states responded to the questionnaire we sent them. Six of these states reported they had no state fair; one state reported that it had no state fair in 1984. Three of the respondents are part of a six-state consortium that holds one joint fair. One state, in which the state fair is operated by a private, nonprofit corporation, would not release financial information. Two states did not provide any supporting financial data. Seven states provided only 1983 fair data and could not be included because our comparison of states is based on 1984 data. Consequently, 18 responses (representing 23 states) are included in the information presented in this appendix.

In reviewing the responses we received, we noted that the respondents provided information in a variety of formats. Our analysis of the 18 responses, therefore, is limited by the following considerations. Although we asked the states to include supporting financial documentation in their responses, some states did not provide the supporting documentation. Consequently, we could not verify or clarify responses to the questionnaire. Some states provided financial statements but did not include notes that were an integral part of those statements.

In addition to the differences in data that the states provided, there are differences in how the states compiled their information. Some of the states' financial statements were done on an accrual basis, and one was done on a modified accrual basis; we could not determine the accounting basis of the other states' statements. The states also classified expenses differently. Some states included interest and depreciation expenses, some did not, and others did not indicate whether they did.

Noting the above limitations, and the fact that we are unable to verify the accuracy of the data presented, we present the following data for informational purposes. Ten of the 18 states reported that they made a profit; eight states reported a deficit. Table A-1, on the next page, shows the profit, state appropriations, and other subsidies reported by the 10 states that claim to have made a profit on their state fairs.

TABLE A-1

STATES REPORTING PROFITABLE STATE FAIRS

<u>State</u>	<u>Profit Reported</u>	<u>State and Other Subsidies</u>	<u>Profit Without State or Other Subsidies</u>
Louisiana	\$ 34,208	\$ 0	\$ 34,208
Minnesota	372,105	0	372,105
New England <u>a/</u>	766,509	8,000 <u>b/</u>	758,509
New Mexico	754,861	0	754,861
Oklahoma	1,187,518	0	1,187,518
Texas	301,106	0	301,106
Virginia	383,296	32,900	350,396
Arkansas	31,013	50,000	(18,987)
Delaware	20,121	28,000	(7,879)
South Dakota	9,851	108,940	(99,089) <u>c/</u>

a/ The following states have a single, combined fair: Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont.

b/ Massachusetts contributes an \$8,000 grant to the fair.

c/ South Dakota reported a \$108,940 block grant.

