COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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November 9, 2016

TO: Supervisor Hilda L. Solis, Chair
Supervisor Mark Ridley-Thomas
Supervisor Sheila Kuehl
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: John Naimo
Auditor-Controller

SUBJECT: **LOS ANGELES COUNTY FAIR ASSOCIATION – FINANCIAL OPERATIONS, GOVERNANCE, AND NONPROFIT COMPLIANCE REVIEW (November 3, 2015, Board Agenda Item 40-A)**

EXECUTIVE SUMMARY

On November 3, 2015, your Board instructed the Auditor-Controller to review the Los Angeles County Fair Association's (LACFA) financial operations (e.g., revenue, rent, etc.), governance structure, and compliance with nonprofit requirements.

Much of the property that comprises the Fairplex was acquired by LACFA and other entities and deeded to the County without charge. The County and LACFA have had a long-standing partnership spanning nearly a century, and a mutually beneficial relationship, in developing the Fairplex property to its current state. Due to this unique partnership, the County has provided LACFA with millions of dollars of both direct financial assistance and subsidies throughout the term of the partnership in the form of rent below market values, waived required rent payments, and direct funding.

The County entered into a Ground Lease and Operating Agreement (Agreement) with LACFA, a private nonprofit organization, in 1988 for use and development of the County fairgrounds and surrounding properties commonly referred to as "Fairplex." LACFA is required to pay the County rent based on a percentage of the gross revenue from their use of the property. During calendar years 2012, 2013, and 2014, the rent payments totaled approximately $95,000, $156,000, and $349,000, respectively.

LACFA administers the annual Los Angeles County Fair (Fair) and various other events (e.g., festivals, exhibits, concerts, etc.) at the Fairplex during the year. They have also developed lodging and meeting facilities at the Fairplex, including the Sheraton Fairplex Hotel and Conference Center (Hotel), the Trade and Conference Center, and two recreational vehicle (RV) parks/campgrounds. They operate several programs for the community as well, including The Learning Centers (which includes the Child Development Center, the Career and Technical Education Center, and the Center for Automotive Arts, among its programs) and Millard Sheets Art Center. In addition, LACFA has established agreements (e.g., subleases, etc.) with several companies to operate and conduct business at the Fairplex year-round. Many of the companies are owned by LACFA, including Cornucopia Foods, LLC, Fairplex RV and Boat Storage, LLC, Event Production Solutions, LLC, and Barretts Equine Limited. These companies provide food and beverage services for the Fair and other events, RV and boat storage, party and event equipment rentals, and equine auction services, respectively.

Review Scope and Summary

We have completed a review of LACFA's financial operations, governance structure, and compliance with nonprofit requirements, as directed by your Board. Our review of LACFA's financial operations covered the period from January 2012 through December 2014 and focused on determining whether LACFA paid the County rent according to the terms of the Agreement and whether LACFA had the financial ability to continue paying rent to the County for the foreseeable future. We also reviewed selected aspects of LACFA's governance structure and compliance with nonprofit requirements.

Scope Limitations and Restrictions

In accordance with your Board's motion, our review had a more limited scope than what would constitute a comprehensive review of LACFA's compliance with all Agreement requirements. As such, we do not provide any assurance regarding compliance beyond the explicit issues we have identified in our report. Had we conducted a comprehensive review, additional issues may have come to our attention.

In addition, LACFA asserted that the scope of our review could result in the public disclosure of information they consider to be proprietary, trade secret, or confidential. To resolve these concerns, LACFA and the County entered into a protective agreement in July 2016 that provides the County with access to LACFA's sensitive records and maintains the confidentiality of LACFA's proprietary, trade secret, and confidential information in a manner consistent with applicable law. Due to the protective agreement, some information in this report is presented in a general, rather than specific and detailed, manner to avoid disclosure of LACFA's proprietary, trade secret, or confidential information.

The following is a brief summary of the significant results of our review:

RV Parks/Campgrounds Rent

LACFA operates two RV parks/campgrounds at the Fairplex, and also uses other areas of the property for RV parking (e.g., parking lots, etc.) when additional space is needed. We noted that LACFA incorrectly applied Agreement requirements when calculating rent for this operation, which resulted in rent underpayments of approximately $15,000 each year.

Hotel and Wholly Owned Company Rent (Gross Revenue)

LACFA is not paying the County rent on the gross revenue generated by the Hotel and their wholly owned companies. Instead, County rent is based on rent payments LACFA receives from these entities for use of the land. It appears that the County was aware of the practice since the early nineties. Additionally, in response to a 2006 audit requesting confirmation of this practice, the County Chief Executive Office (CEO) issued a letter in 2006 that confirmed the practice. However, the practice was not incorporated into the Agreement by an amendment approved by the Board. This practice is unusual with respect to the Hotel, which unlike the wholly owned companies, is a business component of LACFA and is not a separate legal entity.

The practice significantly lowers rent paid to the County. At the very least, the County could receive an additional $1 million in rent each year if it was based on the gross revenue generated by the Hotel and the wholly owned companies. Currently, the County only receives approximately $120,000 in rent from the wholly owned companies, and no rent from the Hotel (as discussed below), before agreed upon rent credits. The practice could also be perceived as a public subsidy of LACFA operations. In addition, LACFA has full ownership of the wholly owned companies and complete control over the amount of rent LACFA receives from them. They are effectively paying themselves and there is a risk that they could reduce the rent they receive from these entities, which LACFA would benefit from in paying lower rent to the County. If LACFA elects not to receive payment from these entities, then no rent is due to the County. This creates a conflict of interest that is not present in arm's-length, third-party business dealings.

Hotel and Wholly Owned Company Rent (Fair Market Value)

We noted that the rents LACFA charges the Hotel and wholly owned companies for use of the land do not appear to reflect current fair market values. For example, the rent LACFA charges Fairplex RV and Boat Storage, LLC is based on a calculated rate of return from the land value in 2010 when LACFA entered into the agreement with Fairplex RV and Boat Storage, LLC. We note that vacant land in Pomona now has a market value that is at least three times the land value used by LACFA to calculate the rent amount for the company. LACFA may have charged more, and the County would then have received higher rents, had the wholly owned businesses been controlled by an arm's-length third-party. It should also be noted that the rent agreements between LACFA and the Hotel and wholly owned companies are generally not subject to County review (only subleases of ten years or more require County review).

Hotel Rent (Accrual)

LACFA is accruing, but not paying, the County rent for the Hotel (approximately $2,500 accruing each year). In 1997, as part of LACFA's refinancing of the Hotel bond debt, LACFA asked the CEO for confirmation that the County would not receive rent from the Hotel until the subordination provisions of the bond documents were satisfied. Under the bond documents, rent paid by the Hotel to LACFA was subordinate to the payment of debt service. The CEO confirmed this practice, and stated the County's expectation that the rent was accruing and it would receive all current and back due rent from the Hotel when the subordination provisions had been satisfied. According to the exchange of letters, this practice was necessary for LACFA to secure refinancing for the Hotel bond, and it appears that the practice goes back further to the original financing of the Hotel, as LACFA has not paid rent to the County for the Hotel since it first opened in 1992. LACFA management indicated that they have not required the Hotel to pay rent since it operated at a loss (although the Hotel currently has positive operating income). In addition, the subordination provision requires that bond payments must be made before the Hotel can pay LACFA, although it is unclear whether that applies to specific bond payments as they come due or paying off the bond in its entirety (LACFA believes it is the latter).

We noted that the initial term of the Hotel bond would have expired by now, and LACFA has periodically issued new bonds to retire older bonds, effectively extending the term of the initial debt. Some of the new bonds also included additional debt for construction projects (i.e., Trade and Conference Center). Given that subordination provisions of older bonds would have expired when new bonds were issued, it appears that even if LACFA is correct in asserting that rent accrues until the end of the bond period, the requirement has been fulfilled and the County should receive rent. In addition, it does not appear as though the subordination provision would apply to additional debt that is not related to the initial construction of the Hotel. LACFA has expressed the opinion that the bond subordination requirement remains in effect for refinancing in the same manner as for the original financing, which if correct, would allow LACFA to continue accruing, and consequently never paying the Hotel rent due to the County for decades, if not longer.

Trade and Conference Center and Catering Rent

LACFA excludes revenue generated by the Trade and Conference Center and all catering services at the Fairplex from gross revenues when calculating rent owed to the County. LACFA placed management of these operations under the Hotel (without notifying the County) and all revenue generated is treated as Hotel revenue. As noted above, LACFA does not pay County rent on Hotel revenue.

Compensation Study

LACFA selected an outside consulting firm to complete a compensation study in 2011. The consulting firm reported that LACFA's executive compensation was reasonable and comparable to similar organizations with equivalent services/situations. We reviewed the compensation study and identified issues that raise questions regarding the appropriateness of its use in guiding LACFA in setting executive compensation. Specifically, the comparable organizations in the compensation study did not appear to be similar to LACFA or competing with them for talent. For example, the compensation study included nonprofit organizations such as large-scale innovative museums (i.e., several facilities, grandiose exhibits), entertainment industry advocacy associations, and sport governing bodies. It also included for-profits such as national boutique hotels and casino chains. The consulting firm also appeared to have included additional forms of compensation (e.g., 401(k), 457, etc.) in total compensation for the organizations they selected, but did not include them for LACFA. This artificially inflates compensation for those organizations in relation to LACFA.

Board of Director and Member Benefits

LACFA incurs significant expenses involving Board of Director and Member events (e.g., meetings at Hotel with meals, drinks, etc.). We reviewed one month of expenses and identified over $30,000 in Board of Director and Member related event expenses. These expenses were generally consistent from month to month. Assuming an annualized amount of $360,000, LACFA would have incurred Board of Director and Member expenses that were more than the annual rent paid to the County during each of the three years we reviewed (i.e., $349,000, $156,000, and $95,000). Directors also receive a $6,000 annual stipend, complementary tickets to the Fair and concerts held on the property, and access to a private dining room and lounge where food and drinks are provided for entertaining important guests (e.g., donors, sponsors, etc.).

Financial Condition

We reviewed LACFA's financial statements for calendar years 2012 to 2014, and evaluated their financial condition. We noted that LACFA appears to have the financial ability to continue operating and paying rent for the near future.

Nonprofit Compliance

LACFA is organized as a nonprofit mutual benefit corporation under State law. Nonprofit mutual benefit corporations are subject to many regulatory requirements, but nearly all of them are procedural in nature (e.g., submitting forms, annual filings, paying fees, etc.). We did not identify any issues that could impact LACFA's nonprofit status during our review.

Detailed Audit Report and Recommendations

Our Detailed Audit Report that identifies the specific results of our review is included in Attachment I. It also identifies eight recommendations pertaining to rent, governance, and other general lease term observations (beginning on page six).

Acknowledgment

We discussed our report with CEO and LACFA management, and their responses are included in Attachment II and III, respectively. The November 8, 2016 response on behalf of LACFA management disagrees with certain findings and recommendations in our report. The County is reviewing LACFA's response to determine if a follow-up memo is warranted. If you have any questions please contact me, or your staff may contact Robert Smythe at (213) 253-0100.

JN:AB:PH:RS:ZP

Attachments

c: Sachi A. Hamai, Chief Executive Officer
Mary C. Wickham, County Counsel
Lori Glasgow, Executive Officer, Board of Supervisors
J. Michael Ortiz, Interim CEO, Los Angeles County Fair Association
Public Information Office
Audit Committee

LOS ANGELES COUNTY FAIR ASSOCIATION
FINANCIAL OPERATIONS, GOVERNANCE, AND NONPROFIT COMPLIANCE REVIEW

DETAILED AUDIT REPORT

Background

Much of the property that comprises the Fairplex was acquired by Los Angeles County Fair Association (LACFA) and other entities and deeded to the County without charge. The County and LACFA have had a long-standing partnership spanning nearly a century, and a mutually beneficial relationship, in developing the Fairplex property to its current state. Due to this unique partnership, the County has provided LACFA with millions of dollars of both direct financial assistance and subsidies throughout the term of the partnership in the form of rent below market values, waived required rent payments, and direct funding.

In 1988, the County entered into a long-term Ground Lease and Operating Agreement (Agreement) with the LACFA, a private nonprofit organization, for the use and development of the County fairgrounds and surrounding properties commonly referred to as the "Fairplex." LACFA is required to pay the County rent based on a percentage of the gross revenue from their use of the property. During calendar years 2012, 2013, and 2014, rent payments totaled approximately $95,000, $156,000, and $349,000, respectively.

LACFA administers the annual Los Angeles County Fair (Fair) and various other events (e.g., festivals, exhibits, concerts, etc.) at the Fairplex during the year. They have also developed lodging and meeting facilities at the Fairplex, including the Sheraton Fairplex Hotel and Conference Center (Hotel), the Trade and Conference Center, and two recreational vehicle (RV) parks/campgrounds. They operate several programs for the community as well, including The Learning Centers (which includes the Child Development Center, the Career and Technical Education Center, and the Center for Automotive Arts, among its programs) and Millard Sheets Art Center. In addition, LACFA has established agreements (e.g., subleases, etc.) with several companies to operate and conduct business at the Fairplex year-round. Many of the companies are owned by LACFA, including Cornucopia Foods, LLC, Fairplex RV and Boat Storage, LLC, Event Production Solutions, LLC, and Barretts Equine Limited. These companies provide food and beverage services for the Fair and other events, RV and boat storage, party and event equipment rentals, and equine auction services, respectively.

Scope

We have completed a review of LACFA's financial operations, governance structure, and compliance with nonprofit requirements, as directed by your Board. Our review of LACFA's financial operations covered the period from January 2012 through December 2014 and focused on determining whether LACFA paid the County rent according to the terms of the Agreement and whether LACFA had the financial ability to continue paying rent to the County for the foreseeable future. We also reviewed selected aspects of LACFA's governance structure and compliance with nonprofit requirements.

Scope Limitations and Restrictions

In accordance with your Board's motion, our review had a more limited scope than what would constitute a comprehensive review of LACFA's compliance with all Agreement requirements. As such, we do not provide any assurance regarding compliance beyond the explicit issues we have identified in our report. Had we conducted a comprehensive review, additional issues may have come to our attention.

In addition, LACFA asserted that the scope of our review could result in the public disclosure of information they consider to be proprietary, trade secret, or confidential. To resolve these concerns, LACFA and the County entered into a protective agreement in July 2016 that provides the County with access to LACFA's sensitive records and maintains the confidentiality of LACFA's proprietary, trade secret, and confidential information in a manner consistent with applicable law. Due to the protective agreement, some information in this report is presented in a general,, rather than specific and detailed, manner to avoid disclosure of LACFA's proprietary, trade secret, or confidential information.

A. Rent Payments

The Agreement requires LACFA to pay the County rent based on a percentage of the gross revenue LACFA receives from the Fair and other uses of the Fairplex property (non-fair revenue). For calendar years 2012 through 2014, LACFA was required to pay the County 1.5% of Fair revenue and 5% of non-fair revenue in rent. In 2008, the County and LACFA entered into the third amendment to the Agreement which provides LACFA with an $800,000 waiver against the rent paid to the County for a period of 15 years ($12 million total), as the County's contribution to the financing, development, and construction of the Trade and Conference Center at the Fairplex. The following is a summary of the rent LACFA paid to the County during the three-year period:

TABLE 1 - SUMMARY OF RENT PAID TO COUNTY

CALENDAR YEAR	FAIR REVENUE	FAIR RENT	NON-FAIR REVENUE	NON-FAIR RENT	FAIR AND NON-FAIR RENT	RENT WAIVER	TOTAL RENT PAID
2012	$ 28,335,181	$ 425,028	$ 9,399,364	$ 469,968	$ 894,996	$ (800,000)	**$ 94,996**
2013	28,949,889	434,248	10,433,869	521,693	955,942	(800,000)	**155,942**
2014	26,539,761	398,096	15,018,645	750,932	1,149,029	(800,000)	**349,029**

NOTE: The third amendment to the Agreement indicates that LACFA will receive an $800,000 waiver against rent paid to the County through 2023. The purpose of the waiver was to support the financing, development, and construction of the Trade and Conference Center at the Fairplex.

We identified some significant changes in LACFA's revenue streams (i.e., over 15% and $100,000) during the three years. Positive changes include generating more revenue from new events throughout the year and increased attendance and ticket prices for concerts at the annual Fair. LACFA also received substantial, non-reoccurring revenue in 2014 from horse training services on the property. Conversely, there were some negative changes the same year due to LACFA moving horse racing from the Fairplex to Los Alamitos Race Course and discontinuing a business operation.

A.1. Rent Verification

LACFA completes lease calculation schedules annually to identify rent payable to the County. We reviewed LACFA's lease calculation schedules for calendar years 2012 through 2014 to determine whether they paid the County rent according to the terms of the Agreement. Our review included confirming the accuracy of the rent calculations on the schedules, evaluating whether rent rates and excluded revenue on the schedules were consistent with the Agreement, and reconciling schedules to LACFA's accounting records. We also sampled the significant revenue items on the schedules and reviewed supporting documentation (e.g., invoices, receipts, checks, etc.) to determine whether they were accurate. With the exception of the issues and practices noted below, we did not identify any material misstatements in rent paid to the County.

A.2. RV Parks/Campgrounds Rent

LACFA operates two RV parks/campgrounds at the Fairplex, and also uses other areas of the property for RV parking (e.g., parking lots, etc.) when additional space is needed. According to the Agreement, the rent basis for one park/campground is 50% of gross revenues, and the basis for all remaining operations is 100%. The 50% basis was the result of LACFA and the County each owning one half of the property on which this RV park/campground is located. For example, if the gross revenue for this property was $100,000, the County would only receive percentage rent on $50,000 (half the revenue from the property).

We noted that LACFA used 50% as the basis for both RV parks/campgrounds and all of the other areas of the Fairplex used for RV parking, even though some of the operations were located on the County's solely owned property, to which the 100% basis should have been applied. This practice resulted in rent underpayments of approximately $15,000 each year.

A.3. Hotel and Wholly Owned Company Rent (Gross Revenue)

As indicated earlier, the Agreement requires LACFA to pay the County rent based on a percentage of the gross revenue they receive from use of the Fairplex. However, we noted that LACFA excludes revenue generated by the Hotel and their wholly owned companies from gross revenue for the purpose of calculating rent owed to the County. Instead, County rent is based on the rent payments LACFA receives from these entities for use of the land. It appears that the County was aware of this practice for some time (since the early nineties). Additionally, in response to a 2006 audit requesting confirmation of this practice, the County Chief Executive Office (CEO) issued a letter in 2006 that confirmed the practice. However, the practice was not incorporated into the Agreement by an amendment approved by the Board. This practice is unusual with respect to the Hotel, which unlike the wholly owned companies, is a business component of LACFA and is not a separate legal entity.

The practice significantly lowers rent paid to the County. At the very least, the County would receive an additional $1 million in rent each year if it was based on the revenue generated by the Hotel and the wholly owned companies. Currently, the County only receives approximately $120,000 in rent from the wholly owned companies, and no rent from the Hotel (as discussed below), before agreed upon rent credits. The practice could also be perceived as a public subsidy of LACFA operations. In addition, LACFA has full ownership of the wholly owned companies and complete control over the amount of rent LACFA receives from them. They are effectively paying themselves and there is a risk that they could reduce the rent they receive from these entities, which LACFA would benefit from in paying lower rent to the County. If LACFA elects not to receive payment from these entities, then no rent is due to the County. This creates a conflict of interest that is not present in arm's-length, third-party business dealings.

A.4. Hotel and Wholly Owned Company Rent (Fair Market Value)

We noted that the rents LACFA charges the Hotel and wholly owned companies for use of the land do not appear to reflect current fair market values. For example, the $50,000 annual land rent for the Hotel is equivalent to the amount it would cost to rent a 2,000 square foot office space or 3,500 square foot retail space in Pomona. Since the Hotel is a 196,000 square foot facility with 224 guest rooms, a conference center, restaurant and bar, and other amenities, the rent LACFA charges the Hotel appears to be well below fair market value. In addition, the Fairplex RV and Boat Storage, LLC rent amount is based on a calculated rate of return from the land value in 2010 when LACFA entered into the agreement with the Fairplex RV and Boat Storage, LLC. We noted that vacant land in Pomona has a current market value that is at least three times the land value used by LACFA to calculate the rent amount for the company. LACFA may have charged more, and the County would have then received higher rents, had the wholly owned companies been controlled by arm's-length third parties. It should also be noted that the rent agreements between LACFA and the Hotel and wholly owned companies are generally not subject to County review (only subleases of ten years or more require County review).

A.5. Hotel Rent (Accrual)

LACFA is accruing, but not paying, the County rent for the Hotel (approximately $2,500 accruing each year). In 1997, as a part of LACFA's refinancing of the Hotel bond debt, LACFA asked the CEO for confirmation that the County would not receive rent from the Hotel until the subordination provisions of the bond documents were satisfied. Under the bond documents, rent paid by the Hotel to LACFA was subordinate to the payment of debt service. The CEO confirmed this practice, and stated the County's expectation that the rent was accruing and it would receive all current and back due rent from the Hotel when the subordination provisions had been satisfied. According to the exchange of letters, this practice was necessary for LACFA to secure refinancing for the Hotel bond, and it appears that the practice goes back further to the original financing of the Hotel, as LACFA has not paid rent to the County for the Hotel since it first opened in 1992. LACFA management indicated that they have not required the Hotel to pay LACFA rent since it operated at a loss (although the Hotel currently has positive operating income). In addition, the subordination provision requires that bond payments must be made before the Hotel can pay LACFA, although it is unclear whether that applies to specific bond payments as they come due or paying off the bond in its entirety (LACFA believes it is the latter).

We noted that the initial term of the Hotel bond would have expired by now, and LACFA has periodically issued new bonds to retire older bonds; effectively extending the term of the initial debt. Some of the new bonds also included additional debt for construction projects (i.e., Trade and Conference Center). Given that subordination provisions of older bonds would have expired when new bonds were issued, it appears that even if LACFA is correct in asserting that rent accrues until the end of the bond period, the requirement has been fulfilled and the County should receive rent. In addition, it does not appear as though the subordination provision would apply to additional debt that is not related to the initial construction of the Hotel. LACFA has expressed the opinion that the bond subordination requirement remains in effect for refinancing in the same manner as for the original financing, which if correct, would allow LACFA to continue accruing, and consequently never paying the Hotel rent due to the County for decades, if not longer.

A.6. Trade and Conference Center and Catering Rent

We noted that LACFA is excluding revenue generated by the Trade and Conference Center and all catering services at the Fairplex from gross revenues when calculating the rent owed to the County. LACFA placed management of these operations under the Hotel (without notifying the County) and all revenue generated is treated as Hotel revenue. As noted above, LACFA does not pay County rent on Hotel revenue. This arrangement appears to be contrary to expectations of the County as set forth in the 2008 Board letter recommending approval of the third amendment to the Agreement. As noted above, the amendment provided LACFA with an $800,000 annual waiver against rent paid to the County for 15 years to support the Trade and Conference Center project. Based on information provided by LACFA, the Board letter indicated that LACFA expected the Trade and Conference Center to generate an additional $250,000 in annual revenue for the County.

A.7. Recommendations Going Forward

LACFA and CEO should work together to reach an understanding regarding rent terms going forward and memorialize the terms with an amendment to the Agreement. Rent terms should be highly specific, clearly defined, and leave no room for interpretation. If LACFA and CEO elect to continue some of the prior practices, any transactions that are not at arm's-length need to be carefully evaluated by both parties to ensure they are equivalent to market values. They should also consider restructuring the rent terms to avoid difficulties and gray areas associated with LACFA's unique business practices and components. One option would be to use the gross revenue reported on LACFA's audited financial statements (with exclusions for offsite revenue) as a rent basis. This would simplify reporting and monitoring. Another option would be to use a flat rent amount based on the Fairplex property value with periodic adjustments over time (e.g., inflation, etc.). The County would receive a consistent revenue stream regardless of LACFA's financial performance, and LACFA would get the flexibility to explore different business models and practices without impacting rent.

LACFA and CEO should determine the amount of back rent that has been accruing from the Hotel and determine when and how that amount should be paid to the County, and whether the accrual of rent should continue under LACFA's current bond obligations. They should also determine whether LACFA should pay rent based on the gross revenue generated by the Hotel (including the Trade and Conference Center and catering services) and the wholly owned companies. In addition, they should develop a plan for LACFA to repay the County the underpayments involving the RV parks/campgrounds.

Recommendations

Chief Executive Office and Los Angeles County Fair Association:

1. **Reach an understanding regarding rent terms going forward, ensure that rent terms are highly specific, clearly defined, and leave no room for interpretation, and memorialize terms by amending the Agreement.**

2. **Identify all past rent underpayments and develop a repayment plan.**

3. **Consider restructuring rent terms to avoid difficulties and gray areas related to the Los Angeles County Fair Association's unique business practices.**

4. **Carefully evaluate all transactions impacting rent that are not at arm's-length to ensure they are equivalent to fair market values. Consider classifying deviations from fair market values that negatively impact County rent as a public subsidy, quantify subsidy amounts and public benefits, and memorialize subsidies by amending the Agreement.**

B. Financial Condition

The County has a vested interest in ensuring LACFA has the financial ability to continue paying rent for the foreseeable future. We reviewed LACFA's financial statements for calendar years 2012 to 2014, and evaluated their financial condition. We noted that LACFA appears to have the financial ability to continue operating and paying rent for the near future. The following is a summary of their revenue and expenses during the three-year period:

TABLE 2 - SUMMARY OF LACFA REVENUE AND EXPENSE			
DESCRIPTION	**2012**	**2013**	**2014**
OPERATING REVENUE	$ 66,647,581	$ 71,607,413	$ 74,739,409
OPERATING EXPENSE	(58,965,099)	(64,813,414)	(68,279,134)
NET OPERATING INCOME	**$ 7,682,482**	**$ 6,793,999**	**$ 6,460,275**
NON-OPERATING INCOME (EXPENSE)	$ (7,959,570)	$ (2,553,540)	$ (14,901,398)
NET INCOME (LOSS)	**$ (277,088)**	**$ 4,240,459**	**$ (8,441,123)**

While LACFA reported net losses in two of the three years we reviewed, we noted that they generated significant operating income during that period and the net losses were attributable to their non-operating activities (i.e., interest, depreciation, and interest rate swaps as explained later in our report). Operating income, non-operating activities, and other aspects of LACFA's financial condition are discussed in detail below.

B.1. Operating Income

Operating income is the profit generated from core business operations. It is one of the more important measures of financial condition because it identifies the fiscal efficiency in which management runs day-to-day operations. Operating income is also available for management to use in strategic business activities (e.g., expansion, improvements, debt reduction, etc.). LACFA had over $6 million in operating income in each of the three years reviewed. We also noted that they had positive operating cash flow.

B.2. Non-Operating Activities

Non-operating activities generally include financing, investing, and other activities that are not directly related to core business operations. LACFA had significant losses from non-operating activities (as a whole) during the three years we reviewed. A summary of LACFA's non-operating activities is as follows:

TABLE 3 - SUMMARY OF LACFA NON-OPERATING ACTIVITIES			
NON-OPERATING ACTIVITIES	**2012**	**2013**	**2014**
INTEREST EXPENSE	$ (2,803,268)	$ (2,836,178)	$ (3,062,200)
DEPRECIATION**	(6,040,994)	(6,366,572)	(6,568,631)
INTEREST RATE SWAP GAIN (LOSS)**	270,631	7,228,772	(5,279,837)
INVESTMENT INCOME	18,242	253,463	9,270
GRANTS & CONTRACTS	350,000	-	-
LOSS ON DISPOSAL OF ASSETS**	-	(158,736)	-
OTHER INCOME (EXPENSE)	245,819	(674,289)	-
NON-OPERATING INCOME (EXPENSE)	**$ (7,959,570)**	**$ (2,553,540)**	**$ (14,901,398)**

** Accounting entries that do not represent cash inflows or outflows.

The items with the greatest impact on LACFA's non-operating expense are interest, depreciation, and interest rate swap gains and losses.

- **Interest:** The interest payments were primarily associated with two bonds issued by LACFA. The bonds were generally related to construction of the Hotel, the Trade and Conference Center, and other capital improvements at the Fairplex.

- **Depreciation:** Depreciation is an accounting entry that allocates the total cost of a capital asset (e.g., buildings, equipment, etc.) to expense over an asset's anticipated useful life. Depreciation is a non-cash expense due to the fact that the assets had already been purchased (i.e., cash, debt). We discuss concerns associated with the physical condition of the Fairplex property and deferred maintenance later in section C.6 of this report (which could impact depreciation going forward).

- **Interest Rate Swaps:** Interest rate swaps are agreements between two entities to exchange future interest payment streams for a specific principal amount. LACFA entered into interest rate swap agreements with a bank for both of their bonds. The bonds initially had variable interest rates, which LACFA exchanged for fixed rates. According to LACFA management, they entered into the agreements to lock in their payment amounts and limit their exposure to interest rate fluctuation. Interest rate swap gains and losses are not cash inflows and outflows. They represent changes in fair market value of the swaps over the year. Depending on the fair market value, swaps can be classified as assets or liabilities. However, LACFA would only have to pay the liability if the swap agreements were canceled (minimal risk of occurring).

We noted that depreciation and interest rate swaps do not impact LACFA's ability to continue operating and paying rent for the near future. Depreciation is tied to capital spending, which organizations can largely manage and control (e.g., build up reserves, etc.), and interest rate swaps essentially generate "paper" gains and losses that will only materialize if canceled.

B.3. Short-Term Liquidity

Organizations with healthy short-term liquidity have sufficient assets to pay their debts and obligations when they come due. We compared LACFA's current assets to current liabilities, and noted that they had an excess of assets during the three years reviewed. A summary of LACFA's current assets and liabilities is as follows:

TABLE 4 - SUMMARY OF LACFA CURRENT ASSETS AND LIABILITIES

DESCRIPTION	2012	2013	2014
CURRENT ASSETS	$ 18,118,136	$ 17,349,563	$ 15,016,165
CURRENT LIABILITIES	(10,958,372)	(12,394,916)	(12,644,250)
DIFFERENCE	**$ 7,159,764**	**$ 4,954,647**	**$ 2,371,915**
CURRENT RATIO	**1.65**	**1.40**	**1.19**

While still acceptable, LACFA's liquidity has decreased over the three years. LACFA management indicated that they had expended cash on construction and other capital improvements during that period (e.g., connecting the Hotel to the Trade and Conference Center, etc.).

C. Governance

Governance is generally comprised of the administrative structure, strategic planning, key officials (e.g., director, etc.), performance management process, and compensation practices of an organization. The different aspects of LACFA's governance are discussed below.

C.1. Administrative Structure and Strategic Planning

We noted that LACFA has approved and adopted articles of incorporation, bylaws, and policies governing code of conduct, conflict of interest, retaliation, and whistleblowing. In addition, LACFA developed a long-term strategic plan that identifies their intended vision of the organization for the future and their specific long-term goals (e.g., business activities, land use, etc.) that coincide with the vision. LACFA also developed step-by-step plans for each year, which serve as a road map for achieving long-term goals.

C.2. Members and Board of Directors

LACFA membership is made up of a diverse range of individuals from the surrounding community (e.g., educators, philanthropists, entrepreneurs, etc.). The members elected an active Board of Directors (e.g., regularly meet, involved, etc.) who collectively appear to have the knowledge and experience necessary to oversee LACFA's different business components and nonprofit purpose.

However, we noted that LACFA incurs significant expenses involving Board of Director and Member events (e.g., meetings at Hotel with meals, drinks, etc.). We reviewed one month of expenses and identified over $30,000 in Board of Director and Member event expenses. These expenses were generally consistent from month to month. Assuming an annualized amount of $360,000, LACFA would have incurred Board of Director and Member expenses that were more than the annual rent paid to the County during each of the three years we reviewed (i.e., $349,000, $156,000, and $95,000). The Directors also receive a $6,000 annual stipend, complementary tickets to the Fair and concerts held on the property, and access to a private dining room and lounge where food and drinks are provided for entertaining important guests (e.g., donors, sponsors, etc.).

C.3. Executive Management Performance Measures

The performance of LACFA executive management is evaluated annually, and consists of a standardized performance evaluation form and a goal and objective assessment. While the LACFA performance evaluation form was fairly generic and not job specific, the assessment included goals and objectives that were measurable, appeared relevant to the position, and aligned with LACFA strategic planning documents.

C.4. Executive Management Compensation

LACFA's executive compensation is largely awarded based on discussions between manager and subordinate (i.e., Board of Directors and Chief Executive Officer, Chief Executive Officer and executive managers) with consideration given to the most recent compensation study performed by consultants. Bonuses are tied to their achievement of their annual goal and objectives, and bonus amounts are allocated based on the overseeing managers' determination of the relative importance of each goal and objective. Compensation is also adjusted annually based on the results of performance evaluations. A summary of executive compensation to LACFA's top four executives is as follows:

TABLE 5 - SUMMARY OF EXECUTIVE COMPENSATION TO LACFA TOP FOUR EXECUTIVES			
TITLE	BASE & BONUS COMPENSATION	OTHER COMPENSATION [1]	TOTAL COMPENSATION
PRESIDENT AND CHIEF EXECUTIVE OFFICER	$ 990,037	$ 55,051	$ 1,045,088
VICE PRESIDENT, FINANCE AND CHIEF FINANCIAL OFFICER	420,519	34,297	454,816
VICE PRESIDENT, SALES, MARKETING, AND PROGRAMMING	396,487	41,987	438,474
VICE PRESIDENT, OPERATIONS	338,777	42,246	381,023

[1] INCLUDES RETIREMENT, DEFFERED, AND OTHER BENEFITS.
SOURCE: LACFA IRS FORM 990 (2014)

In addition, LACFA solicits periodic compensation studies to validate that compensation is consistent with positions at comparable companies; the most recent of which was completed in 2011. However, we identified issues with the study (as presented below), which raise questions regarding the appropriateness of its use in guiding LACFA in setting executive compensation.

C.5. Executive Compensation Study (2011)

LACFA's Board of Directors selected a consulting firm to complete the 2011 executive compensation study. They sent requests for proposals that included a scope of work with sufficient and appropriate details, reviewed all proposals received, and interviewed prospective consulting firms. However, the Board of Directors did not document their justification for selecting the consulting firm that was awarded the contract (e.g., scoring mechanism, etc.), and we identified an area of concern regarding the consulting firm's suitability for the compensation study. Specifically, we noted that the managing director for the project was previously a benefits adviser for LACFA while working for another consulting firm, and designed several aspects of LACFA's compensation and benefit program. This calls into question his level of independence given that he was tasked with reviewing and providing an opinion on some of the work he previously performed. Thus, if the Board of Directors was expecting an independent assessment, the objective may not have been achieved.

The consulting firm reported that LACFA's executive compensation was reasonable and comparable to similar organizations with equivalent services/situations. We reviewed the compensation study and identified the following issues:

- **Selected Organizations:** The comparable organizations in the compensation study did not appear to be similar to LACFA or competing with them for talent. For example, the compensation study included nonprofit organizations such as large-scale innovative museums (i.e., several facilities, grandiose exhibits), entertainment industry advocacy associations, and sport governing bodies. It also included for-profits such as national boutique hotels and casino chains. With the exception of running the Fair, LACFA's core business is managing exhibition space (soliciting entities to rent property for events) and other smaller scale operations (e.g., school programs, daycare, art center, etc.) throughout the year. It should be noted that LACFA's management of the Hotel, the Trade and Conference Center, and catering for the Fairplex is outsourced to a large hotel group.

- **Forms of Compensation:** The consulting firm appeared to have included additional forms of compensation (e.g., 401(k), 457, healthcare, etc.) in total compensation for some of the comparable organizations, but did not include them for LACFA. This artificially inflates comparable organization compensation in relation to LACFA.

- **Compensation Data:** The study indicated that comparative compensation figures were based on an average of four data sets: nonprofit organizations selected by the firm, for-profit organizations selected by the firm, nonprofit organization surveys published by other consulting firms, and for-profit organization surveys published by other consulting firms. However, the study did not include the nonprofit organization surveys published by other consulting firms in their calculation of total comparable compensation, and the firm's own selections were weighted more to compensate. Their selections generally had higher compensation figures compared to surveys.

- **Data Adjustments:** The consulting firm made adjustments to compensation data for comparable organizations to account for differences in operating size, scope, and responsibilities. However, they did not identify the basis or rationale for adjustment amounts, which precluded us from evaluating reasonableness.

C.6. Other Identified Issues

Although outside the scope of our review, we identified the following additional issues that came to our attention:

- **Property Condition:** The Agreement requires LACFA to maintain the Fairplex in good order, condition, and repair. However, the CEO does not periodically perform, or obtain, independent evaluations of the physical condition of the Fairplex. It should also be noted that issues have recently arisen giving cause for concern regarding LACFA's ongoing maintenance of the property. Specifically, the State of California Department of Housing and Community Development cited LACFA in March 2016 for significant public safety violations at one of the RV parks/campgrounds, including unacceptable construction practices, exposed electrical hazards, various leaks, and accumulation of refuse. LACFA did not fully remediate these violations until October 2016 (after receiving notice in August 2016 that operations would be suspended if violations were outstanding any longer), but is now fully compliant. LACFA also did not initially have a permit to operate that particular RV park/campground on the property.

- **Sublease Length:** The Agreement prohibits LACFA from entering into a sublease of the Fairplex that exceeds the length of its lease term with the County. We noted that LACFA entered into a long-term agreement with the City of Pomona to provide affordable housing at the Fairplex that exceeded the term of the Agreement with the County.

- **Financial Information:** The Agreement requires LACFA to report detailed revenue and expense information to the County each month, and provide audited financial statements annually that specify, among other items, Fair revenue, other revenue, and Fair expenses. We noted that LACFA has not reported monthly revenue and expense information, and only provides an annual summary of revenue (no expense information) for the purpose of calculating County rent. We also noted that LACFA's audited financial statements do not specifically identify Fair expenses.

C.7. Recommendations Going Forward

As noted above, the County and LACFA have had a long-standing partnership spanning nearly a century, and a mutually beneficial relationship, in developing the Fairplex property to its current state. Due to this unique partnership, the County has provided LACFA with tens of millions of dollars of both direct financial assistance and subsidies throughout the term of the partnership in the form of rent below market values, waived required rent payments, and direct funding.

The disclosure of compensation totaling nearly a million dollars for the former LACFA Chief Executive Officer and compensation for several LACFA executives ranging between \$250,000 and \$500,000 has called into question LACFA's conscientious use of, the continued need for, and appropriateness of, County financial support and subsidies that have totaled in the millions of dollars over the term of the Agreement. As a result, LACFA and CEO should consider working together to establish executive compensation guidelines that are reasonable and appropriate with respect to LACFA's status as a nonprofit organization and a County and community partner. Similar consideration should also be given to Board of Director and Member event, business, and entertainment expenses.

Recommendations

5. **Chief Executive Office and Los Angeles County Fair Association consider establishing reasonable executive compensation guidelines, and give similar consideration to Board of Director and Member event, business, and entertainment expenses.**

6. **Chief Executive Office consider periodically conducting or obtaining independent evaluations of the physical condition of the entire property. Such an evaluation should identify any significant deferred maintenance issues and provide estimated costs of necessary repairs. The results should be incorporated into the strategic planning process undertaken by Los Angeles County Fair Association with input by the County.**

7. **Chief Executive Office reemphasize that subleases cannot exceed the term of the Agreement with the Los Angeles County Fair Association, and determine what, if any, steps should be taken to confirm Los Angeles County Fair Association's full responsibility for its affordable housing agreement with the City of Pomona.**

8. **Chief Executive Office determine if financial information regarding the net operating results of the annual Fair is of value or interest to the public and on-going oversight of the Agreement, and revise the Agreement or reemphasize this condition with the Los Angeles County Fair Association accordingly.**

D. Nonprofit Compliance

The Agreement requires LACFA to maintain its nonprofit status. We noted that LACFA is organized as a nonprofit mutual benefit corporation under State law. These types of nonprofits differ from charities in that they are established for the benefit of specific groups or members. Typically, groups pursuing common goals will incorporate in this manner (e.g., chambers of commerce, social clubs, unions, etc.). We noted that LACFA was established to operate the Fair and other expositions, and promote the agricultural, horticultural, industrial, and other interests of Los Angeles County.

Nonprofit status and tax exempt status, while related, are not the same. Nonprofit status refers to a designation and method of incorporation under California Corporations Code, and tax exempt status refers to an exemption from taxation under the Internal Revenue Code and California Revenue and Taxation Code. As a result, nonprofit organizations can legally operate without tax exempt status. We noted that the Agreement does not require LACFA to maintain tax exempt status.

Nonprofit mutual benefit corporations are subject to many regulatory requirements, but nearly all of them are procedural in nature (e.g., submitting forms, annual filings, paying fees, etc.). We did not identify any issues during our review that could impact LACFA's nonprofit status.

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SACHI A. HAMAI
Chief Executive Officer

November 9, 2016

TO: John Naimo
Auditor-Controller

FROM: Sachi A. Hamai
Chief Executive Officer

SUBJECT: **RESPONSE TO THE AUDITOR-CONTROLLER'S REPORT "LOS ANGELES COUNTY FAIR ASSOCATION REVIEW–FINANCIAL OPERATIONS, GOVERNANCE, AND NONPROFIT COMPLIANCE"**

The following is in response to your report entitled "Los Angeles County Fair Association Review – Financial Operations, Governance, and Nonprofit Compliance".

Below is our response to the eight recommendations provided by your office:

Recommendation 1: Reach an understanding regarding rent terms going forward, ensure that rent terms are highly specific, clearly defined, and leave no room for interpretation, and memorialize terms by amending the Agreement.

> **CEO Response:** The Chief Executive Office (CEO) agrees with this recommendation and will work with the Los Angeles County Fair Association (LACFA) to clarify rent terms and will ensure that any amendments to the Agreement are specific and provide no room for interpretation.

Recommendation 2: Identify all past rent underpayments and develop a repayment plan.

> **CEO Response:** The CEO agrees with this recommendation, and will develop a repayment plan.

Recommendation 3: Consider restructuring rent terms to avoid difficulties and gray areas related to the Los Angeles County Fair Association's unique business practices.

> **CEO Response:** The CEO agrees with this recommendation. We will seek to restructure rent terms to address these issues.

Recommendation 4: Carefully evaluate all transactions impacting rent that are not at arm's length to ensure they are equivalent to fair market values. Consider classifying deviations from fair market values that negatively impact County rent as a public subsidy, quantify subsidy amounts and public benefits, and memorialize subsidies by amending the Agreement.

> **CEO Response:** The CEO agrees with this recommendation. The CEO will seek to clarify the lease terms, and to maximize the revenue and the public benefits achieved under the lease.

Recommendation 5: Chief Executive Office and Los Angeles County Fair Association consider establishing reasonable executive compensation guidelines, and give similar consideration to Board of Director and Member event, business, and entertainment expenses.

> **CEO Response:** The CEO agrees with this recommendation and will seek to address this through a negotiated lease amendment.

Recommendation 6: Chief Executive Office consider periodically conducting or obtaining independent evaluations of the physical condition of the entire property. Such an evaluation should identify any significant deferred maintenance issues and provide estimated costs of necessary repairs. The results should be incorporated into the strategic planning process undertaken by Los Angeles County Fair Association with input by the County.

> **CEO Response:** The CEO agrees with this recommendation and will implement routine evaluations of the condition of the property.

Recommendation 7: Chief Executive Office reemphasize that subleases cannot exceed the term of the Agreement with the Los Angeles County Fair Association, and determine what, if any, steps should be taken to confirm LACFA's full responsibility for its affordable housing agreement with the City of Pomona.

> **CEO Response:** The CEO agrees with this recommendation. We will work with LACFA to address the agreement with the City of Pomona.

Recommendation 8: Chief Executive Office determine if financial information regarding the net operating results of the annual Fair is of value or interest to the public and on-going oversight of the Agreement, and revise the Agreement or reemphasize this condition with the Los Angeles County Fair Association accordingly.

> **CEO Response:** The CEO agrees with this recommendation and will seek to address this with the LACFA.

Per the existing ground lease and operating agreement between the County and the LACFA, the full implementation of your recommendations is dependent on cooperation from the Fair Association.

If you have any questions, please contact me at (213) 893-2477.

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BMB:FC:LG:zu

c: County Counsel

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November 8, 2016

Client-Matter: 62115-030

BY E-MAIL JNAIMO@AUDITOR.LACOUNTY.GOV

Mr. John Naimo
Auditor-Controller
County of Los Angeles
Kenneth Hahn Hall of Administration
500 West Temple Street, Room 525
Los Angeles, California 90012

Re: Preliminary Response of the Los Angeles County Fair Association – Financial Operations, Governance, and Non-profit Compliance Review by the County of Los Angeles

Dear Auditor-Controller Naimo:

Thank you for providing the Los Angeles County Fair Association ("LACFA") an opportunity to comment on your forthcoming audit. We welcome the opportunity to collaborate with your office to ensure that the facts and analysis in the Auditor-Controller's report are accurate and we look forward to working with the County of Los Angeles (the "County") to obtain agreement on your various recommendations. Having begun a discussion with the County just last year about an amendment and extension to the Lease, your audit is timely—it raises issues that should be a part of the discussion as LACFA works to build upon, and improve its longstanding relationship with the County.

As a threshold matter, LACFA appreciates that your audit has found that:

1) Contrary to media reports suggesting otherwise, LACFA is financially strong, with net operating income that ranged between six and seven million dollars in positive cash flow during 2012 through 2014.

2) LACFA has continuously maintained its nonprofit status and the Auditor-Controller "did not identify any issues that could impact LACFA's non-profit status during our review."

3) The audit found no issues regarding LACFA's conformance with regulations or required permits except for certain conditions at the Fairplex Recreational

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Vehicle Park. However, the report concludes that LACFA is "now fully compliant."

4) LACFA is governed by a code of conduct and policies, which address conflicts of interest, retaliation, and whistleblowing. Furthermore, LACFA has an "active" Board of Directors, the members of which "collectively appear to have the knowledge and experience necessary to oversee LACFA's different business components and nonprofit purpose."

Questions about LACFA's financial health, governance structure, and compliance with non-profit requirements led to the audit in the first place. So we are pleased that the County's report has clarified that LACFA is financially healthy, has maintained its non-profit status, is operating in conformance with all required permits and applicable regulations, and has proper governance mechanisms and personnel in place to oversee LACFA's operations. Likewise, we are pleased that the audit "did not identify any material misstatements in rent paid to the County" after reviewing LACFA's lease calculation schedules for calendar years 2012 through 2014.

We also appreciate that the County audit report provided *some* context and history to what the County calls the "unique partnership" between the County and LACFA. The audit acknowledges that the parties have had "a long-standing partnership spanning over nearly a century" and that this partnership has clearly been "a mutually beneficial relationship, in developing the Fairplex property to its current state."

Importantly, the audit also reminds the reader that "[m]uch of the property that comprises the Fairplex was acquired by LACFA and other entities and deeded to the County without charge." While giving away land may not make sense to the casual observer, this decision to give away the land to the County was integral to the early and continuing intentions of the two parties. LACFA's primary mission, like the County, was and has always been to serve the County and its residents. For decades, the County and LACFA have worked hand-in-hand in this same spirit to serve the County, and residents of the east San Gabriel Valley in particular.

So while we appreciate many of the key conclusions in the audit report, the audit also raises questions that we believe were asked and answered many years ago—in prior independent audit reports, in prior analyses by County Counsel, and in written memoranda by the County's then-Chief Administrative Officer ("CAO") David Jannsen. Although the Auditor-Controller's report does not take a final position on the matter, it suggests a re-interpretation of the County's decades-long interpretation of how rent is calculated with respect to gross revenues generated by the hotel and LACFA's affiliate companies. We must reiterate that any re-interpretation of the Lease is directly at odds with the practice of the two parties, all prior independent audits, confirmation in

2006 by Mr. Jannsen with concurrence of County Counsel, and the historic intention of the parties. From the very beginning, hotel and affiliate revenue have been excluded from rent under the Lease. Unfortunately, none of the County officials who administered the Lease from its inception remain at the County, thus the confusion of the Auditor-Controller is understandable. Not only was it the intent of the parties to exclude the hotel's gross revenue when they negotiated the Lease (something which is reflected in longstanding practice from day one), the hotel could never have been financed and constructed during California's crippling recession of the early 1990s if gross revenues had been included.

While some of the questions raised in the audit report are reasonable given the lack of institutional memory and the absence of e-mail records when the almost three decade old agreement was negotiated, some context is in order. If the County and LACFA had only viewed their partnership through the narrow prism of rent, or if LACFA was only interested in maximizing its own revenues, then LACFA certainly would not have deeded away the Fairplex land to the County so that it could serve the public interest in perpetuity, nor would LACFA have provided millions in nonprofit programming to County residents, none of which is required by the Lease. But this, too, was the intention of the parties. LACFA and the County have been partners working to foster educational opportunities for youth throughout the east San Gabriel Valley and have worked hand-in-hand to develop the Fairplex with an eye toward creating community-building and economic growth for the region. The audit pays scant attention to the specifics of these community benefits, an essential purpose of the relationship as well as the Lease.

Set forth below is some more detailed background and context on LACFA's longstanding relationship with the County, followed by LACFA's perspective on the various matters covered in the audit report.

I. BACKGROUND AND HISTORY OF THE LOS ANGELES COUNTY FAIR ASSOCIATION AND ITS RELATIONSHIP WITH THE COUNTY

Over the last seven decades, the County and LACFA have shared a mission to promote agriculture, horticulture, forestry and viniculture in the region. Through the years, the County has experienced social change, economic change, and political change, yet the relationship between the County and LACFA has endured—and in fact, thrived.

The Los Angeles County Fair began in 1922. Nearly a century later, the Fair is one of the most prominent fairs in the United States, entertaining and educating millions. The Fairplex property has also changed. In the 1940s, LACFA deeded much of the Los Angeles Fairgrounds to the County. The Fairplex is now one of the most valuable properties in the County's real estate portfolio, and houses a museum, hotel, and conference and trade center, among other assets. Although the County supported these endeavors, LACFA financed most of this development

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without County support. Today, the facilities at the Fairplex are worth over $60 million, but cognizant of its longstanding commitment to community investment, LACFA will eventually transfer ownership of these facilities to the County, just as it did with the land. Unfortunately, the draft report only makes passing reference to these facts, ignores that ownership of LACFA assets will revert to the County, and fails to consider how the development of these facilities on behalf of the County factors into the Lease.

The remarkable growth of the Fairplex exemplifies what LACFA can do when aligned with the County. LACFA employs nearly 1,500 workers annually to support the Fair. With the construction of the hotel and conference center, over 160 full time equivalent jobs were created, providing a direct impact in the lives of County residents. These jobs provide income and spur additional economic growth in Pomona. Parents can support their families and afford housing. Businesses have more customers. Residents pay their taxes. By extension, the County and LACFA are able to realize their goal of enriching the lives of others. None of this happens without LACFA and the County working together, yet the connection between the Lease and job creation is not drawn in the County's report. For example, there is no discussion concerning the number of jobs created by LACFA.

But LACFA's work goes beyond hosting a Fair, building a hotel, and creating jobs. Supported by the development of the Fairplex, LACFA supports several affiliated non-profit organizations and community programs. For instance, LACFA operates and maintains a year-round 5-acre educational farm at the Fairplex (known as "The Farm"). LACFA invites over 175,000 students to the Farm annually to learn about agriculture, horticulture, forestry and viniculture. LACFA also oversees numerous programs such as (1) The Learning Centers, (2) the Career and Technical Education Center, (3) Junior Fair Board, (4) Millard Sheets Art Center, (5) the Alex Xydias Center for Automotive Arts, among others. These programs provide vocational training in auto mechanics, arts, landscaping, and other skills. Finally, LACFA administers The Child Development Center, which offers early education for 250 children ages 8 weeks to 6 years, approximately half of whom are from low-income families. The County lists a select handful of the non-profit organizations supported by LACFA, but fails to discuss any of the community benefits produced by these organizations or programs paid for by LACFA.

LACFA also continues to make a tremendous impact in the community. In 2016, over 1.3 million people visited the Fairplex, an increase of 3.18% from the prior year. LACFA also paid millions in taxes and other fees to the County and the City of Pomona. Furthermore, LACFA promotes numerous community events. This includes the hosting of annual competitions for craft beer, extra virgin olive oil and dairy products, hosting the 48th District Agricultural Association Schools' Agriculture and Nutrition Fair, hosting AGDAY LA, hosting the SoCal College Fair, and overseeing the Upland Lemon Festival and the Los Angeles Oktoberfest, just to name a few. None of these facts is addressed in the County audit.

The report states that "the County has provided LACFA with millions of dollars of both direct financial assistance and subsidies throughout the term of partnership in the form of rent below market values, waived required rent payments, and direct funding." However, during the audit period, LACFA did not receive direct funding from the County. In fact, LACFA has not received direct funding from the County for a decade. Moreover, claiming that LACFA receives below market rent ignores the tens of millions in assets gifted and developed by LACFA for the benefit of the County. Finally, to the extent LACFA receives any support from the County, it does so in the form of rent credits over a period of 15 years totaling $12 million (annually valued at $800,000). These rent credits were agreed upon for the specific purpose of developing a $30 million conference center that the County will eventually own, meaning that the County will receive a multimillion dollar facility for less than half the amount it contributed. The rent credit is not a hand-out, but rather reflects an investment by the County, which viewed the construction of a conference center in the east San Gabriel Valley as a key tool for fostering economic growth, employment, and community building.

II. COMMENTS TO DRAFT REPORT

A. CALCULATION OF RENT

In 1948 and 1988, the County and LACFA established long-term ground leases and operating agreements. The current Lease expires on December 31, 2043. The Lease is performance-based; the County receives payments based on certain percentages of the gross revenue from Fair and non-Fair events.

The County audit suggests that hotel and affiliate revenue could have been included in the Lease's definition of "Gross Revenue." However, requiring LACFA to pay a share of Gross Revenues to the County on the businesses that it operates is inconsistent with the performance-based nature of the Lease. As discussed below, charging rent based on Gross Revenue:

- Creates a disincentive and unfair disadvantage for LACFA to develop new business on the property compared to the economic arrangement that third parties have,
- Discourages LACFA from trying profitable businesses that could better utilize the Fairplex property and pay rent to the County,
- Discourages LACFA from looking for ways to diversify income streams and generate net income, and
- Ultimately provides fewer dollars for reinvestment back into the County's asset.

Significantly, the County never cites the Lease. It is clear that the Lease does not contain any provision that would expressly require the inclusion of hotel or affiliate revenue in the rent. Section 3.01 of the Lease states "For each Lease Year, Fair Association shall pay as Rent to County the percentages of ***gross revenues*** derived from the use of the Property and ***received by Fair Association*** during such Lease Year as hereinafter set forth." (Emphasis added.) Similarly, Section 3.07(a) of the Lease defines "Gross Revenue" to include "any and all money and cash receipts . . . ***received by Fair Association*** from use of the Property . . . ." (Emphasis added.) Accordingly, the Lease makes three things clear:

1. Rent is calculated based on "Gross Revenue,"

2. "Gross Revenue" is a term-of-art under the Lease, and

3. Under the Lease, Gross Revenue—and therefore Rent—is solely calculated based upon items of value (such as cash or money) "received by Fair Association."

The obvious implication is that if monies are ***not*** received by LACFA, monies are ***not*** included as part of Gross Revenue and are therefore excluded from Rent. This view of Rent under the Lease—adopted and put into practice by the parties for over 25 years—is not adequately addressed in the report.

For years, both the County and LACFA have agreed that revenues "received by" LACFA are included in the Rent, but revenues "earned by" LACFA are not. The report notes that this practice dates back to the 1990s. The Auditor-Controller also notes that "in response to a 2006 audit requesting confirmation of this practice, the County Chief Executive Office[r] (CEO) issued a letter in 2006 that confirmed the practice [of excluding hotel and affiliate revenue] from rent." The County's Chief Administrative Officer drafted the letter referenced in the County's report on September 11, 2006. The letter states as follows:

> We [the County] agree that revenues earned by [LACFA's separately owned affiliates] and the Hotel do not meet the definition of Gross Revenue and as such shall not be included in the County lease calculation.

Id. County Counsel affirmed this interpretation of the Lease. *See* Addendum 1 (citing 2005 Independent Auditor Report). The report fails to quote this language and omits any reference to County Counsel's affirmation.

The audit report goes on to state that excluding hotel revenues is "unusual" because the hotel is "not a separate legal entity" from LACFA, but the Auditor-Controller leaves out crucial facts. The existence of a separate legal entity is irrelevant. LACFA earns money from the hotel (and LACFA affiliates) in the same way it earns money from every company doing business with LACFA. A third party (Sheraton) operates the hotel under a management agreement. When customers visit the hotel and pay for rooms, events, etc., ***the Sheraton—not LACFA—receives cash*** coming into the hotel. LACFA earns amounts set forth pursuant to the management agreement. The hotel business structure was set up in a way that reflects how a third-party hotel company would have been treated if they had built the hotel. The manner in which LACFA earns monies from the hotel is important.

The audit report also states that there is no "legitimate reason" for LACFA to charge rent to the hotel. However, LACFA charges the hotel rent for the same reason rents and fees are charged to third parties—in both cases, this is a way of recording the amounts "received by" LACFA in order to calculate rent under the Lease. Third parties, affiliate companies, the hotel—in fact, every company or vendor doing business at LACFA—receive cash from customers but pay negotiated rents or fees to LACFA. The negotiated rents or fees are monies "received by" LACFA. LACFA adds these amounts to the Gross Revenue as defined under the Lease and calculates the Rent. The County does not receive gross revenues from third party or affiliate companies so it makes little sense to treat the hotel differently, especially when the monies at issue here are "received by" Sheraton. The fact that LACFA charges rent against the hotel, and the fact that the County acknowledges "the County was aware of this practice since the early nineties" confirms that hotel revenues were never intended to be included in the rent. Nor is this analysis rationalizing a practice after-the-fact; the very same analysis of cash "earned" versus cash "earned" is set out in CAO Jannsen's 2006 letter.

The audit report also omits the history of the hotel. In the late 1980s, LACFA went through an RFP process with the hope of generating interest for financing a hotel on the property, but no third parties were willing to develop the hotel. Had there been a company interested, that company would have invested the capital and been responsible for the profits and losses of the hotel. That third party would have paid rent to LACFA for the land that it subleased, and rent paid to LACFA would have been subject to the Lease. No hotel investor would have paid rent to the County based on gross revenues generated at the hotel because no investor, show promoter, or business on the property pays rent to the County directly based on gross revenues—only LACFA pays the County, and those payments are based on the pre-negotiated rent or fees that LACFA receives.

If hotel revenues were intended to be included in Lease rent, Rent payments would have overwhelmed any profits from the hotel. For example, if the hotel generated $10 million of revenue but broke even or operated at a loss, LACFA would still owe rent for the hotel. This would have created a greater loss, making it more difficult to service construction loan financing or to allow LACFA to reinvest in the Fairplex. This was never the intent of the parties, especially in the economic circumstances of the early 1990s.

For decades, LACFA and the County have excluded hotel and affiliate revenues from rent. Several independent audit firms conducting County-requested reviews, dating back as far as 2000 (beyond the scope of the audit), demonstrate that the payment of rent consistently excluded hotel and affiliate revenues from the definition of "Gross Revenue." *See* Addendum 1. The independent auditors confirm (1) the historic treatment of hotel revenue as excluded from rent under the Lease, (2) the consistent practice between the parties, (3) the CAO's interpretation of the Lease, and (4) County Counsel's review and approval of the same. *Id.*

The report does not cite any documents it relies on to explain why hotel and affiliate revenue should be included in the Lease. During the audit process, your office suggested that two documents may support the inclusion of hotel gross revenues in the rent calculation. First, the County has previously referred to a document drafted by an Assistant Administrative Officer dated June 1990 (approximately two years before the hotel was constructed), but this letter is rife with errors, which makes any reliance on it suspect.[1] Second, we were told about a 1992 letter by the same Assistant Administrative Officer to a state agency that apparently suggests the same; however, we could find no language in that letter which would support a position counter to the County and LACFA's longstanding practice. Regardless, it should be obvious that this material cannot evidence an agreement or understanding between the parties.

As a practical matter, the exclusion of hotel revenues from rent is consistent with the spirit of the Lease. Under the Lease, ownership of the hotel eventually vests in the County, not LACFA. At the end of the Lease, the County will receive a fully functional asset worth several millions of dollars. This connection between hotel revenue and the Lease should be made when discussing rent in the County's report. Additionally, the hotel allows LACFA to host more events and bring more people to the Fairgrounds, which in turn increases the Rent paid to the County. Affiliate revenue also allows LACFA to continue with its non-profit mission. Additional revenues allow LACFA to make a greater impact in the community. The report provides no detail on how these revenues are used or how they benefit the County.

The Auditor-Controller also fails to note that the hotel generates millions in tax revenue. Since the completion of the hotel, the City of Pomona has received more than $13 million in

[1] From what we understand, the 1990 letter from the Assistant Administrative Officer "indicates" that the County expected to receive 3.5% of $1.1 million in revenues from the Hotel. While we are not sure where the $1.1 million number comes from, it is clearly not Gross Revenues—hotel revenues from 1992 to 1995 were approximately $2.3 million (half-year), $5.4 million, $5.95 million, and $6.4 million, respectively. For perspective, the debt service alone on the hotel was around $1.8 million.

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transient occupancy tax. The hotel has also generated millions more in other fees and taxes, including $300,000 in possessory interest tax relating to the conference center. Importantly, the hotel is one of the largest employers in Pomona, providing approximately 160 full-time equivalent jobs to local residents. LACFA provides a substantial economic impact to Los Angeles County. According to the last report done on the Los Angeles County Fair's economic impact by the Los Angeles Economic Development Corporation in 2003, LACFA's impact exceeded $300 million. Adjusted for inflation, that figure could be as much as $400 million or more today.

B. HOTEL AND AFFILIATE RENT (FAIR MARKET VALUE)

The report states that "the rents LACFA charges the hotel and wholly owned companies for use of the land do not appear to reflect current fair market values." This statement is inaccurate as it uses fair market rates in 2016—outside of the audit period—to opine on the validity of Lease terms established several years ago. The report also never identifies how it defines fair market value or the sources upon which it determines that rents are not reflective of fair market values.

First, the report cites rents paid by Fairplex RV and Boat Storage, LLC as an example of rents charged by LACFA that are allegedly below market. Specifically, the County states "[w]e note that vacant land in Pomona now has a market value that is at least three times the land value used by LACFA to calculate the rent amount for the company." However, the fair market value in 2010 when the lease at issue was negotiated versus the fair market value of land in 2016, six years after the Great Recession, is obviously different.

Equally important, with respect to Fairplex RV and Boat Storage, LLC, the report presumes that a third party is willing to rent the property in question. There is nothing in the report to substantiate this assumption, and indeed, practice suggests that finding a tenant for the property—let us not forget these are fairgrounds—is difficult. In 2010, the property at issue here was vacant and was not generating any revenue or rent. No third parties were willing to take possession so LACFA turned a latent asset into a revenue-generating asset by creating an affiliate to use the property. The report claims that LACFA "may" have charged more and the County "would then have received higher rents," but if there are no third parties interested in a property, the County is not paid anything.

Second, the report claims that "the $50,000 annual land rent for the Hotel is equivalent to the amount it would cost to rent a 2,000 square foot office space or 3,500 square foot retail space in Pomona." However, the Auditor-Controller ignores that this rate is based on rents from the early 1990s as stated in the initial hotel management agreement that the County reviewed and approved as part of the hotel's development. This rate is reflective of the difficult economic conditions upon which LACFA financed and constructed the hotel. It is unfair to compare the 1990 rates to 2016 rates.

Ultimately, the report claims that "there is a risk that [LACFA] could reduce the rent they receive from these entities, which LACFA would benefit from in paying lower rent to the County." There is no evidence to support this.

C. HOTEL RENT (ACCRUAL)

The report notes that there is approximately $2,500 annually in accrued hotel rent due to subordination agreements with construction lenders. However, the Lease contemplated hotel development. During development, the County was provided all bond and development documents, including agreements addressing subordination. The County approved the subordination and, indeed, the report acknowledges that the practice of subordination dates back to the opening of the hotel in 1992.

LACFA has never denied an obligation to pay the abated rent amounts. To be clear, LACFA has refinanced the debt not to avoid paying rent, but to obtain significant benefits from lower interest rates. Through these efforts, LACFA has reduced its loan financing rates from 10% to a blended rate of 3.6%—saving an amount that far exceeds the amounts in question. LACFA's debt refinancing is a sound business practice and should be addressed in the report.

D. TRADE AND CONFERENCE CENTER AND CATERING RENT

The Auditor-Controller appears to question whether the County is receiving its fair share of revenues generated by the conference center. Specifically, the report notes how the parties originally expected that the conference center would "generate an additional $250,000 in annual revenue for the County."

The Auditor-Controller's report overlooks the economics leading to the development of the conference center. The conference center cost approximately $30 million to construct. The County provided an $800,000/15-year rent credit to help finance the conference center. In total, the County provided $12 million in credits for a facility that cost more than double that amount. The County will have saved $18 million on a project where it did not have to advance any funds and which will be completely owned by the County in the future. The County also gets free or below market access to the conference center. The report should include this information.

The audit report also states that the County did not receive official notice that management of the conference center was transferred to Sheraton, although there was no requirement to give

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such notice. LACFA's financial statements and rent schedules for every year the conference center has operated show that there is no rent paid on the conference center.

E. EXECUTIVE COMPENSATION

The states that a review of executive compensation was conducted, but fails to offer any analysis comparing the Los Angeles County Fair to other similarly situated non-profits, or even other fair organizations. The report simply claims "[w]e reviewed [LACFA's 2011] compensation study and identified issues that raise questions regarding the appropriateness of its use in guiding LACFA in setting executive compensation."

First, LACFA asked the Auditor-Controller to discuss LACFA's 2011 compensation study with the consultant who prepared the study, which was never done.

Second, in a December 22, 2011 letter from LACFA's compensation experts to the LACFA Board of Directors' Finance Committee, experts opined:

> Based on our evaluation of Fairplex's executive compensation program, ***we find overall a competitive program, appropriate for an organization of Fairplex's size, scope of operations, and tax-exempt status, and we find no problematic or excessive pay practices***. On that basis, we have ***issued our unqualified opinion*** on the reasonableness of Fairplex's compensation program . . ."

(Emphasis added.) In addition, while the Auditor-Controller disputes the findings of the compensation expert, the audit never addresses LACFA's 2008 report, which comes to very similar conclusions concerning executive compensation. There is no reason to ignore the 2008 report.

Third, the Auditor-Controller states that "comparable organizations in the compensation study did not appear to be similar to LACFA or competing with them for talent."[2] However, the 2011 Study looks at organizations on a composite level to best approximate market conditions that could conceivably compete with LACFA. To this end, the Study identifies Los Angeles-area nonprofits where executive compensation is similar—or exceeds—that of LACFA's executives.

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[2] The 2011 Study explains at page 12 that the consultant looked at non-profit organizations with hospitality and entertainment services, with a special focus (where applicable) on county and regional fairs. Trade organizations and non-profits such as museums and other entertainment ventures were viewed with a "secondary emphasis." The report also explains that the consultant also looked at for-profit entities in the hotel, recreational, gaming and hospitality industries because they were considered labor market competitors. The consultant explained that no business in the for-profit sector was a perfect match to the Fairplex and that the intent was to provide a composite to balance different industries to ensure that the group was not overloaded in any particular sector.

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See 2011 Study (referencing the Los Angeles County Museum of Art and Motion Pictures Association). This trend is also evidenced at fairs outside of California, but of similar size to LACFA. For example, the State Fair of Texas reported annual revenue of less than half of LACFA, yet the salary of LACFA's CEO is on par with the CEO of the State Fair of Texas. Similarly, the Los Angeles County Fair employs more people than every major fair in the State of California ***combined***. LACFA regularly generates more revenue than any fair in the State.

Finally, LACFA is a community-based organization in ways that other fairs are not. LACFA serves more than 150,000 students with hands-on, educational programming each year through its FairKids program. In addition, more than 1,000 students benefit from LACFA's year-round educational programs each month. The majority of these students come from socioeconomically challenged communities and benefit from programs that complement the education they receive through the public education system and help prepare them for success in further education and careers. With the exception of about 50% of LACFA's tuition-paying Child Development Center students, these participants benefit from these programs at no cost. LACFA's community and educational programming are substantial and significantly exceed the programming of other fairs. LACFA's CEO and its executive staff lead these efforts. Their compensation is also, in part, recognition of this effort.

F. BOARD OF DIRECTORS AND MEMBER BENEFITS

The report notes that "LACFA membership is made up of a diverse range of individuals from the surrounding community (e.g., educators, philanthropists, entrepreneurs, etc.)." The report also states that LACFA's "active" Board of Directors appear "to have the knowledge and experience necessary to oversee LACFA's different business components and nonprofit purpose." However, the report takes issue with the benefits provided to LACFA's Board of Directors and its general membership. The report's analysis of Board of Director and membership benefits is both misleading and inaccurate.

We note that while the audit period covered a period of 36 months, the Auditor-Controller reviewed Board of Director and Member related event expenses for a single month. The month at issue includes LACFA's annual fair meeting, which includes a full day of events followed by an annual dinner at the Sheraton for Board members and other association members.

LACFA's review of its financial records suggest approximately $250,000 is spent annually on Board ***and*** member events. This is a culmulative number, and thus represents significantly more than just the Board expenses. A substantial portion of these costs are used to host Fair partners, vendors, and other third parties offering to do or doing business with the Fair. We note that from 2012-14, the total amounts donated by the Board of Directors and Association membership were $355,755, $369,729, and $469,669, respectively.

G. OTHER IDENTIFIED ISSUES

First, citing to the Fairplex Recreational Vehicle Park, the report states that "issues have recently arisen giving cause for concern regarding LACFA's ongoing maintenance of the property." The report also states that the property is "now fully compliant" with applicable law, but it would also seem appropriate to note that this resolved issue is the only instance where there has been an issue raised by any regulating entity.

Second, the report discusses how LACFA entered into "a long-term agreement with the City of Pomona to provide affordable housing at the Fairplex that exceeded the term of the Agreement with the County." However, LACFA and Pomona agreed to a buyout provision providing that if the Affordable Housing Agreement (dated April 29, 2009) exceeded the term of any lease in the future, LACFA would reimburse Pomona for the amortized amount of the years not covered under a lease. The County was aware of the Affordable Housing Agreement. *See* December 2010 Indenture of Trust at http://file.lacounty.gov/bos/supdocs/58014.pdf. County documents expressly reference "Pomona Contribution Funds" as "the funds still to be contributed to the [Conference Center] by the City of Pomona pursuant to that certain Affordable Housing Agreement, dated April 29, 2009, between the City of Pomona and [LACFA] in an aggregate amount of $1,950,000." *Id.* at p. 15. At no point has the County objected to the Pomona agreement.

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III. CONCLUSION

We look forward to discussing these issues further. Please contact us should you have any questions or concerns.

Sincerely,

for George David Kieffer

GDK

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ADDENDUM 1

Review of Independent Audit Reports

Report	Content
2000 Auditor: Williams & Tucker Accountancy Corp.	1. The independent auditor conducted "a review of the Association's compliance with the Operating Lease Agreement and related amendments regarding . . . rent payable to the County for the lease year 2000." The independent auditor concluded "[w]e believe the Los Angeles County Fair Association has ***complied with the Ground Lease and Operation Agreement in all material respects.***" 2. Additionally, the independent auditor stated that it "verified the Association's schedule of rent payable to the County, including gross revenues, and schedule of rent credit allowable." The independent auditor concluded "[i]n our opinion, the attached schedule of Year to Date County ***Lease Calculation fairly reflects the rents due to the County of Los Angeles*** in a manner consistent with terms of the ground lease and operating agreement."
2001 Auditor: Conrad and Associates, LLP	1. The independent auditor reports that "[t]he difference between amounts reported on the lease calculation schedule ***excluded hotel revenues and interest income . . . which are not required to be included in the lease calculation per lease*** and amendment to lease agreement."
2003 Auditor: Conrad and Associates, LLP	1. The independent auditor acknowledges that differences between total revenues stated in LACFA's audited financial statements and its lease calculation schedules result from the inclusion of hotel revenue (among other revenue streams) in the audited financial statements but not in the lease calculation schedules. The independent auditor states "[t]he reconciling items noted above ***appear to be in accordance with the Lease Agreement.***"

2004 Auditor: Conrad and Associates, LLP	1. The independent auditor states that "***[c]ertain revenue earned by the Fair Association were not considered to meet the definition of 'gross revenues'*** as defined in the lease agreement, and were accordingly not included as part of the County Lease Calculation." Hotel revenue is specifically identified as one of the assets excluded from the definition of gross revenues. 2. The independent auditor also states "[t]he treatment of subsidiary revenue and Hotel revenue is unclear in the lease agreement. ***It is the opinion of the Chief Administrative Officer (CAO) that the Fair properly excluded the gross revenues earned by the Hotel . . . .***" 3. The independent auditor states that "***gross revenues earned by . . . the Hotel are not included as part of the County Lease Calculation. This treatment is consistent with prior years.***" 4. Approximately one and a half months after the independent auditor published the 2004 audit report, ***the CAO issued a letter clarifying that Hotel revenue was excluded from the definition of "Gross Revenues" under the Ground Lease***. The CAO reasoned that even though hotel revenues are "earned by" LACFA, these revenues are not "received by" LACFA. ***As noted below, County Counsel approved the CAO's interpretation.***
2005 Auditor: Mayer Hoffman McCann, P.C.	1. The independent auditor repeated the analysis provided in the 2004 audit. However, the independent auditor provided an update explaining "[w]e had previously recommended that the County consider amending the lease agreement (or at a minimum prepare a letter of correspondence) to clarify the definition of gross revenues to specifically address the inclusion or exclusion of the gross revenues earned by [the hotel] . . . . Subsequent to June 9, 2006, ***the County Counsel reviewed and approved the CAO's letter of understanding which clarifies the definition of 'Gross Revenues' per the Agreement***."

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2006 Auditor: Mayer Hoffman McCann, P.C.	1. The independent auditor states that "***Gross Revenues earned by . . . the Hotel are not included as part of the County Lease Calculation, which is consistent with the letter of understanding*** from the County Chief Administrative Office dated September 11, 2006."
2007-11 Auditor: Vasquez & Company, LLP	1. The independent auditor states "[v]ariances between revenues report[ed] in the Lease Calculation Schedule and those reported in the Association's audited financial statements were due to elimination of intercompany transactions and other Association revenues not subject to the County lease." 2. Schedule VI of the report excludes "Hotel revenues" as part of its "Revenue Reconciliation."