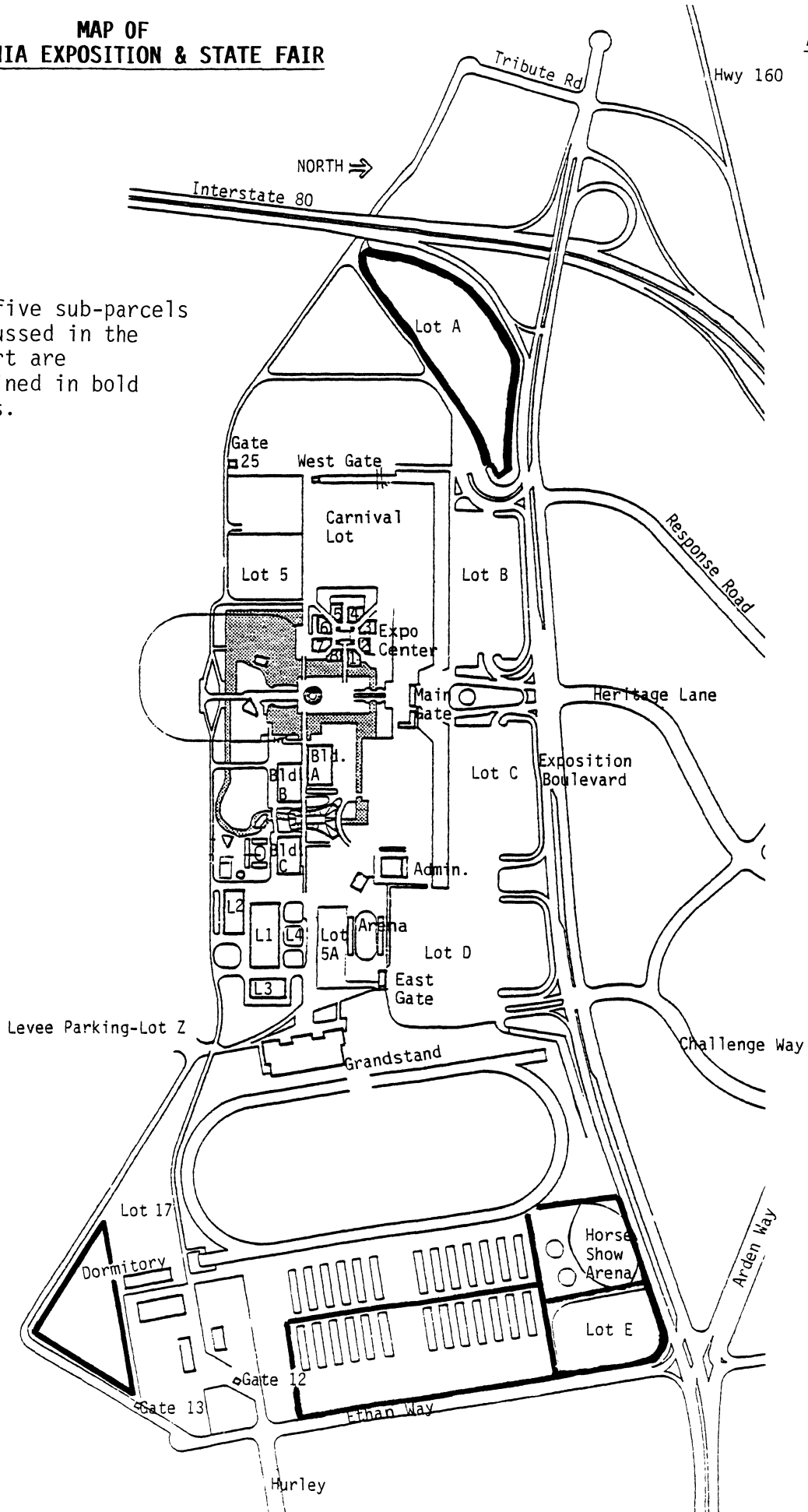
Five of the ten states that reported a profit received a state appropriation or other subsidy. According to the data provided, seven of the ten states would be self-sufficient without their state appropriations or other subsidies. Six of the seven states that were self-sufficient without state or other appropriations included depreciation and/or interest expenses in determining whether they made a profit. The other state did not indicate whether it included depreciation expenses.

In addition, at least two of the seven states that were financially independent leased property. New Mexico leases property to other state agencies and to a flea market for about \$300,000 annually. Minnesota leases property for parking and a warehouse, earning approximately \$105,000 in revenue. Also, at least two of the financially independent states reported revenue from sports events. Minnesota reported almost \$96,000 in 1984 revenue from events, such as hockey games, held at its coliseum. Texas reported approximately \$1.9 million in 1984 revenue from its facilities, including the Cotton Bowl Stadium, the performing arts center, and the coliseum.

Seventeen of the 37 respondents' state fairs are run by state government agencies. Six of the respondents' fairs are managed by private entities. Five respondents reported that their state fairs were nonprofit organizations. One respondent reported that the state fair was managed by a quasi-state entity. Two respondents did not indicate the organizational structure of their fairs, and six respondents reported that they had no state fairs. Of the seven states that were financially self-sufficient, two were state agencies, two were private entities, and three were nonprofit organizations.

**MAP OF
CALIFORNIA EXPOSITION & STATE FAIR**

The five sub-parcels discussed in the report are outlined in bold lines.



cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps